Wealth managers and retirement solution providers: Serving up the goods

Financials sector

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Wealth managers and retirement solution providers – Serving up the goods

This report reviews why the wealth management and retirement solutions markets offer many years of structural growth well ahead of GDP, stock market indices and, we believe, investor perceptions. The top-line growth from normalised levels of savings, individuals replacing employers as the main source of funding retirement, and an ageing population will occur at the same time as the supply of advice is falling. In the near term, these sectors, which are equity market sensitive, should benefit when interest rates rise.

More wealth management services needed

The opportunity from savings is staggering with a reversion to normal savings adding £25bn pa and a £400bn catch up for under-savings since late 1990s. Rising GDP per head growth, an ageing population and wealth transfers all increase demand. The providers are triple geared – larger average portfolios, greater need for advice and more customers in the target group.

Specifically more individual retirement savings needed

Employer paid defined benefit schemes are in terminal decline. The £250,000 average value per head will now mainly come from personal savings, potentially adding millions of customers. Longevity is increasing so even bigger pension pots will be needed to finance the greater number of years post retirement.

At a time when a third of IFAs may leave

The pain from increased regulation will be unevenly spread. Simple, transparent, cheap products will be largely unaffected, while complex ones with unclear charging structures will see a marked increase in their compliance burden. For smaller providers this increased cost may be terminal, potentially reducing IFAs by a third and seeing c 2m customers seeking new advisers. Some elements of the bank-branch distribution model may also become uneconomic.

Valuation

The 2011 P/E valuation across these stocks ranges from under 7x (IFG) to the high 20s (Hargreaves Lansdown) with most of the wealth managers around 13-14x. Average P/E growth 2012/2009 exceeds 60%, well ahead of market growth and from a sector which benefits from interest rates rises. Positive equity markets mean the earnings revisions over the past six months have been mainly upward.

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Syndicate Asset Management

Hargreaves Lansdown
Share plc*

Retirement solution providers
IFG*
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Appendix
Aviva
Legal and General
Old Mutual
Prudential
Resolution
Standard Life
Barclays
Investec
Lloyds Banking Group
HSBC
Royal Bank of Scotland
Ashmore
Charlemagne Capital
City of London Investment Group
Impax Asset Management
Man Group
Polar Capital
Record
Aberdeen Asset Management
F&C Asset Management
Henderson Group
Jupiter Fund Management
Schroders

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Investment summary: Serving up the goods

This report primarily focuses on bespoke wealth-management services to the mass affluent wealthy, and analyses a range of strategic issues affecting that market's superior growth. We believe well above average GDP growth should be sustainable for many years, and those with the right business model will achieve superior top-line growth to this.

Key drivers to wealth managers

1) Increasing wealth in the economy over time (IMF UK GDP per head 2015e $41,081 against $35,053 in 2010) will be supplemented if the savings ratios reverts closer to, if not exceeding, its long-run average. Reversion to historic averages would add c £25bn pa to nominal savings (compared with 2010). If there was a catch up for the 14 years when it was below average, it would add another £400bn to savings. Individual personal wealth is also likely to increase with an ageing population which we discuss in more detail in Key macro drivers section 3. Increasing wealth creates triple-geared opportunities for wealth managers. (i) Average wealth per customer rises – increasing ad valorem fees and transaction commissions based on value. (ii) Demand for sophisticated products increases – especially tax efficient schemes and riskier niche products which can be included in larger portfolios but would be unacceptable in small ones. (iii) More mass affluent customers fall into the target group.
2) Wealth managers have the opportunity to win new mandates when there is any material transfer of assets, especially when the recipient is less experienced in financial affairs. With an ageing, wealthier population, this typically occurs on: (i) Death of the husband – just over 40% of male estates go their spouses which is unsurprising given greater female longevity. (ii) Death of the parent – over 30% of male estates and 45% of female estates are passed on to children. Given the average mortality age, the typical recipient is in their 50s/60s when the inheritance is available for discretionary spend/saving/funding retirement rather than debt repayment. (iii) Pre-inheritance transfers – one way to mitigate inheritance taxes is to transfer wealth ahead of death and, according to research conducted by Aviva in spring 2010, 46% of adults have received a pre-inheritance gift compared with 37% who had received a traditional inheritance. Such sums will typically be smaller and received earlier in life but they can still be a trigger for wealth management services.
3) Demographics: With people living more years in retirement, and the need for more self-provision, there is the potential for a huge increase in savings, especially by the wealthier, who have more capacity to save. We believe investors may be under-estimating near-term improvements in longevity while over-estimating long-term gains. The key issues as we see them are: (i) We believe most investors expect life expectancy to continue to rise. The only question is by how much. It would not be unreasonable to suggest that the market consensus would be around the central case provided by the Government Actuaries Department (GAD). Every year this decade, the GAD has had to increase its longevity assumptions and, on balance, we expect these short-term

upward revisions to continue. (ii) Over the longer term though, many improvements will reach saturation point (eg penetration of flu jabs) and the effect of unhealthy life styles saw the US longevity fall in 2008 on 2007. Potentially, obesity and its related illness could curtail the long-term improvements in UK longevity and the assumptions of continuing, albeit slower, improvements in longevity may be optimistic. There will be an issue when the market anticipates this slowdown, but we believe that is many years away yet. (iii) Wealth already affects longevity and looking forward, we see obesity as a major drag on improving longevity. Statistically this is least likely to affect wealthier women and most likely to be serious for poorer women, meaning that using average statistics may understate the wealth manager opportunities.

Incremental drivers to the retirement solution providers

1) **Funding retirement: Replacing employer provided pensions is a, if not the, key driver to the retirement solution providers**. At the target upper third quartile level, Office of National Statistics (ONS) data shows the average defined benefit (DB) scheme has a value of c £250k and we would expect this to be considerably more at retirement. These funds were historically built by employers, but with the closure of DB schemes, much of them will need to be met by personal saving or else there will be a massive decline in the standard of living for millions of pensioners. Changes to public sector pensions could also have a dramatic effect. Servicing this market will bring millions of new customers into the wealth management and advised space. Additionally, the automatic enrolment of all staff into some kind of pension saving from 2014 will bring millions of new savers for the mass market providers, some of which will leak up into the wealth managers. We also expect the average working life to be extended, again increasing the pot of wealth to be managed.
2) **Pensions and tax**: The main advantage of personal saving into a pension vehicle is the tax relief that is obtained on the contribution. Following the most recent UK budgetary changes, this is at the marginal rate of tax up to an annual contribution of £50,000 (and a catch up for unused allowances over the previous three years). Anything that changes the value of tax relief is likely to impact on contributions to pensions. The key issues are (i) rising general tax rates are likely to encourage saving in tax efficient schemes (positive), (ii) increased tax rates may encourage more advice/management of assets (positive), (iii) recent changes in annual and lifetime allowances may reduce highest earners contributions (negative), and (iv)taxing pension schemes is an ‘easy’ political hit (negative). We believe the government faces the dilemma of needing to encourage retirement savings to replace the employers’ schemes, but at the same time limiting the effect on the Exchequer.
3) **Regulation is a multi-edged sword**. The sector faces a major overhaul in its regulation in the FSA’s Retail Distribution Review (RDR). We see the effects of regulation as: (i) More regulation will see higher expenses for providers (some industry estimates c £500m) and we do not expect most of the cost to be passed on. (ii) The effect will be disproportionately spread with smaller firms facing the most pressure, especially in the IFA market. (iii) The economics of bancassurance is also likely to change. (iv) Simple

products will see the least changes. (v) Existing fee based businesses will see less impact. (vi) It remains unclear whether customer behaviour will change with greater transparency on fees. (vii) We believe the markets' obsession with lost trailing commissions is over-done. The existing trail will be grandfathered and there are many opportunities to charge a range of other fees economically replacing trail.

4) **Advice vs non advice**. We believe there is space for several business models to deliver good shareholder returns. The important issue is that the provider be best at that model. Increasing compliance and regulatory costs, mean that scale is a major competitive advantage especially for the lower-margin non-advice sector. Managing staff and customer relations is the key to the advice sector. In this context a range of distribution models should work.

Sensitivities

There are a number of issues that will have a short- or medium-term impact on the sector's share price performance. These include:

- Equity market weakness (negative) and changes in confidence.
- Sustained asset allocation away from equities.
- Globalisation of funds.
- Commoditisation of product.
- Reputational risk.
- Interest rates.
- Financial Services Compensation Scheme (FSCS).

Valuation

The 2011 P/E valuation across the wealth management and retirement solutions providers discussed in this report ranges from under 7x (IFG) through the high 20s (Hargreaves Lansdown) with most of the wealth managers around 13-14x. This is for average P/E growth 2012/09 of c 60%. With positive equity markets the earnings revisions over the past six months have generally been upward.

Sector description: Mass affluent savings

Wealth management sector

This note will focus on the higher net worth sector rather than private banking or the mainstream long-term savings and banking sectors. It broadly matches the Association of Private Client Investment Managers and Stockbrokers (APCIMS), which is the trade association of 180 wealth management and broking firms who, at more than 500 sites, provide services to private investors. In their 2009/10 annual report APCIMS members claim to manage £400bn of assets, 4.8m portfolios (many execution only) and conducted 22.4m trades that year. To put this into some type of context, total personal deposits in the UK banking sector (which includes APCIMS deposits) are around £941bn.

In the UK there are around 200k individuals with investable assets of £1m to £100m, and a further 4m+ in the £100k to £1m brackets. This is the main target group for the wealth managers and typically is in the older age brackets of society. While there are all types of investment objectives, there is an above-average propensity for income and capital preservation rather than aggressive capital growth.

The services provided range from execution only through the advisory services (typically the wealth manager suggests stocks to buy/sell and the customer makes the decision) to full discretionary management of portfolios of assets. APCIMS maintains three indices for types of customer portfolio and they are indicative of the range of assets that will be managed. Shares, especially UK, are the key class of investment but not the only one to drive sector performance.

Exhibit 1: Asset mix in portfolio indices benchmarked by APCIMS

%	Income portfolio	Growth portfolio	Balanced portfolio
UK shares	42.5	47.5	42.5
International shares	12.5	32.5	25
Bonds	35	7.5	20
Cash	5	2.5	5
Commercial property	2.5	2.5	2.5
Hedge funds	2.5	7.5	5.0
Total	100	100	100

Source: APCIMS 2009/10 Annual Report

Portfolio fees are typically charged quarterly based on the spot value at the period end. In addition there are dealing commissions and, in normal interest rate environments, a net spread is earned from customer cash deposits. In addition, many will provide other services such as tax advice for which the fee structure is typically time-rate derived.

Although done in 2007, we believe the Barclays Wealth review summarised in Exhibit 2 below provides an interesting breakdown on how wealth was generated (survey respondents were asked to list all the ways they created wealth and hence the totals add up to more than 100%). The key conclusions are:

- Earnings are by some way the most important generator of wealth. Bonuses make up a relatively small proportion of this.

- Growth in property prices (historically) was second most important.
- Enterprise (defined as business sale and share options combined) is as important as inheritance.

Exhibit 2: How wealth was acquired

%	National	London England	SE England	S & SW England	Central England	W Engl & Wales	North England	Scot
Earnings	71	74	69	67	74	63	71	78
Bonus	18	20	21	20	15	22	10	19
Property	44	41	37	46	56	44	39	58
Business	13	23	5	16	12	7	3	8
Share	14	10	12	16	8	22	16	28
Inherited	30	32	34	31	20	30	27	31
Shares	22	20	22	18	21	26	19	42

Source: Ledbury Research in Barclays Wealth Insights UK Landscape of Wealth March 2007

ONS data (Exhibit 3) also shows that property is by some margin the biggest asset class accounting for about three times deposits and nearly twice long-term savings.

Exhibit 3: Composition of gross wealth of the household sector

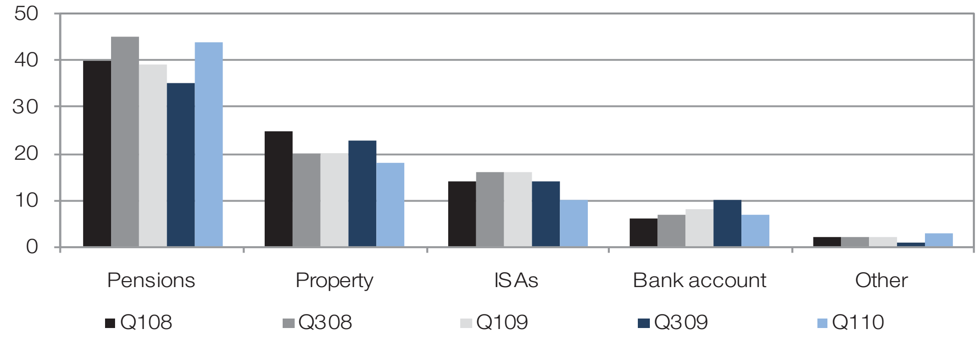
£bn at 2008 prices	1991	2001	2005	2006	2007	2008
Non financial assets						
Residential buildings	1,733	2,481	3,630	3,916	4,197	3,693
Other	509	576	774	823	869	768
Financial assets						
Life assurance and pension funds	911	1,795	2,061	2,195	2,232	1,844
Securities and shares	392	736	698	695	648	463
Currency and deposits	584	801	1,019	1,076	1,137	1,175
Other assets	122	149	153	181	171	180
Total assets	4,251	6,538	8,334	8,886	9,253	8,123

Source: Office of National Statistics in Social Trends 2010 edition

Retirement solution providers

The potential range of retirement solution providers is broad. A recent survey (see Exhibit 4) suggested pensions are viewed as the best way to save by only around 40% of people. In this note will be focusing on financial service providers directly involved in the personal pension space. In particular, we will be focusing on companies heavily involved in the self-invested personal pension (SIPP) market, detailing in the appendix the relevance of (more mainstream) pensions to the life companies, selected specialist asset managers and general asset managers.

Exhibit 4: Best way to save for retirement



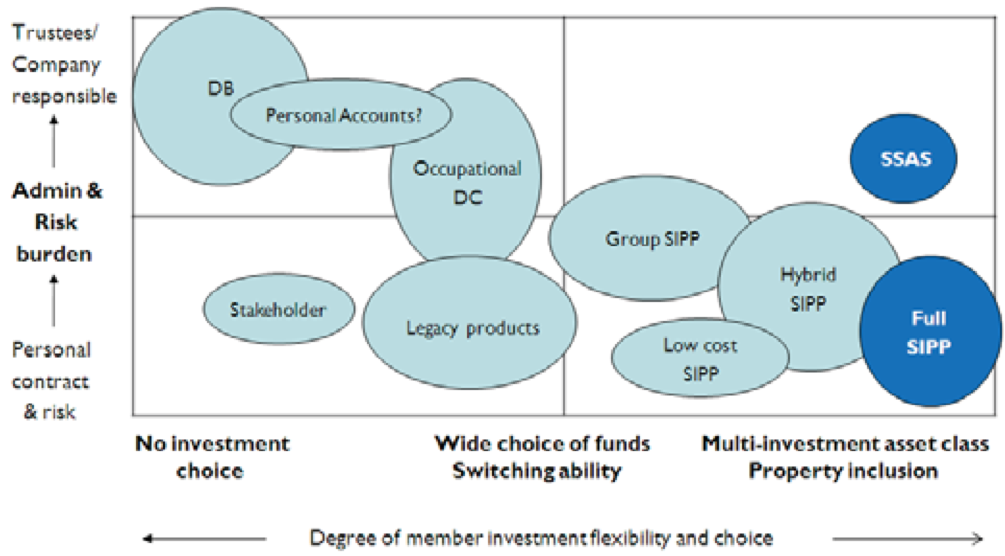
Source: National Association of Pension Fund managers, Workplace Pensions Survey March 2010

Mintel estimates the SIPP market at c £60bn, with c 500,000 accounts from 71 providers. Incremental flows are forecast to grow by 14% y-o-y from 2010 to 2014 rising to c £900m in 2014. A material element of new SIPP assets come when customers consolidate their pensions pots into one vehicle (currently c 75% new flows).

The SIPP market, like wealth management, offers a range of services. Within the SIPP market nearly 40% are what may be termed bespoke, which means that the customer can invest in the full range of assets allowed (critically including commercial property). SIPPs can borrow up to 50% of the net value of the pension fund to invest in any assets, although in practice SIPP trustees are only likely to permit this for commercial property purchase and there is material higher manual administration for such schemes.

Exhibit 5 is a schematic of how the pensions market is divided by the degree of investment choice and who is responsible for the fund. SIPPs are very flexible products and are the responsibility of the person. DB schemes give the holder no choice over investments and are the company's responsibility. In between, there is a range of other products. Generically we would argue that funds that are company controlled (DB, DC, Stakeholder, Personal accounts) will see lots of pensions lumped together and should be considered as institutional money and so of interest to the asset managers in the Appendix. Those with a high personal involvement will either be mass market (eg low-cost SIPPS) or bespoke.

Exhibit 5: Pensions market place in 2012



Source: Suffolk Life: reproduced in Mattioli Woods interim results to November 2010 presentation

As can be seen in Exhibit 6, although the bespoke SIPP market is relatively concentrated, IFG's James Hay, with a c 23/24% share, is the clear market leader.

Exhibit 6: Market share breakdown of bespoke SIPP market

Large players (2)	Medium players (20)	Small players (18)
	Examples	Examples
James Hay (IFG)	Hornbuckle and Mitchell	My SIPP
A J Bell (privately owned)	Pointon York	Scottish Life (Royal London)
	Mattioli Woods	
40% market share	55% market share	5% market share

Source: IFG 2010 interim results presentation

The balance, termed commodity SIPPs, typically have internet dealing in a limited range of asset classes (usually one deposit, equities and bonds) and include providers such as Sippdealxtra (AJ Bell), Vantage Sipp (Hargreaves Lansdown), James Hay e-Sipp, and Killik and Co.

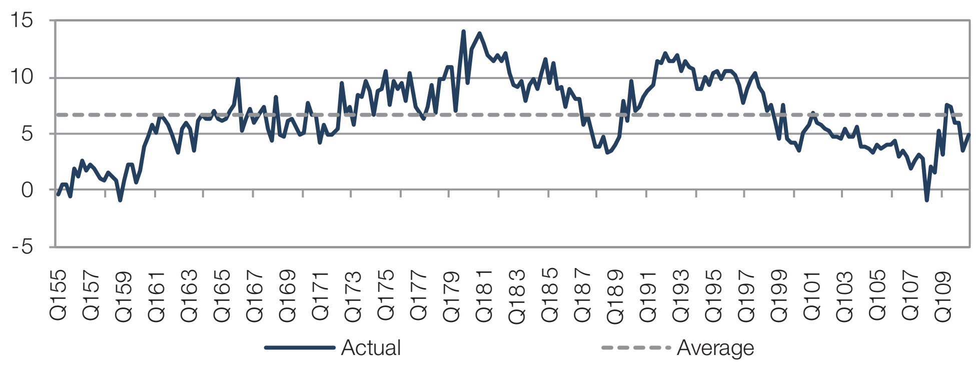
Key sector driver: (1) Increasing wealth

Increasing wealth in the economy over time (the IMF estimates UK GDP per head will be $41,081 in 2015, against $35,053 in 2010) will be supplemented if the savings ratios reverts closer to, if not exceeding, its long-run average. This would add c £25bn pa to nominal savings (compared with 2010) and if there was a catch up for the 14 years when it was below average, it would add another £400bn to savings. Individual personal wealth is also likely to increase with an ageing population, which we discuss in more detail in the Key sector driver (3) section. Increasing wealth creates triple-geared opportunities for wealth managers: (i) Average wealth per customer rises – increasing ad valorem fees and transaction commissions based on value. (ii) Demand for sophisticated products increases – especially tax efficient schemes and riskier niche products which can be included in larger portfolios but would be unacceptable in small ones. (iii) More mass affluent customers fall into the target group.

More normal savings ratio

Despite the ravages of the credit crunch, the UK savings ratio remains below the long-run average (Q310 5% GDP vs 6.6% average see Exhibit 7). Were it to revert back to the average level of the past 60 years this would imply an extra c £25bn annual savings. To catch up for the sustained under-savings from the mid 1990s would require nearly c £400bn in incremental savings. Part of this reversion to historic averages could (i) be cyclically related – savings ratios are typically higher in times of economic weakness/slow growth), (ii) occur once customers stop their unusual current behaviour of paying down debts and choose to save instead, and (iii) be associated with saving for retirement as outlined elsewhere in this section.

Exhibit 7: UK savings ratio (%) from Q155 to Q310



Source: Office of National Statistics

Greater wealth with age, and the population is ageing

As can be seen in Exhibit 8, older people are typically wealthier, with peak wealth just pre-retirement (a combination of highest earnings power, mortgage typically paid and the start of inheritances). Over time, the demographic trend for an ageing population will, ceteris paribus, see more customers for the wealth managers.

Taking those in the median wealth group, this age bracket's wealth (£416k) is over six times the wealth of the median 25-34 year old. We believe wealth starts to reduce on retirement given the lack of earned income, and potentially inter-generational transfers of wealth rather than incremental spending. With the average stay in a nursing home of around 18 months and an average cost just over £30k pa, the total cost of care is a relatively small part of the target group for wealth managers.

Exhibit 8: Wealth distribution by age and decile (£)

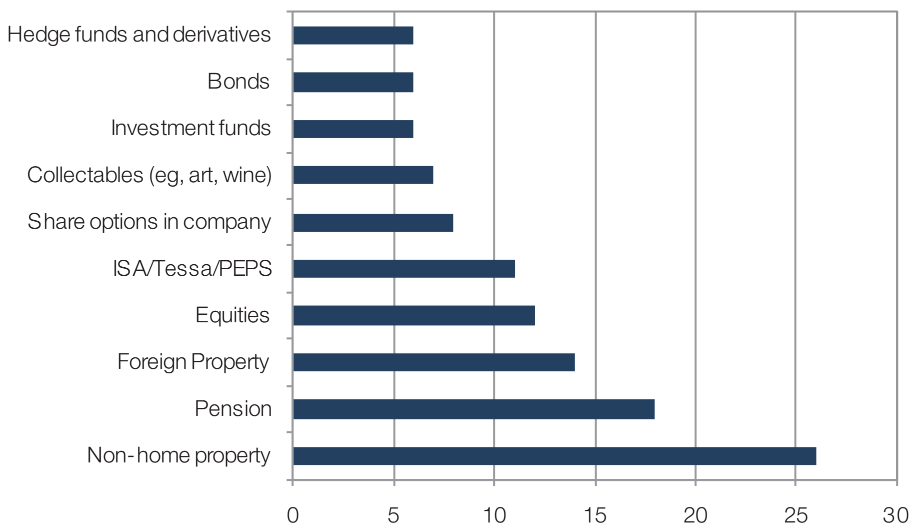
Age/decile	Mean	10th	30th	Med	70th	90th
16-24	37,598	1,900	5,200	12,925	25,100	87,500
25-34	120,915	3,570	24,510	65,886	130,213	284,507
35-44	276,650	8,099	69,448	174,876	322,973	619,849
45-54	455,670	14,780	125,725	287,801	506,045	1,006,173
55-64	634,878	27,700	221,021	416,120	708,600	1,342,003
65-74	457,615	25,010	170,105	306,006	483,546	934,836
75-84	356,942	15,022	100,750	225,222	353,843	693,763
85+	243,786	10,937	49,550	171,824	267,797	511,421
Overall	367,649	8,817	73,452	204,500	389,000	853,099

Source: Government Equalities Office, National Equality Panel 2006-8 Wealth Tables

Saving for old age

As the National Association of Pension Funds (NAPM) survey indicated (Exhibit 2), fewer than half the people surveyed thought pensions were the best way to save. The Ledbury research (Exhibit 9) published by Barclays Wealth shows the distribution of some of these assets with (non-home) property being a heavy concentration of wealth and one where the wealth managers have relatively little involvement at present.

Exhibit 9: Percentage of respondents with more than one-third of assets invested in:



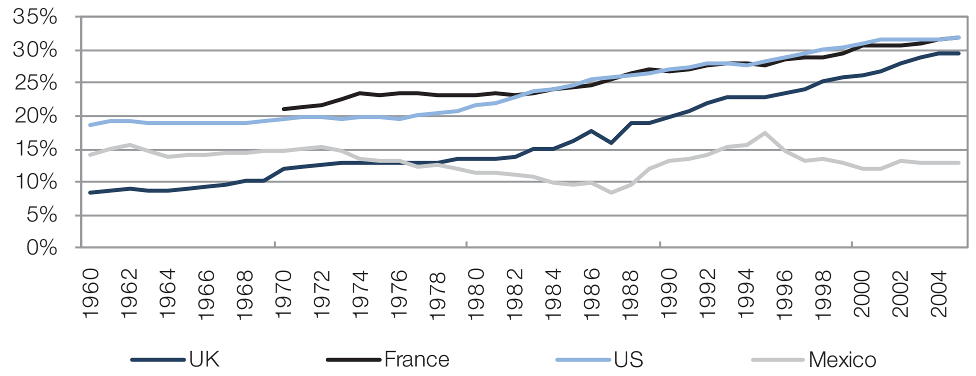
Source: Ledbury Research in Barclays Wealth Insight UK Landscape of Wealth March 2007

More demand for financial services as economy becomes wealthier

It is a longstanding theory that financial services have a positive gearing to the wealth in an economy. Maslow's hierarchy of needs (1943) may be considered in economic terms. When an economy is poor, a greater proportion of GDP is spent on survival, most obviously agriculture.

Once the people have been fed, watered and kept warm, resources can be devoted to other needs. This theory is supported by the proportion of financial services in the UK rising from 8% in 1960 to 30% in 2005. Logically there should be a cap on this growth – Exhibit 10 shows that a spate of growth was triggered by financial de-regulation in late 1970/early 1980s and even before the credit crunch had started to stabilise – but it is unclear at what level.

Exhibit 10: Proportion of GDP in financial services



Source: Groningen Growth and Development Centre 10-sector database, June 2007, http://www.ggdc.net/, de Vries and Timmer (2007)

Impact on wealth managers

We see a triple gearing effect on the wealth managers:

- Average wealth per customer rises increasing ad valorem fees. Most wealth managers charge their portfolio fees based on the value of funds managed. While this may create near-term volatility (especially as many fees are based off quarter-end spot valuations), it means that increasing wealth over time feeds through to higher fees per customer. In addition, with the commissions on most UK and European equity transaction based off the value traded (rather than the number of shares), there should be increased commissions too.
- Demand for sophisticated products increases, especially tax efficient schemes and riskier niche products that can be included in larger portfolios but would be unacceptable in small ones. We note below rising average tax take with rising income and that this will encourage higher earners into tax efficient saving schemes. It is also worth noting that high-risk, high-return investments are much more suited to large, diversified portfolios than small ones. As such products are typically higher-margin products for providers, increasing wealth has a geared effect here.
- More mass affluent customers fall into the target group. We believe there is an ideal size for a wealth manager client. The portfolio needs to be large enough to cover fixed costs (Towry indicated a minimum of £100k) but the investor should not be wealthy enough to require private banking standards (putting an upper optimal limit of say £10m). As overall wealth increases more customers will drop into this target range.

Key sector driver: (2) Wealth transfer

Wealth managers have the opportunity to win new mandates when there is any material transfer of assets, especially when the recipient is less experienced in financial affairs. With an ageing, wealthier population, this typically occurs on: (i) Death of the husband – just over 40% of male estates go their spouses which is unsurprising given greater female longevity. (ii) Death of the parent – over 30% of male estates and 45% of female estates are passed on to children. Given the average mortality age, the typical recipient is in their 50s or 60s when the inheritance is available for discretionary spend/saving/funding retirement rather than debt repayment. (iii) Pre-inheritance transfers – One way to mitigate inheritance taxes is to transfer wealth ahead of death and according to research conducted by Aviva in spring 2010, 46% of adults have received a pre-inheritance gift compared with 37% who had received a traditional inheritance. Such sums will typically be smaller and received earlier in life but they can still be a trigger for wealth management services.

Inheritance for the wealthy is a highly complex subject. The details of the assets passed on inheritance in 2007/08 are given in Exhibit 11 below. Around 270k estates passed on £65bn of assets, of which £60bn was in estates valued in excess of £100k (the minimum we consider for wealth managers to manage). Residential property accounts for around half the value of estates and cash a further quarter. On estates in excess of £300k, there was c £14bn of cash and securities which, if all held with wealth managers (which they are not) would indicate the churn of assets on death is c 3.5%. Given not all such assets are with wealth managers we estimate their churn is actually in the range of 1-2%. Critically, the sale of the main home releases significantly greater financial resources which require management.

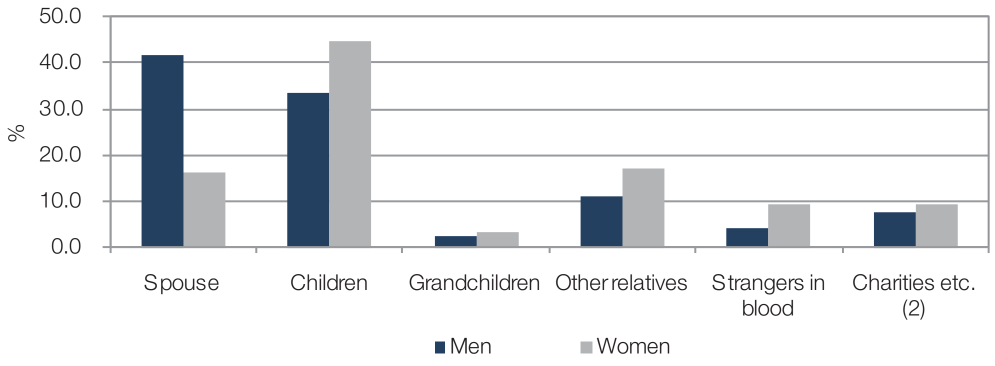
Exhibit 11: Breakdown of inheritance wealth by estate size and asset class

Estate size		£100k to £200k	£200k to £300k	£300k to £500k	£500k to £1m	£1m to £2m	Over £2m	Total
Securities	Number	27,906	27,680	25,821	12,375	3,650	1,374	120,335
	£m	586	694	1,383	1,880	1,529	2,230	8,550
Cash	Number	76,391	53,360	32,129	14,255	3,960	1,410	257,387
	£m	2,914	3,502	3,011	2,144	869	760	15,179
Ins Pols	Number	25,314	18,828	11,322	4,744	1,411	485	87,780
	£m	451	468	569	361	217	101	2,450
UK home	Number	63,276	45,325	27,269	11,954	3,150	1,175	171,220
	£m	8,044	8,387	6,741	4,233	1,799	1,595	32,293
Other prop	Number	1,219	1,647	1,926	2,126	979	512	8,822
	£m	90	109	250	525	501	806	2,317
Other Assets	Number	59,250	43,076	28,993	13,628	3,941	1,414	195,736
	£m	472	708	531	644	389	1,163	4,119
Total	Number	81,481	54,794	32,786	14,615	4,045	1,443	270,465
	£m	12,558	13,868	12,483	9,786	5,304	6,655	64,908

Source: HMRC Statistical tables 12.4 based on years 2007/08

Exhibit 12 details the recipients of estates. Although somewhat dated, we would not expect the overall trends to have changed materially. £25bn was from estates where the deceased was aged over 85, £20bn from 75 to 84 and nearly £10bn 65 to 74. The age distribution for women is even more weighted to older age (46% of estate value for those aged 85 or older vs 31% for men). This is important as it indicates the age of the recipient and where they will be in their own life cycle.

Exhibit 12: Recipients of inheritance wealth



Source: HMRC Statistical tables 12.9 based on years 2000/01

Pre-inheritance transfers

According to research conducted by Aviva in spring 2010, 46% of adults have received a pre-inheritance gift compared with 37% who had received a traditional inheritance. There is no evidence on the amount transferred, but as such gifts are tax free (assuming the donor survives seven years), they have increasingly been used as a mechanism to reduce inheritance tax. For wealth managers there is the opportunity to provide tax advice as well as the opportunity to manage the wealth for the recipient.

Potential slippage from tax and 'SKIers'

One trend that some social commentators are watching is the maturing of 'Yuppies' (young upwardly-mobile professionals) into 'SKIers' (spending the kids' inheritance). The greater number of healthy years in retirement, combined with an aggregate lower proportion of savings means that inheritances are being squeezed.

The total inheritance tax paid in the UK in 2008/09 was c £2.4bn, representing tax at 40% on estates valued over £325k. While this receives a lot of press attention, the direct leakage relative to amount inherited is relatively modest.

Impact on wealth managers

Exhibit 11 indicated that the transfer of financial wealth on inheritance was a relatively minor drag on the existing stock of accounts for wealth managers. There are many opportunities though. As the woman is more commonly the surviving spouse, wealth managers may have a trigger event when the husband leaves an estate to the widow. The crystallisation of the wealth in the family home represents an investable sum when the recipient is of an age to save. Transfers of wealth while the donor is still alive may be smaller, but have great potential for a direct recommendation or the introduction of the next generation of customers.

Key sector driver: (3) Demographics

With people living more years in retirement, and the need for more self-provision, there is the potential for a huge increase in savings, especially by the wealthier who have more capacity to save. We believe investors may be under-estimating near-term improvements in longevity but over-estimating the longer-term gains. The key issues as we see them are: (i) We believe most investors expect life expectancy to continue to rise. The only question is by how much. It would not be unreasonable to suggest that the market consensus would be around the central case provided by the Government Actuaries Department (GAD). Every year this decade, the GAD has had to increase its longevity assumptions and, on balance, we expect these short-term upward revisions to continue. (ii) Over-the longer term though, many improvements will reach saturation point (eg penetration of flu jabs) and the effect of unhealthy life styles saw the US longevity fall in 2008 on 2007. Potentially obesity and its related illness could curtail the long-term improvements in UK longevity and the assumptions of continuing, albeit slower, improvements in longevity may be optimistic. There will be an issue when the market anticipates this slowdown but we believe that is many years away yet. (iii) Wealth already affects longevity and, looking forward, we see obesity as a major drag on improving longevity. Statistically this is least likely to affect wealthier women and most likely to be serious for poorer ones so using national averages may under-state the opportunity for wealth managers.

Longevity

We believe most investors expect life expectancy to continue to rise. It would not be unreasonable to suggest that the market consensus would be around the central case provided by the Government Actuaries Department (GAD). Its latest estimate is that the at-birth life expectancy for a male in 2050 will be 85.1 years compared with 78.5 years in 2010 and 69 in 1970.

Exhibit 13: Male life expectancy at birth

	1970	1980	1990	2000	2010	2020	2030	2040	2050
Life expectancy	69.0	71.0	72.9	75.4	78.5	81.2	82.8	84.0	85.1
Change over 10 years	0.9	2.0	1.9	2.5	3.1	2.7	1.6	1.2	1.1

Source: Government Actuaries Department

Upside potential

Over the past 30 years not only has longevity been increasing, but the rate of improvement has accelerated. The increase in the past three decades is more than in the previous century. The GAD has had to consistently raise its life expectancy, under-estimating the improvements identified below.

Exhibit 14: Male life expectancy at birth (years)

	2000-02	2001-03	2002-04	2003-05	2004-06	2005-07	2006-08	2007-09
Life expectancy	75.62	75.85	76.16	76.52	76.89	77.16	77.40	77.71

Source: Government Actuaries Department, Interim Life Table

We believe there are many drivers to this improvement including:

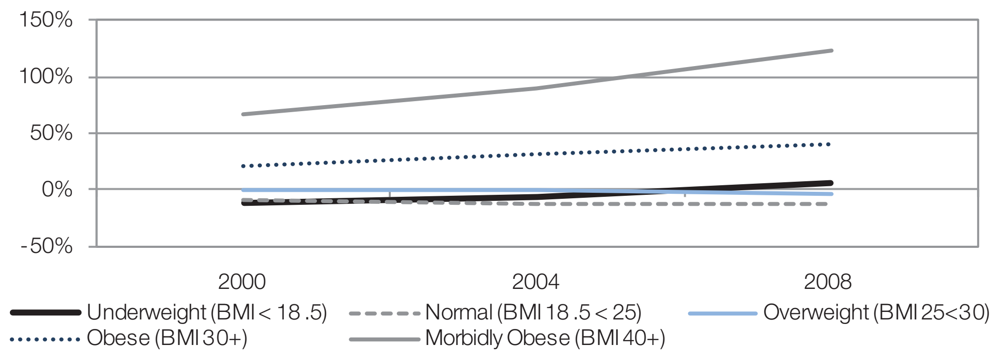
- Take up of flu vaccine for people aged 65 and older has risen from c 25% in 1990/01 to c 75% in 2008/09 (Health Protection Agency). The full benefits of this have yet to be felt.

- Improving survival rates for cancer with, for example, male lung cancer mortality rate in 2008 down to 52 per 100,000 from 76 in 1995 (ONS, Cancer Research UK).
- Falling numbers of smokers, with 22% of males saying in 2008 they were smokers (7% heavy) compared with 30% (and 11% heavy) in 1998.
- Over the past 30 years male deaths from circulatory problems have fallen from c 7,000 per 100,000 to around 2,300.

Potential drags on further improvements include:

- We note a rising trend for alcohol related deaths with c 4,000 each in 2008 for the age groups 55-74 and 35-54 compared with c 2,000 each in the mid 1990s (ONS).
- Some of the advances in preventative care are reaching maximum penetration rates (eg there will be some more pensioners that take the flu jab but the incremental effect is likely to be modest).
- The rate at which death related to circulation in males has slowed over the past five years.
- In the 12 years between 1996 and 2008 the proportion of UK adults with a body:mass index of more than 40 and so classified as morbidly obese has more than doubled (to 2%). Those classified as just obese has risen from 17.5% to 24.5% of the population. Rising obesity brings materially higher risks of many potentially fatal diseases.

Exhibit 15: Change in the proportion of UK adults by weight classification compared with 1996



Source: Health Survey for England, The NHS Information Centre for health and social care in ONS Social Trends 2010

US longevity fell 2008 on 2007

The effect of unhealthy lifestyles saw the US longevity fall from 77.9 years to 77.8 years in 2008 on 2007 (source: The National Vital Statistic Report, “Deaths: Preliminary Data for 2008, published on 9 December 2010). While too much should not be read into one year’s data, obesity and its related illness could curtail the decades-long improvements in longevity.

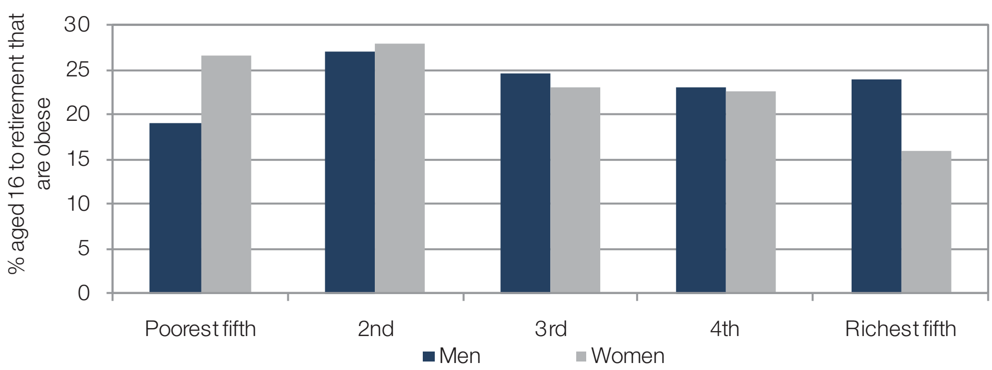
Drag on longevity potentially highest among poor women

National average increases may also distort the impact on financial services providers. We are not concerned with the mainstream product providers, as it is the longevity of the higher decile income and wealth groups that will drive the earnings for the stocks under consideration. Research by the Oxford Institute of Ageing, published on 12 January 2011, revealed a 13 year gap in life expectancy at 65 for men and a 16 year gap for women between those living in the top most affluent areas and those in the bottom least well off areas. Manual work was not the main driver (male non-manual workers only have an extra year on manual workers), but a healthy lifestyle was (adding four or five years to both men and women's lives after 65).

Looking forward we would anticipate that they key drags on extended longevity – especially lifestyle obesity – are more likely to have an impact on poorer women first. Poverty Site statistics indicate that rich women have the lowest propensity to obesity, while poor women have the highest. As such the deciles that are of interest to wealth managers may see further improvements in relative longevity.

Exhibit 16: Obesity by income levels

Note: The data is the average for 2006 to 2008, England.



Source: Health Survey for England, DH; reproduced in the Poverty Site in March 2010.

Impact on wealth managers/retirement solution providers

Greater longevity creates opportunities as greater savings are required to fund retirement. The conservative nature of the elderly means they are more likely to seek financial advice and their current below-average propensity to shop around on the internet makes the personal relationships more important.

Key sector driver: (4) Funding retirement

Replacing employer provided pensions is a, if not the, key driver to the retirement solution providers. At the target upper third quartile level, ONS data show the average DB scheme has a value of c £250k and we would expect this to be considerably more at retirement. These funds were historically built by employers, but now much of it will now have to be met by personal saving or else there will be dramatic declines in living standards for millions of pensioners. Changes to public sector pensions could also have a dramatic effect. Servicing this market will bring millions of new customers into the wealth management and advised space. Additionally the automatic enrolment of all staff into some kind of pension saving from 2014 will bring millions of new savers for the mass market providers, some of which will leak up into the wealth managers. We also expect the average working life to be extended, again increasing the pot of wealth to be managed.

Exhibit 17: Wealth held by individuals in private pensions (inc DB) by age and sex 2006/08

£	Men		Women	
	Mean	% with pension	Mean	% with pension
16-24	17,900	10	16,000	11
25-34	42,700	48	38,200	46
35-44	102,900	70	87,900	64
45-54	203,000	76	168,300	69
55-64	304,900	79	250,300	68
65-74	230,000	78	188,300	63
75+	138,400	74	110,100	59
All	174,700	64	141,500	57

Source: Office of National Statistics

Employer Defined Benefit scheme

As can be seen in Exhibit 18, the non-state pension market remains dominated by the historic preponderance of employer defined benefit schemes. The Association of Consulting Actuaries in its September 2009 survey found 87% of DB schemes were closed to new entrants (and 18% also closed to new accruals from existing members). However, the stock of pension wealth is still dominated by the years of accrual into DB schemes before they were closed. It is also probable that the biggest DB schemes of all, public sector pensions, will see dramatic changes over the next few years, reducing the strain on public finance but increasing the pressure for self provision.

Herein lies the huge opportunity for wealth managers. The upper third quartile have average occupational DB schemes with a value in excess of £250k and retained rights (in previous employers) average over £100k. While there will be a build up of employer defined contribution schemes, most retirement saving will now be built by the individual.

Exhibit 18: Distribution of household private pension wealth: summary statistics 2006/08 (£)

Note: [1] Excludes those with zero pension wealth; [2] Includes those with zero pension wealth.

	Mean	1st quartile	Median	3rd quartile
Current occupational DB pensions[1]	207,700	41,000	107,900	256,700
Current occupational DC pensions[1]	31,200	3,000	8,900	25,400
AVCs[1]	18,500	4,000	10,000	20,000
Personal pensions[1]	38,800	5,300	15,000	37,000
Retained rights in DB pensions[1]	109,000	5,300	25,400	101,700
Retained rights in DC pensions[1]	24,000	2,600	7,200	22,000
Rights retained in pensions for drawdown[1]	100,200	22,500	32,500	189,000
Pensions in receipt[1]	234,400	32,800	98,700	250,900
Pensions expected from former spouse/partner[1]	46,800	300	3,700	28,100
Total pension wealth[1]	198,000	21,200	76,700	220,000
Total pension wealth (whole population)[2]	141,900	0	29,200	144,200

Source: Wealth and Assets Survey, Office for National Statistics

While falling private sector DB schemes are well known, the impact of changes to the public sector are neither clear nor we believe in market expectations. In excess of 80% of public employees are enrolled in pension schemes, around twice the average enrolment in the private sector. As the provision to this group reduces, there is a huge opportunity for the private sector.

Employer defined contribution (DC)

According to the Department for Business Innovation and Skills approximately 9m people were employed in firms of less than 250 staff in 2009. The Association of Consulting Actuaries (ACA), in January 2011, published a survey of 400 smaller firms' pensions where the average employer DB contribution level was 18% of earnings compared with 5.5% for DC schemes and only 14% had open DB schemes compared with 82% in 1996. With contributions to DC schemes so much lower than DB schemes, the ultimate value of the pension pot is likely to be materially less, and if the pensioner does not want a massive drop off in income (a time bomb politicians are already afraid of), there must be more personal saving.

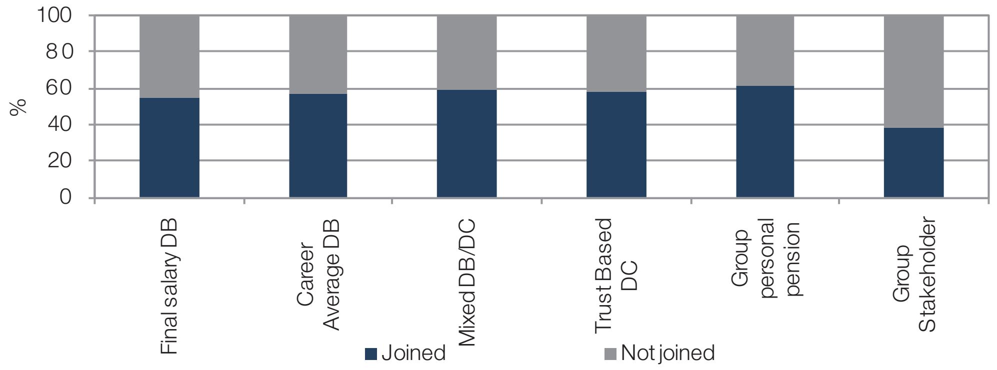
State pension

The state pension provides a floor for the mass affluent but is unlikely to be a key driver to their retirement income and wealth management. A pension fund of c £130k would deliver the same income as the state pension and, as noted above, this is around half of the average value of defined benefit schemes, let alone non-pension assets.

Take up rates of any employer scheme and auto-enrolment

The ACA survey also confirmed just how many employees are not in employer schemes (c 40%), with a surprising consistency across all types of scheme (see Exhibit 19).

Exhibit 19: Smaller firms' scheme membership take-up rates



Source: Association of Consulting Actuaries, Survey of Smaller firms' pensions January 2011

On 27 October 2010, Pensions Minister Steve Webb confirmed that the government would proceed with implementing the reforms set out in the Pensions Act 2008, whereby employers now have the duty to auto-enrol all employees and make contributions to a pension scheme on their behalf. In order to facilitate the requirements for those employers who do not have their own pension scheme, a new national pension scheme (the National Employment Savings Trust or NEST) has been set up. The implementation of the new regime will start in October 2012 for the largest employers (with over 120,000 employees). Other employers will thereafter be brought into the regime in monthly stages, in order of size so that by July 2014 all employers having more than 50 employees will be affected and by September 2016 every employer in the country will have been staged in. NEST will primarily be a mass market product to those (on poorer income) who have not saved for their pensions. It will be institutional money of interest to the providers in the appendix rather than to the wealth managers, although there may be some modest migration up by customers. Working wives may present the best opportunity.

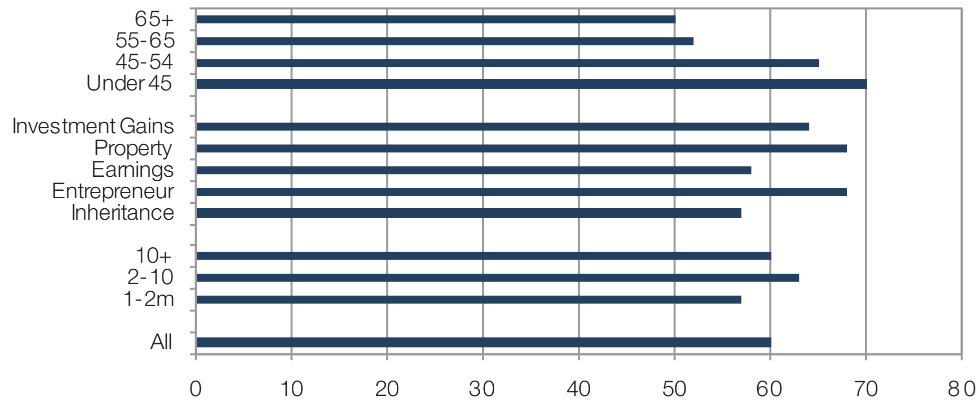
Press coverage may see more interest in pensions

Much of the press coverage on pensions has been negative for several years. In addition to mis-selling scandals, there has been failure of providers such as Equitable, closing defined benefit schemes, strikes over changed entitlements, etc. It is perhaps not surprising that the trust in providers and the government has been so low and that alternative ways of savings for retirements (such as property) have taken favour. Looking forward we believe there will be a number of issues whereby pension savings will again become newsworthy and potentially more positively. In particular the roll-out of auto-enrolment may be used to highlight shortfalls in expected pensions.

Working later

The degree to which retirement can be partially funded by working later is only likely to increase over time. Interestingly it is higher income earners that have a greater propensity to work later. A recent survey by Barclays Wealth suggested 60% of their customers would be commercially active no matter what their age, a pattern consistent across amount of wealth and how the wealth was earned. What is noticeable is that younger customers have a much higher expectations of working – we believe this is a demographic trend rather than retiring being a more attractive option the longer you have worked. Some will argue that people will have to work later because they have not saved sufficiently for retirement and that the opportunity for the wealth managers is less than expected. There will undoubtedly be some, financially irresponsible or incapable people for whom this is the case, but we believe having millions of people without sufficient income in retirement will be politically unacceptable and that there will be more encouragement for private savings.

Exhibit 20: "No matter what my age I envision being involved in commercial/professional work"

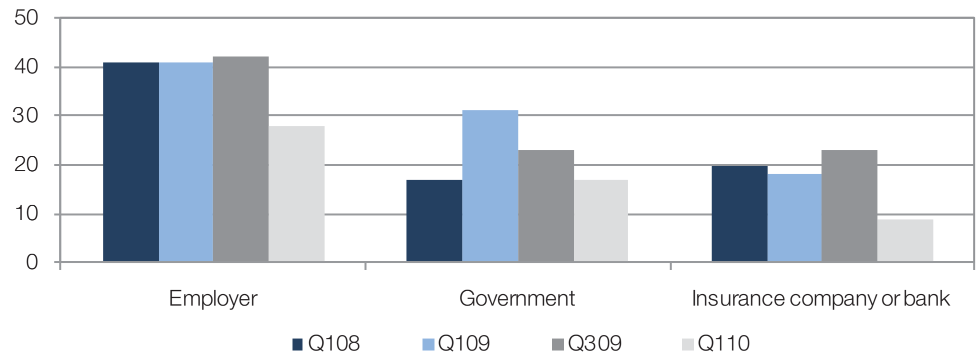


Source: Barclays Wealth, Barclays Wealth Insight Volume 12

Impact on wealth managers/retirement solution providers

The effect on wealth managers is clear. More people will need to save more money over longer periods in order to fund retirement. As pension pots become bigger, the requirement for impartial trusted advice can only increase. As can be seen in Exhibit 21, trust in other providers of pensions has declined rapidly in recent years.

Exhibit 21: Trusted providers of pensions



Source: National Association of Pension Funds, Workplace pensions survey 2010

Key sector driver: (5) Pensions and tax

The main advantage of personal saving into a pension vehicle is the tax relief that is obtained on the contribution. Following the most recent UK budgetary changes, this is at the marginal rate of tax up to an annual contribution of £50,000 (and a catch up for unused allowances over the previous three years). Anything that changes the value of tax relief is likely to affect contributions to pensions. The key issues are: (i) Rising general tax rates are likely to encourage saving in tax efficient schemes. (ii) Increased tax rates may encourage more advice/management of assets. (iii) Recent changes in annual and lifetime allowances may reduce highest earners contributions. (iv)Taxing pension schemes an "easy" political hit. We believe the government faces the dilemma of needing to encourage retirement savings to replace the employers' schemes, but at the same time limiting the effect on the exchequer.

Rising effective tax rates encourage tax efficient saving

Rising income taxes can arise from either higher tax rates on the same income or moving into a higher tax bracket as income increases. While there are official tax brackets (2010/11 £0 to £37,400 basic rate tax 20%, £37401 to £150,000 higher rate tax at 40%, £150,000 + additional rate tax of 50%), in practice the average rate of tax increases with income (see Exhibit 22). Higher incremental tax rates mean that the benefit from avoiding tax rises. Consequently rising incomes and rising taxes will encourage greater use of tax efficient schemes and pensions are the most efficient of them all. The rising average rate of tax paid means there is not a single trigger point at which it becomes tax efficient to start pension savings.

Exhibit 22: Income tax rates and tax payers by income bands

Annual income £	No of taxpayers ('000s)	Average rate of tax %
50,000 – 99,999	1,800	22.4
100,000 – 149,999	304	28.6
150,000 – 199,999	117	30.8
200,000 – 499,999	134	33.0
500,000 – 999,999	26	34.5
1,000,000 +	11	36.0
Total tax payers	29,300	17.3

Source: HM Revenue and Customs in Social trends 2010 edition

Increased tax rates may encourage more advice

As more mass affluent become caught in higher tax effective tax brackets, there will be a growing number of relatively financially inexperienced savers who will be able to benefit from tax efficient schemes. In the first instance, we would expect providers of simple, low value products such as ISAs to be main beneficiaries, but over time this should see more demand for wealth management products.

Changes in allowances may cut high earners' contributions

The 2004 Pensions Act dramatically changed the structure of pensions introducing, from April 2006, full tax relief on annual contributions to personal pensions up to £215,000 and allowing up to £1.5m in a fund before penal tax rates applied. Both these figures were increased as originally planned (2010/11 annual allowance £255,000, maximum fund £1.8m). This was amended in the March 2010 budget where the relief for earners of £130,000 was gradually scaled back so earners of more than £180,000 could only get 20%. The coalition budget changed the rules again with an annual limit of £50,000, the introduction of a claw back if the three prior year's allowances were not used, the re-introduction of full tax relief for higher earners and a reduction in the Lifetime Allowance back to £1.5m. Company managements appear very relaxed with the claw-back and full tax relief for the highest earners, and that they will see the only a modest, if not positive, effect on contributions. We believe this is just the start of the process and that continually changing rules will undermine confidence in the pension product. The effect of one cut in lifetime allowance may be modest, but it will be easier to cut again, having made the first reduction. We believe that highest earners contributions will come under pressure.

Taxing pension schemes an 'easy' political hit

Most investor's awareness of the technicalities of their pension fund is very low. Accordingly in a period when governments need to raise taxes, changing pension fund rules is a relatively politically painless way to generate funds. Options taken to date have included taxing dividends and reducing the contribution limit thus cutting the tax relief provided. There is clearly a balancing act between wanting to raise revenue and encouraging long term savings for retirement.

Impact on wealth managers/retirement solution providers

Rising taxes we see as having multiple effects on wealth managers:

- It encourages more tax-efficient savings giving the wealth manager an opportunity for a sale.
- It encourages sticky savings with ISA/SIPP funds showing less propensity to migrate than many savings.
- It encourages customers to seek higher margin advice.

While there may be an impact of lower contributions from the highest earners, we believe this will be dwarfed by an increase in the number of smaller schemes as more earners seek to limit their tax bills.

Key sector driver: (6) Regulation

In the section below we focus on the business implications of regulation (we give a very brief review of some of the many regulatory initiatives in Appendix 2). We are interested in the effect of regulation rather than its details and investors must consider some over-riding issues, including:

- More regulation will see higher expenses for providers (some industry estimates are c £500m) and we do not expect most of the cost to be passed on. While we believe the banks will, over time, pass on most of their higher capital requirements to their borrowing customers, we do not believe savings/wealth managers will be able to do so when one of the objectives of the proposals is simple transparent pricing. The extra regulatory cost is not completely wasted – it should result in better trained staff, making fewer errors and with less mis-selling cost/compensation claims, but it will be drag on earnings.
- The effect will be disproportionately spread, with the operational disturbance to a single man IFA from additional compliance massively more than firms that can invest in a centralised compliance resource and structure. Of the c 30,000 IFAs currently in the market, up to a third may leave (Ernst and Young review). At 200 clients per IFA, this represents 2m customers needing advice from a new provider.
- In addition, smaller investors may also see the provision of advice fall most significantly. Towry was reported in the *FT* on 26 January as saying that giving financial advice on assets below £100,000 was no longer commercially viable. This type of customer may switch to platform providers such as Hargreaves Lansdown or Share.
- The economics of bancassurance are also likely to change, with Ernst and Young estimating banks would need to charge a fee of £200 per hour to be profitable. The announcement by Barclays in January 2011 that it would close its branch-based mass advice business followed the sale of the Co-op’s IFA business to Syndicate Asset Management at the end of 2010.
- Simple products will see the least changes. A business that is principally execution (such as Share plc) is unlikely to be materially affected by the RDR.
- Existing fee based businesses will see less impact. For example, IFG’s Saunderson House fee-based IFA will feel relatively little effect.
- Greater disclosure may have an impact on revenue. It remains unclear whether customer behaviour will change with greater transparency on fees. There may be a move to simple, and cheaper, products, but given wealth management customers have already decided to pay for advice, the effect may be small.
- The market’s obsession with lost trailing commissions is, we believe, over done. The existing trail will be grandfathered and there are many opportunities to charge a range of other fees (eg ongoing advice fees) economically replacing trail. Whether investors will be willing to pay up-front as much as the providers currently do in commissions remains to be seen and could be a pressure on income.
- There may be some dislocation in the market through 2012/13. It is probable that IFA behaviour will change before the implementation date at end 2012. Specifically, those IFAs leaving the market may try to book as much revenue as possible in 2012. We

question though whether there will be excessive switching between accounts given that, in the current litigious world, investors are highly likely to seek compensation for mis-advice and unnecessary switching could thus incur huge penalties.

- Logically the revenue pressures and economies of scale in compliance mean that there should be consolidation in retail fund providers and in advice givers. We expect most of the companies in this report to be consolidators rather than targets.

Summary of key proposals under RDR

There is a detailed review of RDR in Appendix 2.

Exhibit 23: Summary of RDR objectives

Creating a new market structure	Introducing adviser charging	Higher professional standards
Clients will be offered different types of service depending on their needs under a new 4 tier system:	Providers will play no part in deciding the level of income an adviser receives:	A new minimum level of qualification for independent and restricted advisers
1) Independent advice (unbiased and unrestricted)	• Clarity over charges for adviser services	
2) Restricted advice (including single/multi tie/simplified sales process)	• Clarity over product price	
3) Basic advice	• An end to commission structures including trail commission	
4) Non-advised services (including execution only)	• Charge clients an agreed amount for advice, taken as a fee upfront or deducted from the policy	

Source: Edison Investment Research

Impact on wealth managers/retirement solution providers

For the companies in this report, regulation is likely to see an increase cost burden but an opportunity to gain significant market share, especially from a shrinking IFA market. We note discretionary fund management is not subject to the RDR even though advisory fund management is.

Key sector driver: (7) Advice or non advice models

We believe there is space for several business models to deliver good shareholder returns. The important issue is that the provider be best at that model. Increasing compliance and regulatory costs mean that scale is a major competitive advantage especially for the lower-margin non-advice sector. Managing staff and customer relations is the key to the advice sector.

Advice

Increasing advice generates the opportunity to charge greater fees, and migrating clients up the advice scale is the objective of most wealth managers. However, the provision of any form of advice materially increases the administration and compliance costs. Logically those most likely to seek advice are:

- People scared by volatility in investments and so seeking professional help. Given the experience of markets over the past two/three years this group is likely to be increasing.
- Those moving into new asset classes. For example, people who may have received a large inheritance that was property related may now want invest in equities. Given the low interest rates currently prevalent, there is also an argument that depositors are moving into equities to get a better return.
- The busy rich. Professionals who are occupied running their business may not want/choose to spend time managing their own financial affairs.
- Financially unsophisticated. Where wealth has been acquired by people with limited financial experience (eg where a spouse/parent dies having previously dealt with investments) there is a greater need for advice. Links with professional bodies such as solicitors can provide such introductions.

Non-advice

We believe the non-advice space for both SIPP and wealth management has three major elements and one minor element:

- Customers whose transaction are modest in relation to their financial affairs as a whole and who want to keep them simple. This could be the middle-aged customer with savings who decides to ‘play’ the stock market for example.
- Those with bad experiences from professional advisers. The numerous financial failures and mis-selling scandals may have reduced the demand for advice service. It may be that some of the Barclays customers recently compensated for being sold unfairly risky products will place the money with other advisers, but some may simply manage it themselves.
- Customers with very limited financial needs who do not need/want the complexity of advice. This would be typified by investors in large privatisations or company share schemes.
- Some customers are confident in their own financial planning for all their affairs including pensions. The number of customer here is quite limited and would in isolation be sub-scale.

The key element is simplicity. For providers to generate good financial returns we believe the associated business model has to be both simple and cheap. Scalable platforms, typically using the internet, and automated procedures (simplifying compliance) mean the customer can be offered a low price. Both Share plc and much of Hargreaves Lansdown's business fit this model.

Impact on wealth managers/retirement solution providers

We can see the space for both advice and non-advice models and the critical issue is having the right model for each customer base. For the non-advice approach, this is scaleable platforms, state of the art platforms and marketing machines. The advice route is much more personal relationship driven and this requires a corporate culture that attracts people with that type of personality. Management of staff is critical and, when done well, can seem teams joining and material increases in funds managed (eg Brewin Dolphin, Brooks Macdonald).

Distribution models

Number of branches

It is standard business management theory (eg Hermann Simon's *Hidden Champions of the 21st Century*) that to offset the risks of being attacked by standard products, premium providers must be closer to their customers. For wealth managers, The Barclays Wealth 2007 survey showed a heavy geographic concentration of wealthy respondents living in London (13%) and surrounding counties (total 27%, of which Hampshire contributed 8%, Surrey 6%, Middlesex 5%, Essex 3%, Hertfordshire, and Kent and Sussex 2% each). In addition, many respondents said they had a second home that was in London meaning that they can relatively easily see an advisory based there. The South-East also has a higher net worth per customer than the rest of the country.

Wealth managers have addressed this split by either having a very limited number of branches or aiming for a national coverage with an excess of 30 branches. Clearly the larger number of branches means that the advisor is physically much closer to the customer, offers more diversification of revenue, and potentially less competition for good staff. On the downside it incurs administration cost. Brewin Dolphin would argue the former outweighs the latter with the average office cost for a non-London site described as modest.

Exhibit 24: Wealth managers – number of branches outside London

Brewin Dolphin	36
Redmayne Bentley	33
Charles Stanley	31
Barclays Wealth	18
Ashcourt Rowan (SAM)	15
Rathbone	10
Rensburg Sheppards	10

Source: No of Branches reported on APCIMS website excluding London

Internet

We believe that internet delivery is key to the low-cost non-advice models. Access via the internet is a requirement for most companies, but wealth management is a very personal relationship between the customer and adviser, and so the internet in isolation is not sufficient.

Independent Financial Advisers (IFA)

For most of the wealth management providers, IFAs are a small but growing source of business (the exception being Brooks Macdonald's 80% of new business from IFAs/Professional introducers). There is some product to be sold down the channel, but the key relationship management within advice-giving wealth management is not relevant to this source. IFAs are more important to the retirement solution providers.

With the compliance and regulatory pressures we expect a material number of IFAs to leave the market by the time the Retail Distribution Review is effective. Some industry sources have suggested a third (c 10,000) may exit, providing a huge scope for new customers seeking advice.

Mainstream bank distribution.

Banks should have major competitive advantages in both areas of this report. They have the personal banking arrangements of most customers, and the SME/business contacts to capture the entrepreneurs. The behavioural data available from current accounts is enormous, and with the sophisticated modelling currently available, banks should be able to identify when a customer has the ability and a high propensity to invest. While businesses such as Barclays Wealth are large (profits £95m H110, AUM £153.5bn), one may have expected them to have been dominant. We believe the under-performance of bank distribution is due to:

- Brand – while banks may (or may not!) be trusted for normal banking transactions, the brand does not appear to stretch as well to longer-term savings and equity-related products. Following Northern Rock, it is very noticeable that relationship driven wealth managers/private banks were much better at retaining deposits than the larger banks even though they had a higher proportion of deposits uncovered by government guarantees.
- Staff morale and retention – wealth management is a very personal business which is critically dependent on customer relationships. The type of person that is good at personalising relationships is often not well suited to the cultural constraints within large organisations. As Barclays integrated Gerrards there was a flood of departures which were picked up by competitors like Brewin Dolphin.
- Diversification – we believe that following Northern Rock a number of higher net worth individuals will have sought to diversify assets between providers which would assist independent wealth managers.

Sensitivities: Risk/challenges

We have touched on a number of risks throughout this report. Apart from the stock-specific issues covered in each company section, we would highlight:

- **Equity market weakness.** All these stocks are sensitive to the level, trend and confidence in stock markets. This not only applies to near-term earnings, but also customers' long term asset allocation.
- **Sustained asset allocation away from equities.** We have noted the importance of property to the overall wealth of the economy. A return of confidence in that asset class could see funds leave the wealth management sector, especially given that property can usually be geared to a much greater extent than equities.
- **Globalisation of funds.** Professional investment in large capitalisation stocks is increasingly a global business and small local investors may not be in the best position to identify trends affecting share prices. In addition, communication and information flows mean that UK investors are also looking for international exposure, again not necessarily the forte of a smaller wealth manager.
- **Commoditisation of product.** Technology and regulation are both driving simpler, cheaper, more transparent product lines. Without sustained investment out-performance some investors may question the benefit of receiving advice. This trend may be exacerbated by the FSA's RDR.
- **Reputational risk**. At both the sector and company level, trust is critical to these businesses. Anything that damages, even other providers mis-selling products, can adversely affect business.
- **Interest rates.** We have identified in most company sections the negative impact of sustained low interest rates on the earnings the wealth managers make from customer deposits. There will have been some compensating asset allocation benefit (investors reducing cash balances and chasing yield), but sustained low rates are bad for this sector.
- **Financial Services Compensation Scheme (FSCS).** Many of the companies in this report have issued trading updates to include the FSCS levy whereby healthy companies effectively pay for the losses of failing ones. While FDs may complain about rising regulation costs, the impact of weak regulation can be equally painful. We believe unless we have multi-years sustained charges investors will generally treat these costs as one-offs.

Valuation

Wealth managers

Exhibit 25: Wealth managers valuation matrices (non-Dec year end adjusted to year end)

Dec	2010 P/E (x)	2011 E PE (x)	2010 Yield (%)	2011 E Yield (%)	2011 Div cover (x)	Mkt cap/ FUM (%)
Brewin Dolphin *	13.0	10.6	4.0	4.3	1.4	1.6
Brooks Macdonald	26.4	21.8	0.9	1.1	4.4	4.2
Charles Stanley	14.7	11.7	3.2	3.5	2.1	1.9
Rathbones	19.4	17.0	3.5	3.6	1.7	3.4
Syndicate Asset Mgt	n/m	8.1	0	0	n/m	0.4
Mean	18.4	13.8	2.3	2.5	2.4	2.3
St James Place **	6.6	5.9	1.7	2.1	8.2	6.6
Share plc *	16.6	19.6	1.0	1.1	4.7	n/m

Source: Thomson consensus, Edison Investment Research analysis and estimates (*) EEV basis (**)

Exhibit 26: Wealth managers performance matrices

%	Rev growth 2012/2009	EPS growth 2012/2009	2011 PBT % Revenue	2011 ROE
Brewin Dolphin *	33	62	15	19.5
Brooks Macdonald	46	65	16	33.4
Charles Stanley	33	64	13	14.6
Rathbones	31	64	31	15.3
Syndicate Asset Mgt	29	n/m	7	n/a
Mean	36	64	16	20.7
St James Place (new business)	77	68	55	n/m
Share plc *	13	31	18	12

Source: Thomson consensus, Edison Investment Research analysis and estimates (*)

Retirement solution providers

Exhibit 27: Wealth managers valuation matrices (non Dec year end adjusted to that year end)

Dec	2010 P/E	2011e P/E	2010 Yield	2011e Yield	Div cover
Hargreaves Lansdown	37.3	27.8	2.3	3.0	1.2
IFG	6.5	6.8	3.1	3.9	4.1
Mattioli Woods	16.9	14.4	1.4	1.4	4.8

Source: Thomson consensus, Edison Investment Research analysis and estimates (*)

Exhibit 28: Wealth managers performance matrices

	Rev growth 2012/2009	EPS growth 2012/2009	2011 PBT % revenue	2011 ROE
Hargreaves Lansdown	83	121	63	106
IFG	60	20	14	17
Mattioli Woods	40	74	32	19

Source: Thomson consensus, Edison Investment Research analysis and estimates (*)

Company profiles

Brewin Dolphin

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/09	212.3	32.1	10.9	7.1	16.2	4.0
09/10	250.9	39.0	12.9	7.1	13.7	4.0
09/11e	276.2	50.9	16.3	7.5	10.9	4.2
09/12e	282.9	54.7	17.8	8.0	10.0	4.5

Note: *normalised, Edison estimates.

Investment summary: Growing market leader

Brewin Dolphin (BD) is the largest independent wealth manager and has consistently grown ahead of its benchmark. Word-of-mouth recommendation has been supplemented by teams joining BD, disillusioned with some of the bulge bracket players. Margins and portfolio mix have been improving from below peer levels, and there are further opportunities to improve both. Consensus estimates have been rising, and the P/E and yield both look attractive relative to peers.

Potential for upside

(1) BD has consistently grown funds ahead of market. (2) It is an attractive home for teams of professionals leaving larger, bureaucratic providers. (3) There has been a steady stream of earnings upgrades over past six months. (4) All but four staff contracts were renewed in 2010. (5) Margins have been on a rising trend and there is an opportunity to increase them by addressing non-staff costs. (6) There is upside from the migration of advisory funds to discretionary accounts. (7) BD has the largest national network of offices providing the most comprehensive coverage closest to the customer. (8) Valuation is below peers despite in-line forecast earnings growth. (9) The proposed sale of the Corporate Advisory and Broking unit focuses BD on wealth management.

Sensitivities

(1) Margins are around two-thirds of Rathbone Brothers and Rensburg Sheppards (now part of Investec). (2) The mix of assets under management is still more weighted to lower margin advisory funds. To date switching has been relatively slow but there is an opportunity to improve. (3) Some in the market appear concerned about loss of trail commission when the Retail Distribution Review (RDR) is implemented in 2012; for reasons identified in the thematic section we believe these concerns are over-done.

Valuation

The stock is trading at 10.9x our year to September 2011 estimated earnings. This is well below its five-year average P/E multiple of around 15x and the mean of the wealth managers (c 13x). The yield (2011e c 4.2%) is attractive and well covered by earnings (1.5x). Adjusting for disposals, 2012 on 2009 forecast revenue growth in line with peers and earnings growth at the higher end of the range. The market cap/FUM is just 1.6%. The average of our three valuation approaches indicates c 200p as fair value.

Price*	177p
Market Cap	£409m

**As at 16 February 2011*

Share price graph

Share details

Code	BRW
Listing	FULL
Sector	Financials
Shares in issue	230.9m

Price

	High	Low
52 week	177.5p	114.0p

Balance Sheet as at 26 September 2010

Gross Debt/equity (%)	1
NAV per share (p)	61.5
Net cash (£m)	62

Business

Brewin Dolphin is one of the largest independent private, client investment managers in the UK and manages around £25bn. It provides a complete service for private investors, charities and pensions.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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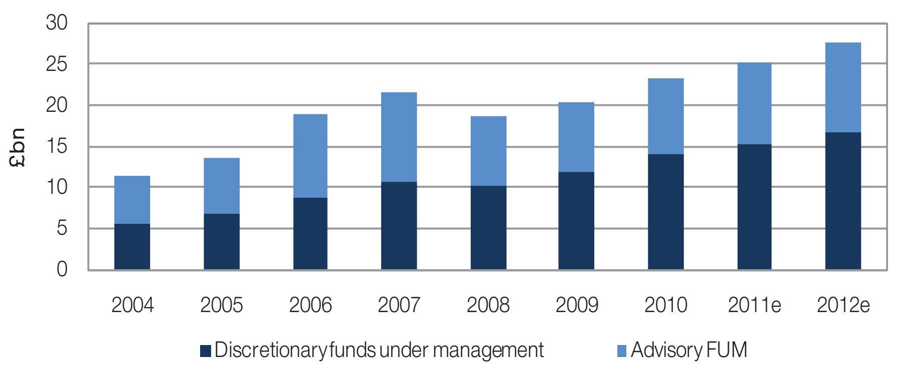
Company description: Growing market leader

BD is the largest independent private client investment manager (PCIM) in the UK and manages around £25bn of funds. The group provides a complete investment management and financial planning service on behalf of private clients, charities and pension funds from its 41 offices. BD has shown an impressive record of growing funds managed – and therefore revenue – ahead of the market using a plethora of channels and distribution approaches. September 2010 discretionary funds were 2.5x the 2004 level (advisory funds: 1.6x) compared with the FTSE 100, up by just 22% over the same period.

Exhibit 1: Funds managed by Brewin Dolphin (year end September)



Sources: Brewin Dolphin, Edison Investment Research estimates

Where growth comes from

Exhibit 2: Drivers to fund growth

	Advisory funds	Discretionary funds	Total managed funds
27 Sept 2009	8.7	11.8	20.5
Inflows	0.7	1.6	2.3
Outflows	(0.4)	(0.3)	(0.7)
Transfers (switches)	(0.1)	0.1	0
Market moves	(0.3)	0.8	1.1
26 Sept 2010	9.2	14.0	23.2
% increase, y-o-y	5.7%	18.6%	13.2%

Sources: Brewin Dolphin, Edison Investment Research estimates

BD has repeatedly seen its funds grow materially ahead of the market. As can be seen in Exhibit 2 (above), the vast majority of the growth in 2010 has come from net inflows rather than market movements. To understand the BD story, one must appreciate where this growth is coming from. BD uses multiple options to generate new funds, many delivering ahead of peers.

- **Market flows.** New business will be dependent on the level, direction and volatility in markets, and the level of interest rates. These are significantly outside management control.
- **Referral by existing clients.** We believe more than half the organic growth comes from referrals by existing BD clients or increased balances from them.
- **Opening new offices.** One new office was opened in 2010 (two opened in 2009), bringing the total to 41. Management indicates that national coverage is nearly complete and that any further openings will be very selective.

- **Increasing staff in existing offices.** It is clear that the focus is now to generate more income from the existing offices; for example, a team of 10 was added in Glasgow. In 2010 six new teams joined (after six joined in 2009 and 21 joined in 2008) bringing the total number to c 150.
- **Business development team.** This unit introduces BD products to the independent financial adviser market and generated £380m in new FuM in 2010 (£235m in 2009).
- **Charity investment management team**: BD has established a specialist unit to service this space and at September 2010 had £1.7bn of FuM (March 2010: £1.7bn, September 2009: £1.5bn).
- **Cross-selling more products.** The over 60 qualified financial planners are an important cross-selling tool, with BD having £2.9bn of FUM in various tax wrappers (March 2010: £2.9bn; September 2009: £2.3bn).

Operating margin improving, but below peers

BD continues to report a pre-tax operating margin that is well below peers. For 2010, it reported 15%, well below the c 24-25% we believe that Rathbone Brothers and Rensburg Sheppard are delivering. Even excluding amortisation and redundancy, BD is forecast to be around 18% in FY11. We believe the issue lies with costs and, most notably, with non-staff costs, where BD's expense is materially higher than its peers. Regulation is a factor for the companies, although BD believes it may have met more of the costs earlier than peers. Management emphasise that its control of IT in-house, and recent investment, may lead to incremental cost and depreciation. The non-staff associated with the advisory business may also be a factor. We note that BD has a national office network of 41 offices, while both Rathbone Brothers and Rensburg Sheppards have around a quarter of this. In addition, there should be economies of scale as the group's growth is faster than peers, and there should be a positive mix effect of more wider-margin discretionary (rather than advisory).

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** In addition to fund management fees, BD has sensitivity in new business flows and its pension fund.
- **BD investment performance.** In private client investment management, the brand is critically important. There is a significant allowance by customers for a trusted provider (and BD's referral rates show it has this status), but investment performance is critical.
- **Integrating new teams.** The track record to date has been exemplary..
- **Cost control.** In 2010, costs grew by 4% less than revenue and we are forecasting a similar positive gap in 2011.
- **Interest rates.** Rising interest rates in due course are likely to assist BD's earnings on its own cash but may see less migration by customers from their bank deposits into equity investment.
- **Regulation.** We believe more regulation is inevitable and will bring increased costs and lower flexibility. The FSA's RDR, effective from 2012, is likely to be significant. As with all regulation, it is an opportunity as well as threat as it may squeeze out smaller competitors, allowing BD to expand both organically and by acquisition.

- **Financial Services Compensation Scheme.** In its recent interim management statement, BD indicated a levy of £6m would be incurred in this financial year (after £1m in 2009/2010). This charge represents 13% of pre-tax pre-levy profits.

Financials

Our forecasts assume that BD continues to grow its FUM and long-term targets ahead of the market. 2010 confirmed this trend. With a good control of costs, there is a strong recovery in profits and growth in net assets. The slower revenue growth in 2012 reflects the disposal of the corporate advisory and broking business which is assumed to be in for the whole of this year.

Exhibit 3: Profit and loss (£ '000s)

Year end: September	2007	2008	2009	2010	2011e	2012e
Commission income	95,236	87,471	90,650	98,566	106,451	111,774
Financial planning and trail income	17,931	21,009	20,225	34,960	37,757	39,645
Investment banking fees and retainers	24,642	9,410	8,297	10,877	13,052	0
Investment management fees	60,223	69,079	68,069	90,487	101,345	109,453
Total fees and commissions	198,032	186,969	187,241	234,890	258,606	260,872
Other income	11,247	19,526	25,071	15,999	17,599	21,999
Total operating income	209,279	206,495	212,312	250,889	276,205	282,870
Total staff costs	(117,641)	(105,834)	(106,401)	(120,420)	(128,705)	(130,971)
Amortisation of intangibles assets - client relats	(1,774)	(4,244)	(6,566)	(6,349)	(6,300)	(4,556)
Other operating costs	(56,882)	(70,607)	(78,873)	(92,094)	(98,356)	(100,045)
Total operating expenses	(176,297)	(180,685)	(191,840)	(218,863)	(233,362)	(235,572)
Operating profit	32,982	25,810	20,472	32,026	42,843	47,298
Finance Income	7,406	7,142	2,435	1,293	2,198	3,297
Finance costs	(564)	(994)	(968)	(453)	(453)	(453)
Other gains and losses	0	0	0	(495)	1,500	0
Financial services levy	0	0	0	(1,000)	(6,000)	0%
Pre tax profit	39,824	31,958	21,939	31,371	40,088	50,142
Pre-tax adjusted for amort, redundancy & levy	42,544	36,836	32,143	38,973	50,888	54,698
Tax	(12,211)	(9,939)	(6,404)	(9,818)	(10,824)	(13,037)
% effective rate	-31%	-31%	-29%	-31%	-27%	-26%
Profit after tax	27,613	22,019	15,535	21,553	29,264	37,105

Source: Brewin Dolphin, Edison Investment Research

Exhibit 4: Balance sheet

Year end: September	2007	2008	2009	2010	2011e	2012e
		2009 Restatement re intangible				
Assets						
Intangible assets	65,767	85,685	89,605	91,114	86,558	82,230
Property plant and equipment	20,949	27,975	22,260	19,384	19,772	18,167
Available for sale investments	11,526	10,626	10,609	6,114	6,114	6,114
Other receivables	2,059	2,098	2,269	2,306	2,421	2,542
Deferred tax assets	542	0	852	1,097	1,097	1,097
Total Non-current assets	100,843	126,384	125,595	120,015	115,962	110,151
Trading investments	1,251	724	644	632	632	632
Trade and other receivables	356,385	283,404	441,290	331,423	364,565	370,022
Cash and cash equivalents	87,946	60,546	69,271	87,921	100,426	102,676
Total current assets	445,582	344,674	511,205	419,976	465,624	511,966
Total assets	546,425	471,058	636,800	539,991	581,586	622,117
Liabilities						
Bank overdraft	543	3,717	4,289	1,046	1,046	1,046
Trade and other payables	404,873	306,855	468,619	359,086	394,995	434,494
Current tax liabilities	4,965	484	1,715	4,433	4,655	4,887
Provisions	0	2,068	1,871	5,420	5,691	5,976
Shares to be issued including premium	4,504	8233	5056	438	500	500
Total current liabilities	414,885	321,357	481,550	370,423	406,886	446,903
Net current asssets	30,697	23,317	29,655	49,553	58,737	65,063
Retirement benefit obligations	9,735	7,964	16,253	12,498	9,498	6,498
Deferred tax liabilities	0	1,938	0	0	0	0
Deferred purchase consideration	664	2,960	3,221	1,749	1,836	1,928
Provisions	0	0	172	44	46	49
Shares to be issued including premium	5,809	16,946	17,385	13,661	5,235	1,000
Total non-current liabilities	16,208	29,808	37,031	27,952	16,616	9,475
Total liabilities	431,093	351,165	518,581	398,375	423,502	456,378
Net assets	115,332	119,893	118,219	141,616	158,084	165,739
Number of shares (m)	203.5	208.1	212.3	230.3	232.6	234.9
NAV (p)	56.7	57.6	55.7	61.5	68.0	70.5
Funds	2007	2008	2009	2010	2011e	2012e
Discretionary funds under management	10.7	10.2	11.8	14.0	15.3	16.6
Advisory FUM	10.9	8.5	8.7	9.2	10.0	10.9
Managed funds	21.6	18.7	20.5	23.2	25.3	27.6
Other funds		3.5	4.1	4.3	4.7	5.2

Sources: Brewin Dolphin, Edison Investment Research

Brooks Macdonald Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/09	21.8	3.2	22.26	5.50	47.8	0.5
06/10	35.1	5.7	36.31	9.00	29.3	0.8
06/11e	42.6	6.4	45.33	10.45	23.4	1.0
06/12e	47.3	7.7	52.80	11.95	20.2	1.1

Note: Consensus estimates; *Adjusted for amortisation of acquired intangibles.

Investment summary: Super-charged baby

Brooks Macdonald (BM) has consistently increased funds under management (FUM) by 30% ahead of its benchmark index, with the growth driven by having an early focus on high-quality service to upper-end IFAs and strategic partnerships. Its market share remains small, and excellent operational gearing comes from the fund growth. On the downside, its customer base is new and P/E valuation high.

Potential for upside

(1) Annual gains in AUM averaged 30% ahead of the benchmark index, with the beat accelerating in recent years. (2) The group is still small, allowing more growth by opening new offices and hiring incremental staff. (3) Operational gearing is strong. (4) Earnings enhancement is expected from the Braemer acquisition in FY12. (5) There was an early focus on target IFA market generating first mover advantage. (6) The balance sheet is strong with net cash of c £10m. (7) BM is attractive to staff, having won several employer awards. (8) Directors hold of 27% shares, aligning their interests with shareholders. (9) The fee margin is above peers, although it is distorted by initial fees on portfolios being transferred. (10) The consensus June 2011 EPS estimate has been raised by 6% over the past six months and c 30% on a year ago.

Sensitivities

(1) 80% of new business comes from IFAs and professional introducers, potentially increasing customer mobility and incurring incremental fees. (2) Stock liquidity is low.
(3) Relative to peers, the near-term P/E valuation is high for similar EPS growth.
(4) The relatively low portfolio size puts some modest pressure on operational efficiency.
(5) The client base is relatively new. This affects referral rates, portfolio sizes and potentially customer mobility.

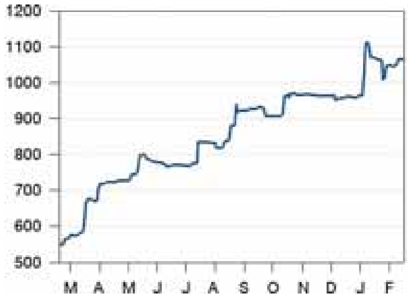
Valuation

The historic, consistent delivery of above-average fund growth is reflected in the stretching P/Es (adjusted to December 2011, P/E 21.8x against 10.9x at Brewin Dolphin, and 17x at Rathbone Brothers). The earnings growth in consensus estimates is 65% June 2013 on June 2010, and is not materially faster Brewin Dolphin and Rathbone Brothers. The upgrades to next year's EPS over the past six months was 16% at Rathbones and 9% at Brewin Dolphin, both ahead of BM albeit the latter's full year increases are well ahead of peers. The yield (c 1%) is not especially attractive.

Price*	1,065p
Market Cap	£113m

**As at 16 February 2011*

Share price graph



Share details

Code	BRK
Listing	Full
Sector	Financials
Shares in issue	10.6m

Price

	High	Low
52 week	1,110p	549.5p

Balance Sheet as at 30 June 2010

Debt/Equity (%)	N/A
NAV per share (p)	117
Net cash (£m)	14.4

Business

BM is a rapidly growing wealth manager with £2.7bn FUM. It generates 80% of new business from IFAs and professional intermediaries and has an above-average SIPP proportion to funds managed.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts
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Company description: Super-charged baby

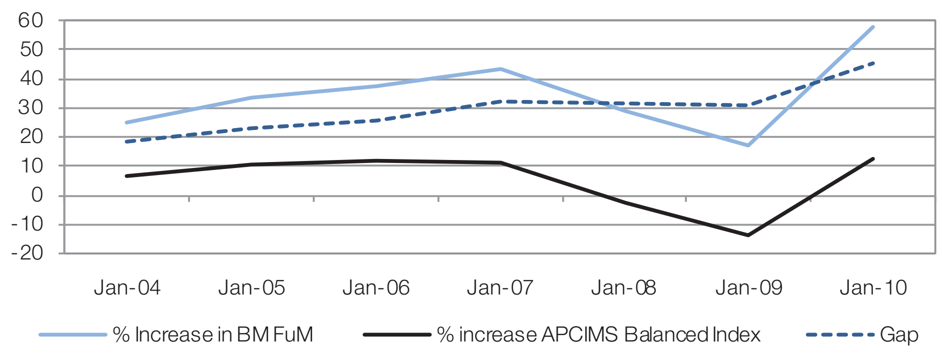
Founded in 1991, BM is a relatively new starter on the block. It has FUM of £2.7bn at end-December 2010 (up from £2.4bn end-September). It offers high quality, fee-based private client discretionary fund management including private portfolios (44% of FUM), SIPPS (42%), charities and trusts and a managed portfolio service (7%) aimed at clients with portfolios of £20k to £150k. It also has a modest, but growing, fee-based financial consulting practice. BM has offices in London, Manchester, Winchester, Tunbridge Wells (April 2009) and Edinburgh (September 2010) and has appetite to expand its geographic presence. 80% of new business is generated from 140 'high quality' IFAs and professional introducers. In July 2010 it completed the acquisition of Braemar Group, which manages £500m of property and has £45m in specialist funds. BM's stated aim is to provide high risk-adjusted returns for all types of portfolio with diversification in all asset classes (including commodities, private equity and hedge funds), and high returns through selection of the best managers and investment vehicles (including unit trusts, investment trusts, direct, structured and specialist investment companies).

Organic growth

The exhibit below demonstrates the outstanding growth achieved by BM. Its funds remain modest (£2.7bn December 2010) and are just over 10% of Brewin Dolphin and just 0.6% of the APCIMS membership, allowing considerably more scope for market share gains ahead of the expected industry growth. Three key business messages should be drawn:

1) It has grown funds every year, including an impressive 17% in the year to June 2009 (when its benchmark index fell 14%).
2) Over the past six years, its average pa AUM growth was 30% ahead of the index.
3) The rate at which it has outpaced the index has accelerated over time and as the business has grown. The growth from £2bn in June to £2.7bn in December 2010 suggests this trend has continued.

Exhibit 1: % increase in BM funds and the benchmark index from June 2004 to 2010



Source: Edison Investment Research, Brooks Macdonald plc accounts

Relationships withs IFAs/professional introducers

BM is unusual in that 80% of new business is through IFA and professional introducers. BM has shown great flexibility in its relations with IFAs, for example, with the strategic alliance with Origen (one of six), which saw BM take complete management of Origen's discretionary fund management business in May 2008. This relationship not only brought £65m in FUM but also an 11-office, 400-staff distribution network.

BM would argue that its competitive advantage in this space is that it was early to establish a business development group focused exclusively on high-quality servicing to this source of business. This, in turn, allowed an BM to develop an early track record with the introducers and develop momentum. The growth in assets is hard evidence of the company's success, although others are now increasingly giving this area attention.

We highlighted in the thematic section that we believe smaller IFAs will find the incremental compliance costs disproportionately painful. BM advises that the distribution of new business from smaller IFAs is minimal, with its 140 counterparties being larger IFAs.

BM faces incremental costs, having a greater proportion of new business from paid introducers (cost 25-50bps), only some of which will be borne by the customer. This is a negative relative to free word-of-mouth recommendations from longstanding clients.

Staff hirings and new offices

BM is proving an attractive place to work. This is visible in its announced fund manager hirings and from it being in the *Sunday Times* list of best companies to work for. The average number of professional staff in FY10 was just 63 (up from 53 in the year to June 2009), meaning the hirings are material. We do not believe there is any meaningful constraint on BM growing ahead of the market by opening new offices and hiring incremental staff, although there have been no announcements since June.

Buying in fund managers and teams is not cheap. Note 12 in BM's report and accounts highlights that the total gross intangible for client relationships and new teams is around £3.1m, incurring an charge of £311k in 2010 (£219k in 2009).

Referrals from, and additional investments by, existing clients

New deposits from existing accounts are currently at below peer levels. We believe this is due to: a newer customer base; younger customers who are still acquiring wealth; and success with IFA distribution. Over time we expect this to be an increasing portion of new business.

Acqusitions

BM has made two acquisitions recently – Lawrence House and Braemer Group. They are the only acquisitions in the company's 20-year history and, while opportunistic tactical add-on may occur, we do not believe acquisitions are a key part of the group's strategy.

Newer client base

Some may argue that BM's client base is more mobile than most of its peers. Specifically, we note: (i) 80% of new business has moved to BM because of third-party recommendations, which could change if either BM's or the customer's relationship with IFAs changed. (ii) Rapid growth means that a far greater proportion of clients are new to the company and have yet to build long-term relationships with their account manager. BM says its attrition rates remain very low with death and divorce being the biggest reasons for lost assets.

The newer, younger customer base also means that the average size of the portfolios is somewhat below peers. Excluding the non-bespoke small value MPS offering, we understand the average portfolio is around £700k, at which level the competitive disadvantage from size is modest.

Sensitivities

The group's main sensitivities are to:

- Equity markets.
- Interest rates. We believe that, in line with other competitors, rises in interest rates up to c 3% are likely to be shared broadly evenly with customers. On customer cash balances of around £330m, a 50bp increase in base rate shared on this basis could be worth £0.8m of profit, while the £10m of own cash (post Braemer) would see an incremental £50k profit for such a rise.
- Tax regimes. Major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- Regulation. While we believe most regulatory pressure will be felt on the smallest players, there is likely to be an ongoing increase in compliance expenses.
- Financial Services Compensation Scheme. BM advises an invoice of £545k, 8% of consensus PBT to June 2011. The charge is a smaller proportion of profits given BM's above-average fee generation.

Financials

Consensus estimates have a rapid growth in revenue (46% up 2013 on 2010) which, with the inherent operational gearing, generates underlying EPS growth of 65% over that period. Continued high RoA and RoEs are expected.

Exhibit 2: Financials (£m)

Income statement	2009	2010	2011e	2012e	2013e
Revenue	21.75	35.11	42.64	47.33	51.12
EBIT	2.99	5.61	6.29	7.77	8.43
EBITDA	3.54	6.40	7.24	8.37	9.17
Pre-tax profit	3.19	5.68	6.42	7.71	8.64
Net income	2.25	3.86	5.24	6.54	7.47
Per share data					
EPS	22.26	36.31	45.53	52.80	60.00
Dividend per share	5.5	9.00	10.45	11.95	13.60
Cashflow per share		82.11	54.67	66.11	75.34
Balance sheet					
Net asset value		12.41	16.75	22.38	28.82
Net cash		14.37	17.25	21.65	26.52
Book value per share		121.13	156.20	208.70	268.80
Valuation					
ROA (%)		20.61	23.24	22.85	20.48
ROE (%)		37.65	35.92	33.41	29.19

Source: Thomson

Charles Stanley Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/09	101.8	10.8	17.3	8.75	17.0	3.0
03/10	115.0	13.7	21.2	9.45	13.9	3.2
03/11e	124.7	16.8	26.8	10.65	11.0	3.6
03/12e	139.9	19.4	31.0	11.33	9.5	3.9

Note: Consensus estimates; *Normalised for amortisation of acquired intangibles.

Investment summary: Growing grandee

Charles Stanley Group (CS) is a long-established (1792), wealth manager that, with a traditional and conservative culture, has doubled funds under management (FUM) over five years. Consensus EPS estimates have been rising, with forecast 2012 EPS 64% above 2009. Although increasing, discretionary funds make up 62% of the managed funds, well below peers and depressing near-term fee margins, although providing an opportunity for improvement. P/E valuations are below peers.

Potential for upside

(1) FUM have doubled over the past five years. (2) Consensus estimates for revenue growth and EPS growth are in line with peers at 33% and 64% respectively (2012 on 2009). (3) The long history of the group means it has established, sticky client relationships. (4) Strong partnership culture. (5) There is an opportunity to widen margins by continuing the recent trend of migrating advisory funds to discretionary ones. (6) Management is closely aligned to shareholders, with the chairman and family owning 50% of the group. (6) CS is attracting “significant levels of new business from third-party sources” (Report and accounts 2010). (7) CS has one of the larger national networks and is still opening new offices. (8)Consensus 2011 earnings estimates have risen 16% over the past six months. (9) Upside from more normal interest rate environment – 2010 profits down £4.4m on 2009 because of rate levels.

Sensitivities

(1) Management succession. Three of the four parent company directors are aged 61-64, presenting a challenge should they need replacing in rapid succession. (2) No independent directors mean corporate governance will be considered by some as an issue. (3) At 62% of managed funds being discretionary, CS still has an adverse mix effect compared to peers. Not only are advisory fees lower, but they are captured by the Retail Distribution Review (RDR), while discretionary asset management funds are not. (4) While funds under administration were £14.3bn, funds managed were £7.1bn (31 December 2010).

Valuation

CS is trading on one of the lowest P/Es (December 2011 adjusted 11.7x v peers 13x) and highest yields (2011e 3.5%) of the companies in this report.

Price*	**294p**
Market Cap	**£131m**

**As at 16 February 2011*

Share price graph

Share details

Code	CAY
Listing	FULL
Sector	Financials
Shares in issue	44.7m

Price

	High	Low
52 week	312.5p	191p

Balance Sheet as at 30 September 2010

Debt/Equity (%)	N/A
NAV per share (p)	174
Net cash (£m)	34.6

Business

CS is one of the UK's larger independently owned, full service stockbrokers, advising on substantial client funds. Funds under administration were c £14.3bn with £7.1bn under management as at end-December 2010.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Growing grandee

Although CS's background as a stock broker (member of LSE since 1852) gives it a different heritage from most of the other companies in this report, it is the wealth management operations that dominate the group's financials. The principal activity of the private client division is providing investment management services to individuals, trusts and charities. The financial services division includes a SIPP administrator, a discount financial intermediary, an employee benefits provider and financial planning and wealth management areas. Charles Stanley Securities is the group's advisory, broking and corporate finance arm for smaller and mid-cap UK-listed companies. At the market's peak in 2007/08, CS Securities was generating corporate finance fees of £5-6m and divisional profits of £2-3m.

Exhibit 1: Financials

Year end March 2010 (£'000s)	Private clients	Financial services	CS Securities
Commission	54,768	135	7,123
Fees			
Investment management	22,695	261	-
Administration	18,690	8,054	152
Corporate finance	-	-	3,114
Total revenue	96,153	8,450	10,389
Direct costs	(58,064)	(8,511)	(10,478)
Divisional profit	38,089	(61)	(89)

Source: Edison Investment Research, Charles Stanley Group accounts.

The group does not allocate a material element of cost (2010 £28.3m) to the divisions although by most allocation bases the vast majority would fall on the private clients division.

Exhibit 2: Breakdown of funds under management

£bn (at March year end)	2005	2006	2007	2008	2009	2010	Dec 10
Discretionary FUM	1.4	2.2	2.6	3.1	2.7	3.9	4.5
Advisory FUM	2.1	2.7	3.0	2.9	1.9	2.4	2.6
Total managed funds	3.5	4.9	5.6	6.0	4.6	6.3	7.1
Discretionary as % total	*40%*	*45%*	*46%*	*52%*	*59%*	*62%*	*63%*
Advisory dealing funds	1.9	2.4	2.4	2.2	2.0	2.8	3.0
Execution only funds	2.3	2.4	2.6	2.8	2.4	3.7	4.2
Total administered funds	4.2	4.8	5.0	5.0	4.4	6.5	7.2
Total	7.7	9.7	10.6	11.0	9.0	12.8	14.3

Source: Edison Investment Research, Charles Stanley Group accounts

CS works through a number of brands. Charles Stanley & Co. provides full service stockbroking, financial planning and benefit consultancy and small- and mid-cap advisory and institutional broking. EBS Management provides specialist pensions administration services (2,608 SIPPS, 366 SSASs at March 2010). Garrison Investment Analysis markets unit trusts, open-ended investment company units and packaged financial products to private clients, both directly and in wrappers such as ISAs and pensions. CS Financial Solutions delivers pension benefit consultancy, corporate risk solutions, wealth management and wealth protection cover through personnel with extensive experience of corporate and individual requirements. CS has one of the larger national networks (34 offices) with the bias in the South, South East and South West.

Management succession and corporate governance

CS's corporate governance is unusual and more like a professional partnership than its quoted peers. It operates a two-tier board structure comprising the board of the parent company Charles Stanley Group ("the company board"), and the board of its primary operating subsidiary, Charles Stanley & Co. Together these boards are known as the group board. The company board comprises four executive directors, who also serve on the group board, together with eight further executive directors. There are no non-executives, which will cause some investors concern.

The parent company executive directors have been with the company an average of 30 years and, relative to peers, there is a concentration of ages with three of the four aged between 61 and 64. Potentially this could lead to management succession issues.

Exhibit 3: Parent company board directors

Name	Title/responsibility	Age	Joined CS	Shares
Sir David Howard	Chairman, MD	64	1967	12.7m
Peter A Hurst	Finance director	61	1987	0.2m
E Michael Clark	Private clients, dealing, research	63	1976	0.8m
Michael RI Lilwall	CS Securities, Financial Services, business development	52	1997	0.1m

Source: Charles Stanley Report and Accounts 2010

In addition to Sir David Howard's holding of 12.7m shares (28% of group), John LS Howard holds 5.2m (12%) and the total family holding is around half the group.

Sensitivities

The company's main sensitivities are:

- Equity markets.
- Interest rates. In its 2010 R&A, CS advised that the lower interest rates in that year had cut £4.4m from pre-tax profits compared with the year before.
- Tax regimes. Major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- Regulatory regimes. While we believe most regulatory pressure will be felt on the smallest players, there is likely to be an ongoing increase in compliance expenses.
- As with all our companies, the report and accounts identifies additional risks in reputation, regulation, competition, technology and operations.
- Compensation schemes. FSCS costs were £686k in the year to March 2010 (c 5% group pre-tax) with a further £2.6m for the current year.

Financials

For March 2013 on March 2010, consensus estimates are for revenue to rise 33%, EPS 64% and dividends 26% (to a nearly 3x cover). The 2013e yield of 4.1% is safely covered.

Exhibit 4: Financials

Note: Adjusted PBT will be a little higher than the numbers in the exhibit.

Income statement	2009	2010	2011e	2012e	2013e
Revenue	101.77	114.99	124.69	139.93	152.54
EBIT	6.37	11.44	15.30	15.53	17.56
Operating profit	6.37	NA	16.03	18.50	20.87
EBITDA	10.79	14.18	19.12	20.76	23.24
Pre-tax profit	10.83	13.72	16.82	19.38	21.69
Net Income	7.63	9.39	10.78	13.01	14.67
Per share data					
EPS	17.30	21.18	26.83	31.00	34.75
EPS - fully reported	14.65	NA	22.25	29.80	34.40
Dividend per share	8.75	9.45	10.65	11.33	11.95
Cashflow per share	43.28	24.18	36.29	38.54	42.26
Balance sheet					
Net asset value	72.15	73.33	79.81	87.38	97.56
Net debt	N/A	(35.76)	(42.11)	(48.80)	(58.79)
Book value per share	163.45	164.61	177.95	194.00	216.80
Returns					
ROA (%)	2.12	3.42	5.51	5.36	5.74
ROE (%)	10.66	12.80	14.61	15.02	15.14

Source: Thomson

Rathbone Brothers

Year End	Revenue (£m)	PBT * (£m)	EPS * (p)	DPS (p)	P/E (x)	Yield (%)
12/09	116.6	32.4	52.4	42.0	23.7	3.4
12/10	127.2	38.5	63.8	44.0	19.4	3.5
12/11e	141.4	44.2	73.1	44.4	17.0	3.6
12/12e	153.3	50.7	85.8	46.5	14.5	3.8

Note: Consensus estimates. * Adjusted for amortisation of intangibles and FSCS levy.

Investment summary: Steady Eddie

Rathbone Brothers (RB) has consistently increased funds under management (FUM) with organic growth averaging 7% pa since 2005. It has advised clients for over 100 years and has a loyal client base. There is upside potential from both the below peer fee structure, and a more normal interest rate environment. FY10 EPS beat consensus and P/E estimates for 2011 have been raised by 16% over the past six months.

Potential for revenue upside

(1) If interest rates trend to more normalised levels (as we expect), we see revenue and profit upside of c £10m. (2) There is some potential to improve the fee structure, which appears to be below some peers (annualised 85bps return in investment management compared with, say, Brewin Dolphin's 92bps on advisory and 121bps on discretionary funds). (3) Having a banking licence differentiates the group, meaning it can offer a broader product range, more management flexibility on managing interest rates and, with a low-risk asset base, earn good economic returns on capital.

Organic and acquired growth strategy

(1) Good organic growth in funds has been consistently delivered. (2) Opportunistic acquisitions, like the agreement with Lloyds Banking Group, appear sensibly priced and fit strategically. We expect RB to be a consolidator. (3) RB's modest unit trust business has upside from focused management with a target is to double this business.

Sensitivities

(1) Wage control has been good through the credit crisis but may now come under pressure. (2) The unit trust business remains modest and some may question its strategic value. (3) The banking licence exposes RB to higher regulatory and compensation costs. (4) The rate of organic growth has slowed over past two years.

Valuation

RB is a well regarded, long established, wealth manager that has consistently delivered good growth. It does not have the P/E rating of a small, super-charged player like Brooks Macdonald, nor the risk rating of the recovery play Syndicate Asset Management, but is rather a steady-as-she-goes, dependable stock. The yield is reasonable and well covered by earnings. The modest unit trust operation and the banking licence, two differentiating features of the company, are not sufficiently material to change this relative rating.

Price*	1,240p
Market Cap	£538m

**As at 16 February 2011*

Share price graph

Share details

Code	RAT
Listing	FULL
Sector	Financials
Shares in issue	43.4m

Price

	High	Low
52 week	1,257p	762.5p

Balance Sheet as at 30 December 2010

Debt/Equity (%)	N/A
NAV per share (p)	4.27
Net cash (£m)	79.1

Business

RB is a traditional wealth manager with £15.6bn FUM (Dec 2010). It has a modest unit trust business and unusually holds a banking licence.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Steady Eddie

The core of RB is a traditional wealth management business where it currently manages £14.6bn. About half new business comes from existing clients and half from new clients. IFAs have become an increasingly important contributor to the latter over recent years. In addition, there is a 40-person trust and tax division (London and Liverpool) and a 24-person unit trust division (FUM £1bn). Unusually, RB has a banking deposit licence and takes its clients' cash deposits directly on its own balance sheet. As can be seen in Exhibit 1, there is a remarkable consistency in the organic growth of the business, adding an average of around 7% to funds every year for the past five years.

Exhibit 1: Breakdown and growth dynamics of funds under management

£bn	2005	2006	2007	2008	2009	2010
Investment management	8.3	10.3	11.2	9.4	12.2	14.6
Unit trusts / other	1.2	1.9	1.9	1.1	0.9	1.0
Total funds	9.5	12.2	13.1	10.5	13.1	15.6
Investment management						
Opening FUM	6.9	8.3	10.3	11.2	9.4	12.2
Organic in-flows	0.9	1.1	1.5	1.6	1.3	1.5
Purchased in-flows	0	0.9	0.1	0.4	0.6	0.6
Outflows	(0.5)	(0.5)	(0.6)	(0.7)	(0.7)	(0.8)
Market moves	1.0	0.5	(0.1)	(3.1)	1.6	1.2
Closing FUM	8.3	10.3	11.2	9.4	12.2	14.6
Net organic growth	5.8%	7.2%	7.8%	7.4%	6.7%	5.3%

Source: Edison Investment Research, Rathbone Brothers accounts

The weight of funds in client portfolios is in excess of £1m, with a small proportion in the below £100k range. Roughly half the funds are private client funds and a further quarter in tax-efficient schemes like ISAs and pensions. RB has an unusually high 91% in discretionary funds.

Exhibit 2: Breakdown of funds under management

Client portfolio size		Client types	
50%	£1m+	46%	Private client
18%	£500k - £1m	15%	Trust and settlements
17%	£250k - £500k	13%	ISA
12%	£100k - £250k	11%	Charities
2%	£50k - £100k	11%	Pensions (inc SIPPs)
1%	< £50k	3%	Other

Source: Edison Investment Research, Rathbone Brothers accounts

The banking licence

RB is unusual among its peers in that it has its own banking licence. Client deposits are taken directly on RB's balance sheet. It then takes a turn by re-investing the funds in the money markets/debt securities. A number of company-specific issues arise.

- RB has more control on managing interest rate exposure by being the intermediary.
- RB can offer a bundled service to its clients, including lending facilities. Given the importance of property in most wealthy portfolios, the ability to gear easily may be an important differentiating factor both on customer service and product availability.
- The risk profile of assets is low, meaning the regulatory capital requirement is low (RB has a 28.3% Basel III tier ratio) and so the ROCE is attractive. Of customer deposits of

£762m, just £40m is lent on to customers (no impairments 2008-10) and the vast majority is invested in held-to-maturity, short-dated bank and building society certificates of deposit and gilts. As regulatory capital becomes increasingly risk-sensitive, this becomes more of a competitive advantage.

- RB incurs incremental regulatory/compliance costs, both in meeting the operational requirements but also with issues such as customer compensation levies and potentially staff remuneration.
- Customer deposits are only insured up to the compensation scheme limits and are exposed to RB credit. The trust in the brand is very strong – as shown by minimal deposit withdrawals identifiable to guarantee limits through the credit crunch – but it could introduce a liquidity issue not present in other wealth managers.

RB reviewed its licence in 2010 and concluded that it made economic sense to retain it.

Acquisition strategy

RB has supplemented organic growth with a steady string of opportunist acquisitions of companies and investment teams, as well as normal hiring of teams from competitors. Most recently, it entered an ongoing deal with Lloyds Banking Group acquiring certain historic portfolios and entering a new distribution agreement. We would expect this to continue and for RB to be a consolidator into this market.

Unit trust operation

RB is also unusual in having a unit trust business, which has accounted for up to a 10th of funds managed. Approximately half the unit trust's FUM are in the flagship Income Fund. There are some clear synergies on things like dealing platforms and investment research, and RB's review in 2010 targeted significant growth by addressing sales, remuneration, and communications issues. Although not detracting from the RB story, the strategic rationale for the unit trust business in RB is more open to question. The unit trust market is predominantly IFA distributed, with an increasing trend towards consolidation platforms, model portfolios, funds of funds (c doubled since 2005) and funds being bought rather than sold. Neither IFA distribution nor the other trends match the core RB wealth management model. The business is a small part of the group (<10% FUM, <5% profits) and arguably takes a disproportionate amount of management time. On the upside, recent performance in many funds has been upper quartile, and the unit is profitable again.

Sensitivities

The group's main sensitivities are to:

- **Equity markets.** In addition to the business operations being sensitive to equity markets, RB has a pension fund whose deficit is c 10% of group equity.
- **Investment performance.** In private client investment management, the brand is critically important.
- **Interest rates.** Rising interest rates in due course are likely to assist RB earnings on its own cash but may see less migration by customers from their bank deposits into equity investment. The basis-point return on interest in 2010 is around a third that

seen in more normal years (eg 2006/07), suggesting annual NII and profit could rise by c £10m if rates rise to a level above all the savings floors.

- Regulation. We believe more regulation is inevitable and will bring increased costs and lower flexibility. The FSA's Retail Distribution Review (RDR), effective from 2012, is notable. As with all regulation, it is an opportunity as well as threat as it may squeeze out smaller competitors, allowing RB to expand both organically and by acquisition.
- Financial Services Compensation Scheme. In its results, RB indicated a levy of £3.6m for 2010, representing c 10% of pre-tax pre-levy profits (after, £0.2m in 2009, £1.4m in 2008).

Financials

Consensus estimates have RB increasing revenues from 2009 to 2012 by 31%, in line with peers. The operational gearing feeds through to underlying EPS growth of 64%. The pre-tax profit margin of c 30% is consistent throughout the forecast period. This consensus was taken before all the results note were published and it is likely that further upgrades will be seen.

Exhibit 3: Financials

Income statement	2008	2009	2010	2011e	2012e
Revenue	129.15	116.56	127.18	141.41	153.27
EBIT	42.76	32.44	38.50	42.03	50.31
Operating profit	42.76	32.44	38.50	43.75	50.80
EBITDA	47.37	35.81	42.06	46.88	55.43
Pre-tax profit	42.76	32.44	38.50	44.20	50.72
Net income	29.27	22.56	27.60	31.35	36.98
Per share data					
EPS	68.47	52.40	63.80	73.10	85.81
EPS - fully reported	44.45	45.53	49.76	68.22	81.14
Dividend per share	42.00	42.00	44.00	44.36	46.50
Cashflow					
Cashflow per share	381.89	(639.42)	104.64	89.47	103.87
Balance sheet					
Net asset value	184.63	182.49	185.37	196.10	210.70
Net cash	82.50	139.04	79.10	N/A	403.71
Book value per share	431.29	421.54	427.32	451.56	490.30
Valuation					
ROA (%)	2.31	2.18	2.67	3.65	4.67
ROE (%)	15.85	12.36	15.00	15.29	17.33

Source: Thomson (consensus estimates)

St. James's Place

Year End	New business (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/09	419.0	228.9	38.1	4.5	8.1	1.5
12/10e	581.8	314.0	46.6	5.3	6.6	1.7
12/11e	657.7	359.9	52.6	6.4	5.9	2.1
12/12e	743.3	417.3	60.1	7.1	5.1	2.3

Note: Consensus estimates. New business calculated on an APE basis. PBT is EEV operating profit before tax and excludes investment variances and economic assumption changes. EPS is fully diluted and calculated on EEV operating earnings after tax. Cash EPS in Exhibit 2.

Investment summary: Strong growth, low risk

St. James's Place (STJ) offers an advice-led service from its own sales network. Five-year compound growth in funds under management (FUM) is 15.1%, with a 26% increase in 2010, supported by strong customer retention. We see plenty of room for further growth. STJ has a low-risk capital base and produces capital-light products avoiding complicated guarantees.

A beneficiary of the RDR with room for growth

Since STJ sells its own products, it cannot offer independent advice. So, it must seek to offer good advice. It was *Daily Telegraph* wealth manager of the year in 2007, 2008 and 2010 which indicates a level of success. The Retail Distribution Review (RDR) will reduce IFA competition within the advice market and make it easier for STJ to recruit quality sales people. Datamonitor estimates there are around nine million people in STJ's target market with liquid assets of between £50k and £3m in the UK.

Sensitivities

(1) Advice-led selling is relatively expensive. Debate around disclosures under the RDR could lead customers to re-examine this choice, with a negative impact on demand and/or margins. (2) Liquidity is currently low as the market awaits the sale of Lloyds Banking Group's 60% stake. (3) In common with the life assurance sector, accounting and valuation is a complex issue for investors.

Valuation

STJ is investing in growth and we think it appropriate to focus on value creation as shown in the European Embedded Value (EEV) disclosure, particularly as the business is supported by expected growth in shareholder cash-flows (and dividends) and has a low-risk capital base. Cash earnings are currently held back by strong new business growth, which requires investment in acquisition costs with positive cash-flows only emerging over the long-term life of the policies. EEV measures the net present value of these cash flows that will emerge. On consensus forecasts, the shares are at a 20% discount to 2011e EEV per share despite a normalised (ignoring equity market fluctuations and changes in the discount rate) return on EEV of 15.1%. The 2011e P/E is only 5.9x. Improving cash returns per share see the 'Cash P/E' decline from 63.0x 2009 to 20.8x 2012e.

Price*	308p
Market Cap	£1.5bn

**As at 16 February 2011*

Share price graph

Share details

Code	STJ
Listing	Full
Sector	Life Assurance
Shares in issue	485m

Price

	High	Low
52 week	310.9p	204.2p

Balance Sheet as at 30 June 2010

Debt/EEV (%)	None
EEV per share (p)	295
Net cash (£m)	N/A

Business

St. James's Place is a leading UK wealth management company, established in 1991. It has grown to more than 200,000 clients with £27bn in funds under management. It is differentiated by providing its own advice-led distribution network and outsourcing investment management.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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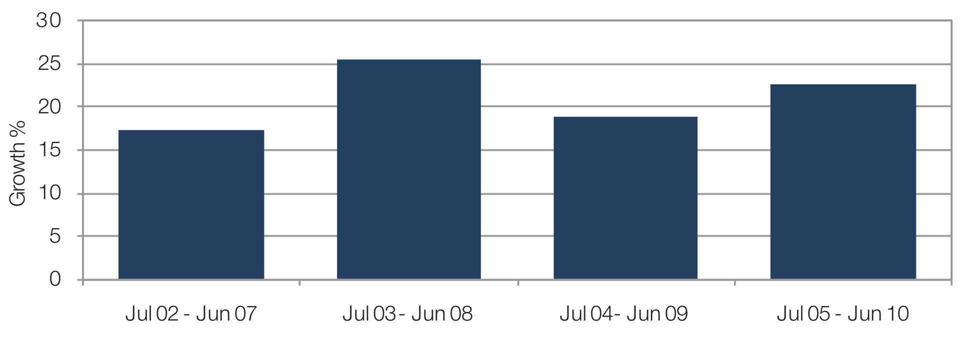
Company description: Advice-led selling

St. James's Place had FUM of £27bn at end-December 2010, an increase of 26% in the year, and compound growth over five years of 15.1%. Although quoted in the life assurance sector, STJ does not aim to produce the full range of traditional life assurance products and is best viewed as a wealth manager providing a range of pension, investment and savings wrappers. It does, however, offer non-core investment products as a distributor. Unlike life assurance peers who rely very heavily on IFA distribution, STJ operates its own self-employed sales force, referred to as "partners". It is a face-to-face, advice-led proposition targeted at mass affluent/high net worth investors. It serves more than 200,000 customers with more than 1,500 partners. Investment management is outsourced to more than 20 external fund managers, chosen by the STJ investment committee, which is supported by consultants. This has enabled it to target better-performing fund managers covering a wide range of styles and strategies, switching where necessary, and maintaining good levels of client retention.

Demand for good advice

STJ is focused on that part of the affluent/high net worth savings market that is willing to pay for face-to-face advice, differentiating it from fund platform providers. It is also different to an IFA offering. STJ is selling its own products (or a limited range of non-core third party products) and is not therefore offering independent advice, but we do not think this distinction matters so long as the advice, products, investment performance and service are valued by the client. STJ has long held a medium-term target of 15-20% growth in new business sales, broadly split between growth in the number of partners and growth in productivity (or sales per partner).

Exhibit 1: Growth in new business premiums (APE)



Source: St. James's Place interim results presentation

Over shorter periods business volumes can fluctuate sharply, largely according to market conditions. Over the medium term, STJ has successfully met its targets. We think growth has been well controlled: it would have been possible to chase faster growth by recruiting still more self-employed partners, but this would have come at a risk to the business culture, compliance, and reputation. The RDR will see the number of IFAs competing with STJ in the advice market shrink, and it will make it easier for STJ to employ good quality sales people, former IFAs who will now welcome the benefits of a well resourced organisation. It is possible that debate around the RDR will increase scrutiny over the relatively high charges associated with STJ's advice-led model. The RDR will distinguish between manufacturing fees and advice fees (basically the amount paid to the "partners"). We think that there could well be some pressure on the advice fee but are less concerned about the manufacturing fees, which are the source of the group's earnings. Indeed, we think that for larger case sizes there is already some downwards shift in the fee expectations of "partners".

Complexity: Three sets of figures

We focus on the EEV results, supported as they are by expected faster increases in cash earnings.

Life assurance accounting and stock valuation is a notoriously complex area for investors. The business is long term, with an initial cost/investment in new business (administrative expenses and sales commissions) and shareholder cash returns only emerging over time (largely a function of FuM fees and customer retention). The paradox is that fast (ultimately profitable) growth in new business can generate reported losses in the short term, which does not make it easy for investors to assess performance.

IFRS accounting attempts to smooth profit recognition over time, but does not accurately reflect the ultimate value of new business or the real movement in cash. We tend to put little weight on IFRS.

STJ also publishes European Embedded Value (EEV) earnings and the Cash Result to shed more light on performance. EEV measures the long-term value creation of the business by calculating the net present value of future cash flows. This obviously requires a number of assumptions to be made, for example, about customer retention, future expenses and the performance of investment markets that will drive FUM fees. Over time, actual performance against future assumptions at STJ has been positive, which gives much comfort to the EEV calculation.

The Cash Result shows the actual cash being generated by the business and is mainly a function of FUM fees (less the unwind of surrender penalties) less cash invested in new business. We expect this to grow in coming years, supported by a maturing book. It takes around six years for long-term business, which must carry distribution costs but earns no bid-offer spread, to contribute positively to shareholder cash-flow. This is because initially FUM fees are offset by the unwind of surrender penalties. More than £7bn of pension business has been written in recent years representing around £50m in pent-up annual pre-tax cash income.

Share overhang

Lloyds Banking Group owns 60% of STJ, a stake it inherited from HBOS, which bought it in 2000. It is generally expected that Lloyds will eventually dispose of its stake and indeed it is non-core. The STJ culture and business model is so different from a traditional life assurance business or bancassurance operation that HBOS never tried to 'integrate' it into its existing operations and nor will Lloyds. For this reason, we do not think a 'trade sale' to another bank or insurance group is at all likely as few institutions would wish to tie up capital in an essentially 'portfolio investment'. Our expectation is that the stake will eventually be placed in the market.

In the short term we think this prospect has had a depressing effect on the share price, even though increased liquidity in the shares would be welcome and would even eventually drive a higher rating.

Sensitivities

- **Equity markets**. Levels and trends are drivers to both fee earnings on FUM and new business sales (mainly over the shorter term).
- **Customer retention.** This clearly has a direct impact on the growth in FUM. The period that FUM will remain with STJ is a key assumption in the EEV results analysis on which we base our valuation.
- **Reputational risk.** STJ's business model relies on clients being prepared to pay for trusted advice, well-designed products, investment performance and service and is vital that the business does not become or appear to be seen as a "selling machine".
- **Tax regimes**. Major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- **Regulation.** While we believe most regulatory pressure will be felt on the smallest players, there is likely to be an ongoing increase in compliance expenses. Overall we feel this will benefit STJ by reducing the numbers of IFA competitors and making it easier to grow the sales-force.

Financials

As a relatively young company investing in new business creation, STJ has looked much more attractive from a 'value creation' (EEV) basis than on nearer-term cash measures. If the assumptions that STJ is using in its EEV calculation are correct, these will converge over time. We focus on the 20% discount to EEV per share despite a normalised RoEV of 11-12% as evidence of undervaluation.

Exhibit 2: Financials

Note: * Consensus data supplied by company.

£m	2009	2010e	2011e	2012e
New business sales (APE) *	419.0	581.8	657.7	743.3
New business profits *	155.4	201	235.8	267.8
New business margin - pre-tax	37.1%	34.5%	35.9%	36.0%
EEV operating profit before tax *	228.9	314	359.9	417.3
EEV per share (p) *	285	349.3	388.3	434.7
EEV operating EPS (p) - fully diluted	38.1	46.6	52.6	60.1
DPS *	4.5	5.3	6.4	7.1
IFRS GROSS profit *	49.9	80.5	117.4	141.9
IFRS EPS (p) - fully diluted	8.3	12.9	18.8	22.4
Cash Result after tax *	23.5	39.5	60.2	74.5
Cash EPS	4.9	8.0	12.1	14.7
Ratios				
PER - based on EEV operating	8.1	6.6	5.9	5.1
PER - based on IFRS	37.3	23.8	16.4	13.7
PER - based on cash earnings	63.4	38.4	25.5	20.9
Yield	1.5%	1.7%	2.1%	2.3%
P/EEV	108.3%	88.2%	79.3%	70.9%

Source: Edison Investment Research

Syndicate Asset Management

Year End	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/09	37.5	(19.1)	(14.29)	0.0	N/A	N/A
03/10	35.7	(2.5)	(0.20)	0.0	N/A	N/A
03/11e	40.3	2.8	0.13	0.0	12.3	N/A
03/12e	48.2	6.1	0.24	0.0	6.7	N/A

Investment summary: Turnaround story

Syndicate Asset Management (SAM) is the turnaround story in the wealth management sector. Having over-extended itself with acquisitions, it has spent two years completely overhauling its finances, management, operations and procedures. This process is nearing completion and the new group can now focus externally on growth. Consensus estimates, although lower than a year ago, still show a strong recovery into 2012. The P/E rating has yet to reflect it.

Potential for upside

(1) The group's major restructuring is largely complete, allowing SAM to focus externally on growth. (2) Ashcourt Rowan, the mass affluent provider and core of the group, is already showing strong organic growth with revenue up 28% in the six months to September 2010. (3) The £1 acquisition of the Co-operative's branch-based IFA network has increased Ashcourt Rowan's geographic footprint and funds under management (FUM) by £1bn. (4) New products should help organic growth. (5) The 2011 consensus P/E is the lowest of the wealth managers. (6) There are clear triggers for re-rating shares when management initiatives across the group deliver growth.

Sensitivities

(1) EPIC FUM and revenues fell when largest client redeemed funds to meet World Trade Centre claims. This set a new profit floor, c £800k below historic levels. (2) The highest net worth unit, Savoy, saw revenue fall in the six months to September 2010 (on prior year) because of the departure of a small team which has now been replaced. While the benefits of restructuring meant costs were less, and so the unit was profitable, the lower revenue base is not the story the market wants to hear in a sector with strong fundamental growth. (3) Management started to emphasise growth in summer 2010 and group-wide delivery has yet to happen. (4) Tangible net assets are just £8m (equity £60m goodwill/intangibles £52m). (5) Consensus 2011 earnings estimates have fallen and are now c two-thirds of their level a year ago.

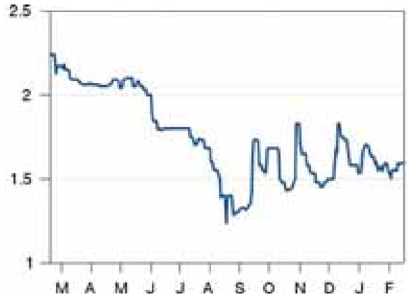
Valuation

On consensus P/E estimates SAM is the cheapest of the wealth managers trading at a 2011 (December adjusted) P/E of 8.1x, If the market's confidence in estimates rises, the shares will sharply re-rate. No dividend is forecast, but should one may be declared, this is another positive trigger for the shares to re-rate.

Price*	**1.60p**
Market Cap	**£29m**

*As at 16 February 2011

Share price graph



Share details

Code	SAM
Listing	AIM
Sector	Investment Services
Shares in issue	1,804m

Price

52 week	High	Low
	2.24p	1.23p

Balance Sheet as at 30 September 2010

Debt/Equity (%)	N/A
NAV per share (p)	11.3
Net cash (£m)	9.0

Business

Syndicate Asset Management is the holding company for an integrated group of specialist investment management businesses including Ashcourt Rowan (mass affluent), Savoy (high net worth) and EPIC (institutional – fixed income). Funds under management are around £6.5bn (end October 2010).

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Turnaround story

SAM is the holding company for an integrated group of specialist investment management businesses across the UK. In the past four years, FUM have more than doubled from £2.5bn in 2005 to approximately £6.5bn today. Syndicate's wealth management services are available to clients through its wholly-owned businesses Ashcourt Rowan and Savoy. Savoy provides a premier stock broking and investment management service while Ashcourt Rowan is more targeted at the mass affluent market. SAM provides tailored investment management services to institutional clients – typically pension funds, local authorities, and corporations – through EPIC Investment Partners, with a material bias to fixed-income funds. There was a modest operation in the Channel Islands, which has now been sold.

Exhibit 1: Divisional break down in the six months to 30 September 2010

(£'000s)	Ashcourt Rowan	Savoy	EPIC	CI	Total
Revenue	12,381	3,346	1,713	1,092	18,532
Cost of sales	(4,819)	(1,194)	(627)	(714)	(7,354)
Gross profit	7,562	2,152	1,086	378	11,178
Admin expenses	(5,697)	(1,672)	(1,000)	(486)	(8,855)
Deprec and amortisation	(617)	(47)	(2)	-	(666)
Operating profit	1,248	433	84	(108)	1,657

Source: Syndicate Asset Management

Restructuring nearing completion

SAM was floated as a £33m cash shell in September 2005, with the specific strategy of exploiting consolidation opportunities in wealth management. Having over-extended the balance sheet and management controls with a spree of 11 acquisitions costing £75m by 2008, SAM was widely expected to fail early in 2009. Management would acknowledge that the last two deals especially were overpriced and there was little opportunity to complete integrations or centralise controls. A financially-exposed balance sheet compounded problems going into the credit crunch.

A new management team was appointed and is believed to have reviewed a complete range of options including sale, partial sale and re-capitalisation/restructuring. The latter was assessed to give the maximum value for shareholders. There has been a fundamental overhaul of the business. Ashcourt and Rowan were merged (saving £600k in regulatory capital), finance, compliance, IT and HR were centralised (saving £300k pa in expenses), and the offshore retail funds (Zenith) were sold in 2010 (having only been bought from Insight in 2007). A single IT platform should be fully implemented by March 2012. In some ways, many of these changes were simply integrating the previous deals, but it has transformed the group into being profitable and cash generative. A single location in London, down from three, is being phased in during Q211.

The finances of the group have also been transformed. In 2009, £22m in new equity was raised and used to repay bank debt (£8m), loan notes (£7m), reduce with negotiation deferred consideration (£1m) and ensure there was a positive cash position.

The board and management team was completely refreshed as shown in Exhibit 2.

Exhibit 2: Board / Management and their date of appointment

Note: Mark Cheshire holds both group and Ashcourt Rowan CEO positions.

Position	Name	Date appointed
Non-exec chairman	Peter Dew	April 2010 (board 2006)
Non-exec director	Buzz West	2005
Non-exec director	Ranil Perera	March 2010
Group CEO	Mark Cheshire	Dec 2010
Group CFO	Neil Hale	March 2010
CEO Savoy	Chris Jeffries	April 2009
CEO Ashcourt Rowan	Mark Cheshire	November 2009
CEO EPIC	Ravi Shankar	March 2010

Source: Syndicate Asset Management

Growing from here

Although there is some residual restructuring to complete, most notably on systems integration, we believe the group can now start to re-focus on the external world and on growing its business. There is some evidence this has started to happen with Ashcourt Rowan revenues rising from £9.7m in H110 to £12.3m in H111. There are clear initiatives in the other divisions and delivery of growth will be a trigger for re-rating the shares.

Ashcourt Rowan

Ashcourt Rowan (pre the Co-operative deal) had 17 branches weighted to the South East, around 20,000 clients, 14 asset managers and 67 financial planning advisers. Financial planning accounted for nearly 60% of FUM with c 650 SIPPs/SSAS. Growth is partially targeted from new product launches (eg, low-cost SSIP July 2010), incremental office openings and tactical bolt-ons in the traditional acquisition route. The target is to double the size of the business organically in three years from November 2009. More centralised management control in the performance of each manager is another aspect expected to encourage growth.

SAM has announced the acquisition of the IFA business of the Co-operative for an initial consideration of £1 (and £450k in deferred consideration for trail commissions), which brings in £1bn of FUM, c 55,000 clients and 52 qualified IFAs. The IFA network is weighted to the Co-operative's core franchise in the Midlands and the North, complementing Ashcourt Rowan's existing footprint in the South.

Savoy

Revenue fell H111 on the prior year because of the loss of a small team of managers who have subsequently been replaced (although the new managers have yet to be at full run rate in terms of assets). We note the division was profitable this year compared with losses last. Management is now looking to leverage the fixed cost base by growing (i) the number of fund managers (from around 30), (ii) the average funds per managers (£36m) and (iii) the number of clients (4k). Part of this is a new client relationship and investor portal platform due to go live in the first quarter of 2011 and there is carefully targeted marketing (eg Polo day). Historically, this business had been left largely to run itself, with little investment of financial or management resources. Current management indicate that this drift is no longer the case.

EPIC

EPIC FUM and revenues fell when largest client redeemed funds to meet World Trade Centre claims. This set a new profit floor, c £800k below historic levels from which to grow. There remains concentration risk with the largest client accounting for around half of revenue, although it has indicated no intention to make further withdrawals in the immediate future. EPIC has responded with new product offerings (including a bond fund open to retail investors for the first time in July 2010). More funds targeted at specific fixed-income niches are planned and EPIC has introduced a cash management product. A dedicated sales team was put in place through 2009, increasing the number of clients from 10 (January 2009) to over 30 now.

Sensitivities

The group's main sensitivities are to:

- **Equity markets.**
- **Investment performance.** In private client investment management, the brand is critically important.
- **Interest rates.** Rising interest rates in due course are likely to assist SAM's earnings on its own cash, but may see less migration by customers from their bank deposits into equity investment.
- **Regulation.** We believe more regulation is inevitable and will bring increased costs and lower flexibility. It is an opportunity as well as threat as it may squeeze out smaller competitors, allowing SAM to expand.
- **Financial Services Compensation Scheme.** SAM has not yet indicated the levy but management indicate there is no reason for them to be out of line with peers.

Financials

Unsurprisingly, consensus estimates for this company are sparse. The limited data has rapid growth in revenue and earnings which should not be too surprising given the restructuring which SAM has faced. Even so, the revenue growth is not out of line with peers.

Exhibit 3: Financials (£m, March year end)

Income statement	2008	2009	2010	2011e	2012e
Revenue	40.29	37.49	35.68	40.30	48.20
EBITDA	6.07	1.16	(2.62)	3.60	7.00
Pre-tax profit	3.91	(19.07)	(2.51)	2.80	6.10
Net income	2.90	(19.04)	(2.10)	N/A	N/A
Per share data					
EPS	1.70	(14.29)	(0.20)	0.13	0.24

Source: Thomson

Hargreaves Lansdown

Year End	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
06/09	132.9	72.3	11.3	7.29	53.5	1.7
06/10	159.0	90.7	13.9	11.88	43.5	2.0
06/11e	202.4	127.3	19.4	15.99	31.2	2.6
06/12e	244.4	161.9	24.8	20.30	24.3	3.4

Note: Consensus estimates.

Investment summary: Perfection priced in

Hargreaves Lansdown (HL) is a marketing machine. Economies of scale and highly automated processes allow HL to be both extremely profitable (100%+ ROE) and share savings with customers, thereby ensuring their loyalty. The simple product range is cheap and relatively low regulatory risk. However, investors are paying for many years of outperformance, allowing no room for error.

Potential for upside

(1) HL has delivered superior growth and consensus estimates, which we expect to continue (FY to June 2013 on FY to June 2010 EPS 100%+). (2) A low-risk model means capital requirements are minimal, resulting in an ROE over 100% and the pre-tax profit margin (as a percentage of revenue) is 60%. (3) Highly automated processes are efficient, give significant gearing and reduce risk. (4) HL is a marketing machine. (5) The low-cost, simple product range should benefit from the FSA's Retail Distribution Review (RDR). (6) Management interests are closely aligned to shareholders, with Messrs Hargreaves and Lansdown owning 32% and 23% respectively. (7) HL has a strong balance sheet with net cash of £98.4m and surplus regulatory capital of c £42m. (8) It will be a major beneficiary if the government sells its bank stakes with any mass retail offering. (9) Consensus 2011 estimates up 21% over past year. Revenue and EPS growth in H1 were ahead of FY expected run rate.

Sensitivities

(1) Maintaining first choice on the internet requires a continual investment in technology and marketing (2010 £8m). (2) A tightly-held shareholder structure means liquidity is poor for the size of its market capitalisation. (3) P/E valuation anticipating future growth. (4) Potential above-average IT risk given automation in process.

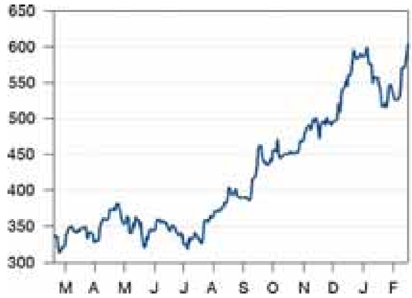
Valuation

The June 2011 P/E of 31x discounts a considerable growth in earnings relative to financial peers. Earnings would need to more than double to bring it into line with wealth manager peers. Putting it another way, investors are paying for many years of superior growth with HL only down to the peers' current rating in 2014. While superior growth has been consistently demonstrated in the past, including in the recent interim results, the valuation leaves little room for earnings disappointment, or sentiment remaining anything other than very positive.

Price*	604p
Market Cap	£2.9bn

**As at 16 February 2011*

Share price graph



Share details

Code	HL.
Listing	FULL
Sector	Financials
Shares in issue	474.3m

Price

	High	Low
52 week	603.5p	311.5p

Balance Sheet as at 30 December 2010

Debt/Equity (%)	N/A
NAV per share (p)	20.6
Net cash (£m)	98.4

Business

HL is a fund supermarket, a fund manager, a discount broker, a stockbroker, a pensions specialist, an annuity specialist, a wealth manager and a financial adviser. It has £22.3bn of AuA (December 2010).

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Perfection priced in

The key to HL is its 'Vantage' division, which represents all activities relating to the direct-to-private investor platform. Vantage offers clients the administrative convenience of being able to hold and manage their investments, including unit trusts, OEICs, equities, bonds, investment trusts and cash, irrespective of the tax vehicle, in one place with consolidated valuation reports, a single dealing service and instant online access. As at 31 December 2010, Vantage administered £20.9bn of assets directly on behalf of private investors, of which £8.5bn was in ISAs and £5.8bn in SIPPs. By this measure, the directors believe Vantage is the largest fund supermarket and wrap platform for the private investor in the UK.

The 'Discretionary' division is focused on the provision of managed services such as the Portfolio Management Service (PMS) and range of multi-manager funds. The 'Third Party/Other Services' division includes activities relating to the broking of third-party investments and pensions, certificated share dealing and other niche services such as currency, CFDs and spread betting. In this division, clients' investments are not administered within the group.

Exhibit 1: Divisional financials half-year end-December 2010

(£m)	Vantage	Discretionary	3rd party/other
Renewal income	42.0	3.5	2.9
Management fees	4.1	7.1	-
Initial charges	0.6	0.8	6.0
Interest receivable	14.3	0.1	0.3
Stock broking	10.7	-	1.2
Other	1.7	0.2	1.6
Total revenue	73.4	11.6	12.0

Source: Edison Investment Research, Hargreaves Lansdown plc interim results

What is unique about the business model?

The HL model is a classic example of the stack it high, sell it cheap model.

- Fund supermarkets and wrap platforms typically serve the IFA community and are paid for acting as administrator while the IFA takes the distributor cut. Hargreaves Lansdown provides its fund supermarket and wrap platform direct to the private investor, thereby capturing the economics of both.
- This dis-intermediation model is reinforced by the discounts (from HL suppliers and fund providers) achieved by being the UK's largest private investor platform.
- Highly automated delivery means platform is scalable.
- Further volume growth is generated by passing on a portion of these benefits in up-front discounts to clients.
- HL also can afford to incentivise clients to stay by passing on a portion of annual management charge it receives as a loyalty bonus. In the year to June 2010, Hargreaves Lansdown has provided over £120m in discounts and rebates.

What breaks the virtuous circle?

HL has established the critical mass and volumes required to be the lowest cost producer, thus attracting further volumes. In the six months to December 2010, HL Vantage accounts grew from £16.3bn to £20.9bn with £1.3bn of net new business inflow (ie, 8% net new inflow in six months). Like all such models there are risks and the vicious circle downwards can be as dramatic as on the way up. Our review concludes that the model is robust for the foreseeable future but investors should especially consider the risk of new entrants attracted by HL's own profitability and success.

- Competition – the most likely cause of the virtuous circle breaking is competition. Capital is not a constraint (HL: own regulatory pillar 1 capital requirement is just £7m), nor the capitalised infrastructure cost (HL total property, plant and equipment cost c £14m). However there has been an un-quantified investment taken through the P&L including the majority of IT development and HL's brand has taken many years to build. Bears will argue IT staff can be bought ,and clever marketing can build a brand, albeit it would take a lot to reach HL's level and the valuable client/marketing list built up over 30 years. A determined and deep-pocketed competitor could make serious in-roads in this market, noting that the HL brand is very strong. Ironically, the more successful HL is (with ROE expected to exceed 100% for first time in 2011), the greater the chances of a competitor entering the field. We would not expect HL to do nothing, but any defensive action would reduce earnings and the share price rating does not give room for such a move.
- Market itself slows – as outlined in the thematic section of this report, we do not anticipate a slowdown in the structural growth of personal wealth management in the UK. Indeed, it may be argued that the low-cost, mass-market ISA/SSIP/savings model will be big beneficiaries from market trends like NEST. HL proved through the credit crisis that it can grow AUM, revenue and EPS through severe market dislocations.
- Market share caps – HL has grown by taking share in the growing market. Even so there are still only 346,000 active Vantage clients and their total assets are around 5% of the APCIMS funds managed. This is a highly fragmented market and we do not see market share constraints for the foreseeable future.
- Technology – technology is such that incremental volumes should be handled with minimal cost. However, the model requires that systems be effective and available to customers at all times. Failure to deliver this could materially damage the brand. The system needs to be state of the art, typically requiring major systems replacement every three to five years. Step changes in capacity can be built into these upgrades and HL undertook a major project in 2010 with its office consolidation.
- Reputational risk – HL has won, and continues to win, a plethora personal financial awards across a range of products and media. The associated brand is highly valuable and an integral part of the HL story, and is a major barrier to potential competitors replicating the model. Anything that undermines the brand could be a major problem as the extraordinary returns HL is making can only make competition inevitable.

Low regulatory risk

HL is extremely well suited to the current political/regulatory environment with its preference for simple, transparent products delivered at low cost to the mass market. As smaller IFAs get squeezed out, it has the opportunity to broaden this product range. Any popular sale of the government's stakes in UK banks could create a massive new opportunity. In its 2010 report and accounts, HL commented it had restructured the Financial Practitioners division and was ahead of the game in preparing for the RDR. Its FSCS levy (£3m) was 3% of profits, well below the average for companies in this report.

Sensitivities

The company's key sensitivities are:

- Equity markets.
- Interest rates – HL has actively managed its interest receivables with H111 seeing NII up 46% on average balances up 10%. Money markets have seen unusual conditions, and depositors with some flexibility on timing can exploit counter-party liquidity needs. Having taken advantage of these conditions, while there is upside from rising rates, its relative opportunity for HL is less than peers.
- Tax regimes – major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- As with all our companies, the report and accounts identifies additional risks in reputation, regulation, competition, technology and operations.
- We believe the regulatory risk in HL's simple model is below peers.

Financials

As can be seen in the exhibit below, HL has been and is expected to continue to be a rapid growth story. FY to June 2013 on FY to June 2010 is expected to see revenue up 83% and, with further operational gearing, pre-tax profit up 117% and EPS 121%.

Exhibit 2: Financials (June year end)

Income statement	2009	2010	2011e	2012e	2013e
Revenue	132.85	158.97	202.42	244.37	290.31
EBIT	69.81	89.80	124.40	159.44	187.54
Operating profit	69.81	89.80	131.30	166.60	202.65
EBITDA	71.56	92.23	128.26	164.47	196.45
Pre-tax profit	72.34	90.70	127.30	161.91	196.49
Net income	51.43	64.92	92.38	116.03	144.37
Per share data					
EPS	11.30	13.90	19.37	24.82	30.72
EPS - fully reported	11.20	13.10	19.33	24.79	31.81
Dividend per share	10.10	11.88	15.99	20.30	24.23
Cashflow per share	NA	15.27	19.42	24.96	27.91
Balance sheet					
Net asset value	84.65	66.11	118.68	158.24	213.85
Net Cash	NA	30.14	112.24	141.91	177.13
Book value per share	17.85	13.94	23.32	30.20	39.49
Returns					
ROA (%)	31.79	33.99	57.28	59.10	51.05
ROE (%)	66.38	81.20	105.69	102.29	83.64

Source: Thomson

Share plc

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/08	12.0	2.4	1.07	0.22	25.7	0.8
12/09	14.1	2.7	1.28	0.25	21.4	0.9
12/10e	15.3	3.5	1.65	0.28	16.7	1.0
12/11e	14.7	2.7	1.40	0.30	19.6	1.1

Note: *Normalised; Edison estimates.

Investment summary: Share the efficiency

Share plc has consistent double-digit earnings growth from its core, low-cost, largely internet, retail share dealing platform. Both its brand and balance sheet are strong. Management has vigorously addressed the loss in interest income when the superbly executed hedge expired in November 2010. There is also the opportunity for a step change in customer numbers on the re-privatisation of banks. On the downside, the P/E valuation is full and stock liquidity poor.

Potential for upside

(1) The low-cost, low-charge model has delivered proven market share gains over many years, in all types of equity market conditions. (2) The brand is well recognised in delivering low-cost, simple products. (3) Material cash balances (£10m, c one quarter market cap) provide flexibility in acquisitions and capital management. (4) A significant proportion of customers are shareholders. (5) There is material potential upside to customer numbers if government stakes in banks are sold through any mass market/popular mechanism (as has been promised). (6) The Retail Distribution Review (RDR) and other regulatory change should have a modest impact.
(7) Management is closely aligned to shareholders, with the CEO and family owning 76% of the shares. (8) We believe management is exploring strategic options to accelerate medium-term earnings growth. The drop in 2011 associated with the end of the hedge policy should be a brief hiccup only. (9) Consensus 2011 EPS has risen by 13% over the past six months alone.

Sensitivities

(1) Superbly executed interest rate hedge expired on 10 November 2010 requiring some incremental risk, to limit the 2011 fall in earnings. (2) Liquidity in stock remains low. (3) The P/E valuation is full, although there is still 20%+ upside on our other measures. (4) It will always need to be lowest cost to grow or else expand into adjacent business areas, which may require new skills and incur new risks.

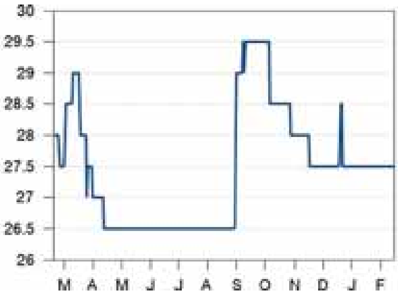
Valuation

Share plc trades on a full 2011 P/E multiple of c 20x. Concerns about replacing the interest rate hedge have been outweighed by longer-term growth and cash generation prospects as well as the tight liquidity. Our DCF and Gordon's growth models have indicative valuations of 32p and 35p respectively.

Price*	27.5p
Market Cap	£40m

*As at 16 February 2011

Share price graph



Share details

Code	SHRE
Listing	AIM
Sector	Investment Services
Shares in issue	143.7m

Price

52 week	High	Low
	29.5p	26.5p

Balance Sheet as at 30 June 2010

Debt/Equity (%)	N/A
NAV per share (p)	11.3
Net cash (£m)	13.8

Business

Share plc owns The Share Centre and Sharefunds. The Share Centre is a self-select retail stockbroker that also offers share services for corporates and employees. A high proportion of income is derived from stable fee and interest based revenues.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Share plc is a research client of Edison Investment Research Limited

Company description: Share the efficiency

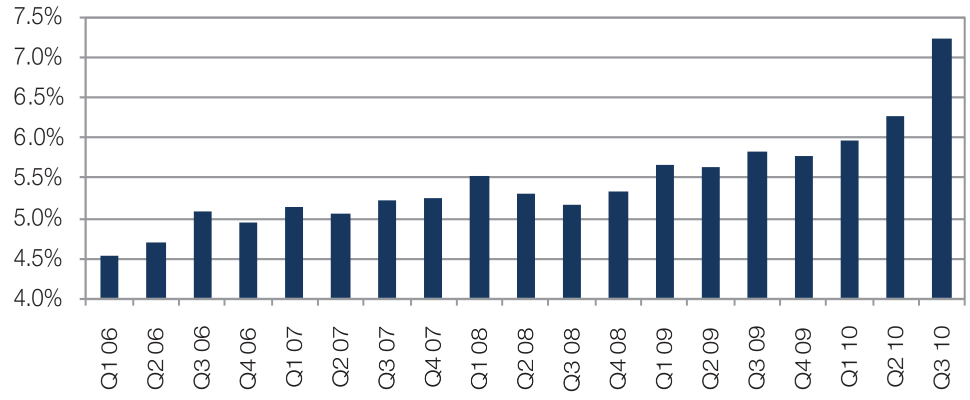
Share plc generates a highly visible earnings stream through its principal subsidiary, The Share Centre, which provides equity-related execution services to private individuals and corporates. The internet is a major source of distribution and Share is different from the other companies in this report as its focus is execution, not advice/asset management. The company has a customer account base of approximately 210,000, which has been growing steadily.

Simple is best and delivers growth

"More people enjoying straightforward investing" is Share plc's mission statement. It encapsulates the strategy of simple is best. The aim of such an approach is to be the low-cost producer for transaction driven business. This leads to low charges for customers and increases volumes, which, in turn, generates efficiency gains, thus keeping the virtuous circle turning.

There are many proven business models with this philosophy and Share plc still has a modest market share allowing for many years of above-market growth. The multi-year market share growth is evidence the model works, and the strong operational gearing generated in recent years, shows that the objective of building a scalable platform has been delivered. There has been a distortion from the valuable interest hedge policy but the Q310 share would still be in excess of 6.1% without any benefit from it.

Exhibit 1: Share's market share of revenue



Source: Share plc

The 'simple is best' model in the internet world requires constant systems upgrades to ensure they are state of the art. For EGG, this meant major re-launches every three to four years and we would expect the same at Share plc. Indeed as technology develops, the risk is that this cycle accelerates. In profit and loss terms, this incurs ongoing material IT expenditure and even though the www.share.com website had a major upgrade in February 2009, this cost is unlikely to moderate significantly.

We also expect there to be an ongoing material advertising spend. We note Share plc has been active across all media, not least internet advertising, and that it uses every opportunity to promote the brand (eg the CEO is a regular interviewee on the BBC). Marketing is of course discretionary in the short term, but over the longer term we do not expect marketing expenses to fall materially from their current levels of a quarter of costs and a fifth of revenue, having totalled c £8m over the past four years. We believe that in the long term a high level of expenditure is necessary for this internet-based business model.

Replacing the interest rate floor

The company's interest rate floor protection policy, which management believed to be unique, ensured that the group generated interest earnings equivalent to 3.5% on customer deposits up to a maximum balance of £90m until November 2010, assisting the revenue market share gain noted above. While the interest rate floor protection policy was visionary in its conception and has provided a major bulwark during a challenging trading period, its expiry in November 2010 leaves a huge hole. To put it into context, the H110 group total revenue was just £7.5m and pre-tax profit £1.6m when the hedge policy contributed £1.3m.

Share plc has not just sat on its hands. Management actions include:

- At the net interest income line, Share plc has agreed with a building society to deposit up to £10m and receive a variable rate of 2.5% above base rate with security of 1.5x the deposit (in the form of segregated mortgages). These favourable terms reflect: the continued closure of the US asset-backed commercial paper market; money markets focusing deposits with larger names; and the duration of deposits (two to three years). The returns on c 10% of cash balances are materially enhanced, while the any extra liquidity risk could be managed by say borrowing against the deposit if required.
- Further action could, for example, involve moving along the yield curve. In essence, rather than accepting short-term rates at close to zero, the company could use longer-term deposits. However, this creates a liquidity mis-match between its assets and liabilities, which will limit any upside.
- At the earnings level, the group has bought back shares through a tender offer, which we expect to improve earnings by c 10%. It is still cash rich.
- Share plc should also benefit from rising customer deposits volumes given its account generation over recent years.
- It is possible that the annual marketing spend (c £2m annually 2006-10) could be cut, but we have demonstrated above that we do not consider that this would be viable other than in the short term.

In addition, a rising rate environment should see some benefit. Customers are paid base rate less 3.5% on cash balances, which are then deposited in the money markets (typically for one to three months). As the money market rate (LIBOR) anticipates changes in retail rates, there is a benefit in a rising rate market. In a steadily rising rate environment, this can be 25-50bps. With market movement and management action we are forecasting £2m of interest in 2011 rising to £2.75m in 2012. We believe management ambitions are to accelerate growth from historic levels and that 2011 will be a hiccup in a long-term story.

Sensitivities

Share plc faces a range of sensitivities. The key elements are:

- **Interest rates:** In November 2010 the group's interest rate protection contract on customer balances matured and it will no longer earn 3.5% on £90m of funds. Looking forward Share plc will benefit from rises in interest rates.
- **Equity market levels and trends** are drivers to both account fees and dealing commissions through investor confidence, but market share gains limit the downside.

- **Customer numbers.** To date, Share plc has been growing its customer base, a trend we expect to continue. Any reversal of this trend would be a key risk and there is a natural cap to the market share it may be expected to take.
- **Acquisitions.** Share plc has been active in making acquisitions, which can introduce incremental risk to the group.
- **Technical issues.** There is clearly a stock overhang/liquidity issue given that the founding shareholder, family and associated trusts have a stake of 76%.
- **Regulatory issues.** Share plc operates in an increasingly regulated industry that carries high reputational risk and where breaches of codes of practice can lead to financial penalties and loss of business. The group continues to have a relatively low level of customer complaints. Share's exposure to the Financial Services Compensation Scheme is believed to be modest and will be detailed with the results on 1 March.

Financials

The maturity of the interest rate hedge materially drags revenue and, despite all the management actions, there will be a lost year of earnings growth. The core model growth beyond that is very impressive.

Exhibit 2: Financials

£'000s	2008	2009	2010e	2011e
Year end 31 December				
PROFIT & LOSS				
Revenue	11,973	14,128	15,260	14,693
Cost of Sales (exc amortisation and depreciation)	(10,578)	(11,880)	(12,195)	(12,372)
EBITDA	1,395	2,248	3,065	2,322
Depreciation	(73)	(76)	(120)	(126)
Amortisation	(16)	(16)	(16)	(16)
Operating profit (pre exceptional)	1,306	2,156	2,929	2,180
Exceptionals	(655)	0	0	0
Other	(55)	(114)	0	0
Investment revenues	859	303	275	275
Profit Before Tax (FRS 3)	1,455	2,345	3,204	2,455
Profit Before Tax (norm)	2,358	2,710	3,455	2,706
Tax	(588)	(639)	(897)	(687)
Profit After Tax (FRS 3)	867	1,706	2,307	1,767
Profit After Tax (norm)	1,700	2,061	2,548	2,008
Average Number of Shares Outstanding (m)	158.3	160.5	154.0	143.0
EPS - normalised (p)	1.07	1.28	1.65	1.40
EPS - FRS3 (p)	0.55	1.06	1.50	1.24
Dividend per share (p)	0.22	0.25	0.28	0.30
EBITDA Margin (%)	11.7%	15.9%	20.1%	15.8%
Operating Margin (before GW and except.) (%)	10.9%	15.3%	19.2%	14.8%
BALANCE SHEET				
Fixed Assets	3,031	3,338	3,053	2,795
Current Assets	21,694	26,124	21,557	24,256
Total Assets	24,725	29,462	24,611	27,051
Current Liabilities	(5,954)	(9,387)	(9,924)	(10,874)
Long term Liabilities	(1,479)	(1,355)	(910)	(910)
Net Assets	17,292	18,720	13,777	15,267
CASH FLOW				
Operating Cash Flow	1,306	2,156	2,929	2,180
Net cash from investing activities	840	76	(325)	325
Net cash from (used in) financing	764	(348)	(5,196)	(429)
Net Cash Flow	730	2,170	(2,985)	1,699
Opening cash	11,642	12,372	14,542	11,557
Closing net (debt)/cash	12,372	14,542	11,557	13,256

Source: Edison Investment Research, Share plc accounts

IFG Group

Year End	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/08	105.1	18.3	24.3	3.6	5.2	2.9
12/09	94.4	15.3	19.3	3.6	6.5	2.9
12/10e	126.5	20.9	18.8	4.0	6.8	3.1
12/11e	140.3	29.2	20.6	5.0	6.2	3.9

Note: *Normalised.

Investment summary: Delivery due in 2011

IFG has focused a disparate group of businesses into growth areas. Around half the group's earnings will come from its position as the UK's largest provider of bespoke SIPPs, where deal synergies provide incremental benefits to market growth. The other main business is in international corporate and trustee services. The valuation is half the average of companies in this report. Potential triggers for a re-rating include delivery by James Hay, earnings growth, sterling reporting and fewer Irish macro concerns.

Potential for upside

(1) P/E valuation is under half of the level of its peers. (2) The integration benefits from James Hay acquisition are on track and generate earnings growth directly under management control. (3) We estimate the return on investment from James Hay is 22% post tax. (4) The market leading position in bespoke SIPPs gives economies of scale. (5) There is a clear strategic direction. (6) Diversification away from equity risk relative to peers. (7) International operations diversify risk outside the UK and Ireland (8) Strong cash generation should see net cash in 2011. (9) The UK advisory business (Saunderson House) is fee based and fully compliant with the Retail Distribution Review (RDR). (10) There is upside from rising interest rates. (11) IFG's base case target, 4,000 new SIPP accounts pa, is 60% above current levels, and would be a c10% market share of new business (which appears conservative compared to the 23/24% share of stock).

Sensitivities

(1) Market sentiment may continue to view IFG as an Irish institution and sovereign risk in Ireland is unlikely to mitigate in the immediate future. (2) EPS growth of 20% (our 2012 estimate on 2009) compares less favourably with peers. (3) Consensus 2011 EPS earnings are down 6% over the past six months as interest rate sensitivity in James Hay has been clarified. (4) Acquisitions are likely, and while James Hay is demonstrably adding value, there is a risk future ones will not.

Valuation

IFG is clearly trading on a massive to discount peers. While consensus earnings growth is below peers, investors are paying 6x for double-digit earnings growth.

Price*	€1.27
Market Cap	€158m

*As at 16 February 2011

Share price graph

Share details

Code	IFP
Listing	Irish Stock Exchange, UK FULL
Sector	Financials
Shares in issue	124.4m

Price

52 week	High	Low
	€1.4	€1.0

Balance Sheet as at 30 June 2010

Debt/Equity (%)	19
NAV per share (c)	91
Net debt (€m)	21.6

Business

IFG provides financial services comprising a pension administration and personal advisory business (operating in Ireland and the UK) and international corporate and trustee administration services.

Revenues by geography

UK	Europe	US	Other
66%	29%	N/A	5%

Analysts

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Company description: Delivery due in 2011

Having been an eclectic mix of businesses for many years, IFG is now focused on two main activities: financial services (being pension administration and financial advisory services primarily in the UK and, to a lesser degree, Ireland); and international corporate and trustee services, which have delivered profit growth of 21% CAGR 2000-09. With the acquisition of James Hay, and associated synergies, the former will increase to around 60% of group profits driven by the self-invested personal pensions (SIPPs) business. There remain a number of small non-core businesses that the group has scaled back to break-even level or is holding for disposal.

Exhibit 1: Financial summary

	2009	2010e	2011e	2012e
IFG International	12,152	11,000	11,800	13,098
UK Pensioner Trustee	2,951	10,500	15,500	17,500
UK Financial Services	2,267	3,000	3,900	4,200
Ireland Financial services (inc centrals and property)	(490)	(2,890)	(1,774)	(1,054)
Adjusted business pre-tax profits	16,880	21,610	29,426	33,744

Source: IFG report and accounts, Edison Investment Research forecasts

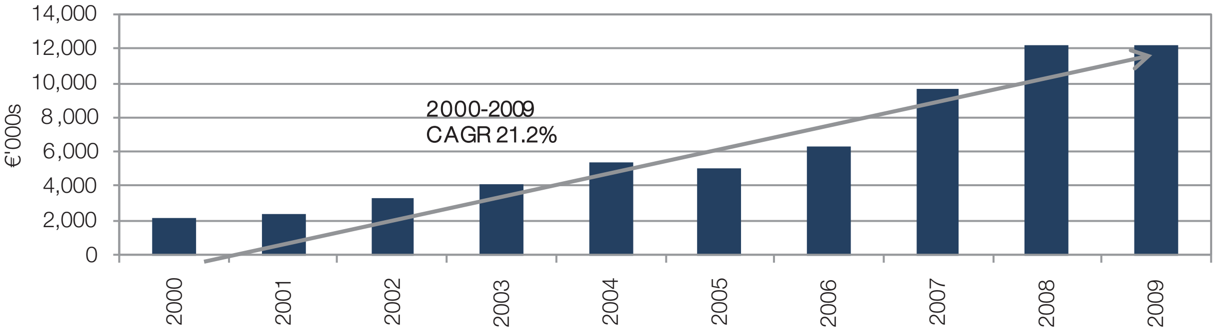
The international corporate and trustee business is well spread by customers, and geography. It is an area driven by globalisation, taxation protection and regulation, all long-term trends that have stimulated double-digit organic growth. IFG has supplemented this with acquisitions.

Exhibit 2: Breakdown of international revenue (2009)

	IoM IFG Inter	IoM Mgd Trust	IoM FNTC	Jersey	Cyprus	Others	Total
No entities	1,849	1,371	1,250	936	1,270	764	7,440
Annual charges (£m)	2.7	0.0	1.8	1.2	1.5	3.4	10.6
Division revenue	8%	0%	5%	3%	4%	10%	30%
Average per entity (£)	1,434	0	1,410	1,321	1,183	4,453	1,419
Time and other chgs (£m)	6.1	0.9	2.8	7.0	4.3	3.8	24.9
% division revenue	17%	3%	8%	20%	12%	11%	70%
Average per entity	3,324	648	n/m	7,512	3,370	4,986	3,351

Source: IFG

Exhibit 3: Historic pre-tax profit from international trustee and corporate services division



Source: IFG

Delivery from re-focused James Hay

The opportunities from James Hay are enormous. IFG's total investment in James Hay (including integration costs) was around £46m. The underlying annual business profit is c £7-8m, which, with synergies of £5.2m and normal interest rates, should see a 2013 pre-tax profit of c £13m or a 30% return (post-tax: 22%-plus), double their current level.

The real opportunity lies in taking a business that was being managed as a non-core operation into one focused on generating new business. The combined group has c 23-24% of the higher-margin bespoke SIPP market by number (40,000 and 1,500 SSASs), making it the biggest provider in the UK market. It has just 7% of the new business flow of this market. IFG has targeted 4,000 new accounts annually in five years compared with 2,250 run rate ahead of acquisition and has launched a new E-Sipp and private client product in Q111.

We believe this target may be overly conservative. Even though it is up 60% over five years, it only represents a market share of around 10%, less than half the current stock of business. Admittedly, the historic share is a legacy issue, as James Hay had effectively lost its way for a number of years, and it will be a major management challenge to turn it around. As most analysts are basing forecasts on the target number of SIPPs, the growth built into the UK divisions is well below peers.

Triggers for re-rating stock price

IFG is clearly trading on a massive discount to peers. We believe it may be due to:

- Perceptions that it is an Irish financial – triggers for re-rating: results quoted in sterling, delivery of earnings and growth by James Hay, less sovereign risk on Ireland.
- Interest rates – IFG gave initial guidance on James Hay which, not unfairly, included the interest rate expectations at that time. Since then, expectations of rate increases have been deferred, and IFG's November 2010 presentation updated the market on this sensitivity, leading to cuts in consensus estimates. This should now be in the market and as with others in this report, IFG should benefit when rates start to rise noting the constraints from competitive pricing and customer asset allocation decisions.
- A questionable historic acquisition strategy and unfocused business – trigger: delivery on James Hay with the financial returns already starting in H110.
- Falling EPS from non-recurring one-offs in H109, tough market conditions (in Ireland and the international corporate and trustee business) and the acquisition-related shares issued in 2010 – trigger: earnings delivery and growth.
- Delivery on James Hay – Earnings growth should come as IFG delivers new business growth, synergies from integration and the benefits from rising interest rate in due course.
- Intangible assets (€139m) exceed net assets (€113m) giving the group a negative tangible net worth – trigger: positive tangible value in 2012.

Ireland macro concerns a near-term drag

We believe IFG's Irish heritage has been a major drag on its share price over the past two years. Over the medium term, sovereign risk should reduce and IFG's non-Irish earnings should become even more transparent. However, in the near term, there are multiple effects:

- The liquidity on the ISEQ listing is materially more than its UK listing and many non-Irish investors cannot, or choose not to, invest in this market. While the shares are fully fungible between markets, we do not believe many investors will value this fact.
- Even though the majority of earnings will be generated in sterling, IFG reports in euros. We believe the group will report in sterling from 2011.
- There are some residual businesses operating in Ireland. The personal pensions business is likely to be ongoing and profitable (H110 €1.2m operating profits from individual advisory and group pensions). However, there is an unprofitable title insurance business

(sale intended), and a residual mortgage broker that has suffered with the property downturn (near-term neutral contribution targeted). Including group overheads, Ireland business reported a loss of €1.4m in H110, having generated €8.1m of the group's €57.3m revenue.

Sensitivities

The company's key sensitivities are:

- Equity markets.
- Interest rates – in its November presentation, IFG advised that the full-year effect of interest rates at 0.5% would cut £4m from pre-tax profits.
- Tax regimes – major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- Regulatory regimes – while we believe most regulatory pressure will be felt on the smallest players, there is likely to be an ongoing increase in compliance expenses.
- Compensation schemes – IFG has indicated a 2010 levy of £1.08m, c 6% of normalised pre-amortisation pre-tax profits although its accounting treatment is under consideration.

Financials

The acquisition of James Hay was transformational to IFG's financial statements with major changes to the revenue and costs lines and new shares issued to fund the deal.

Exhibit 4: Financial summary

€'000s	2008	2009	2010e	2011e	2012e
Year end 31 December	Re-stated	Re-stated			
PROFIT & LOSS					
Revenue	105,087	94,350	126,500	140,290	151,513
Cost of sales (excl. amortisation and depreciation)	(84,472)	(74,914)	(99,451)	(110,750)	(118,000)
EBITDA	20,615	19,436	27,049	29,540	33,513
Depreciation and amortisation	(5,142)	(6,714)	(8,250)	(8,250)	(8,250)
Operating profit (pre-exceptional)	15,473	12,722	18,799	21,290	25,263
Exceptionals	0	(2,370)	(7,254)	(500)	0
Other (inc FSCS levy)	625	(79)	(1,300)	0	0
Investment revenues	(2,899)	(1,519)	(700)	(200)	550
Profit Before Tax (FRS 3)	13,199	6,324	4,345	19,590	25,813
Profit Before Tax (norm.)	18,332	15,266	20,910	29,226	34,824
Tax	(1,675)	(1,131)	(600)	(3,134)	(5,163)
Profit After Tax (FRS 3)	12,465	5,375	3,745	16,456	20,651
Profit After Tax (norm.)	17,598	14,396	21,556	25,967	29,662
Average number of shares outstanding (m)	72.4	74.8	115.0	126.0	128.0
EPS – normalised (c)	24.29	19.25	18.75	20.61	23.17
EPS – FRS3 (c)	17.21	7.19	3.26	13.06	16.13
Dividend per share (c)	3.63	3.63	4.00	5.00	8.00
EBITDA margin (%)	19.6%	20.6%	21.4%	21.1%	22.1%
Operating margin (before GW and except) (%)	14.7%	13.5%	14.9%	15.2%	16.7%
BALANCE SHEET					
Fixed Assets	101,626	98,383	129,872	125,133	120,407
Current assets	73,782	68,467	75,409	92,809	109,202
Total Assets	175,408	167,207	205,281	217,942	229,609
Current liabilities	57,602	57,311	49,611	50,819	49,781
Long-term liabilities	129,758	119,410	104,865	100,073	94,035
Net Assets	45,650	47,797	100,416	117,869	135,575
CASH FLOW					
Operating Cash Flow	12,566	16,356	19,680	33,956	36,895
Net cash from investing activities	(40,328)	(8,769)	(45,000)	(2,000)	(2,000)
Net cash from (used in) financing	29,088	(8,012)	39,286	(14,556)	(18,502)
Net Cash Flow	1,326	(425)	13,966	17,400	16,393
Opening gross cash	24,291	21,284	21,948	35,914	53,314
Closing gross cash	21,284	21,948	35,914	53,314	69,707
Closing net cash	(48,065)	(44,466)	(17,729)	6,997	31,457

Sources: Edison Investment Research, IFG accounts

Mattioli Woods

Edison investment research

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
05/09	13.3	4.13	17.11	3.90	17.2	1.3
05/10	13.7	4.51	18.73	4.35	15.8	1.5
05/11e	15.5	4.88	21.30	4.85	13.8	1.6
05/12e	17.0	5.72	25.55	4.90	11.5	1.7

Note: Consensus estimates. *Adjusted for amortisation of acquired intangibles.

Investment summary: Break-out story

Mattioli Woods' (MTW) core self-invested pension scheme (SIPP) and small self-administered pension scheme (SSAS) markets should deliver double-digit earnings growth aided by some competition squeezed out by regulation. With a stong balance sheet and well-rated paper, acquisitions are likely in both the core and adjacent areas, such as corporate schemes and discretionary fund management. The stable, well-regarded management has ambitious plans.

Potential for revenue upside

(1) The core market should deliver double-digit growth for foreseeable future driven by demographic, tax and regulatory changes. (2) Smaller competitors are getting squeezed out by regulation. (3) Stong balance sheet and cash generation (£1.5m operating cash generated in six months to November 2010). (4) The share rating means that earnings enhancement from a (partially) equity-financed deal is probable. (5) Clear, logical plans to expand from core business into closely-aligned product areas. (6) Chairman and CEO each own c 20% of the company aligning their interests with shareholders. (7) Stable management team (average service of executive Directors nearly 15 years). (8) Geared to rising interest rates – Edison estimates c £0.45m profit per 0.5% rise subject to no material change in cash holdings.

Sensitivities

(1) Acquisition risk – the track record on acquisitions has been good, but the size and nature of acquisitions is likely to move from tactical in-fills to strategic deals, which is likely to see equity issuance. (2) After rapid share price appreciation since September, the P/E is nearly twice that of IFG. (3) Unlike most companies in this report, next year's earnings estimates are unchanged over the past year.

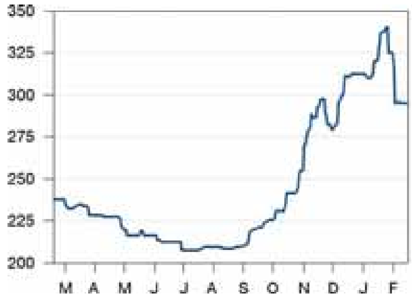
Valuation

After the sharp rise in share price since early September, the shares trade on a calendar year 2011 December adjusted P/E of c 14x) with a 4x covered yield of c 1.4%. While neither of these appear compellingly cheap, we note the quality of earnings has been exceptionally good with consistent growth delivered even through the credit crunch. Looking forward, consensus estimates are for 74% EPS growth over 2009-12, well ahead of the market as a whole and at the upper end of companies in this report.

Price* **295p**
Market Cap **£52m**

**As at 16 February 2011*

Share price graph



Share details

Code	MTW
Listing	AIM
Sector	Financial services
Shares in issue	17.6m

Price

	High	Low
52 week	340p	207p

Balance Sheet as at 30 November 2010

Debt/Equity (%)	N/A
NAV per share (p)	116
Net cash (£m)	1.8

Business

Mattioli Woods provides retirement wealth management services (SSASs and SIPPs) targeted at senior executives, professionals and owner-managers.

Revenues by geography

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

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Company description: Break-out story

MTW is in the bespoke retirement solution market. It has £2bn funds under trusteeship spread across 1,195 direct SSASs, 1,665 direct SIPPs, 215 third-party SSASs and 1,273 third-party SIPPs. MTW manages the whole customer relationship income although presentationally it is spread across three business segments. In H111, pension consultancy and administration accounted for £4.3m revenue (57% group) and £1.2m of pre-tax profit (33% of group). Investment planning accounted for £2.5m of revenue and £2.1m of profit. Executive time is allocated to each division according to need, and this can distort the relative profits between periods. MTW also has an involvement in property syndicates with its clients, covering 44 properties under administration that are valued at c £80m, generating revenues of £0.6m and profits of £253k. MTW was also appointed by PWC, the liquidator, to assist with winding up The Freedom SIPP. Apart from any financial gains (including 33 new clients to date), this is indicative of the esteem in which MTW is held in the market place.

Exhibit 1: MTW strategy for providing range of retirement solutions

Service offering		Existing channels	Target market
Advice	Specialist consultancy Investment	Direct marketing and referral	Owner managers Senior professionals IFAs Other intermediaries Corporates Mass affluent
Administration and trusteeship	Mattioli Woods City Trustees	IFAs and other intermediaries	
Investment products	Banking Structured products Property syndicates	Existing clients	
Investment management	Custodian Capital Limited Discretionary portfolio management	Property syndicates Referred externally	

Source: MTW interim results presentation

Growth in core SSAS/SIPP market

In the thematic section of this report, we have highlighted why we believe a whole range of factors mean this core market will deliver double-digit growth for many years to come. MTW management has also highlighted:

- The amount of press coverage, ensuring the mass affluent are thinking about their pensions. Ongoing developments such as NEST mean this will remain in the public eye for several years ahead.
- There is a limited and potentially shrinking number of advisers that actually meet the client needs for advice to be trusted, impartial, high quality and personalised.
- The capital required for personal investment firms will rise (in MTW's case from £0.9m to £1.9m), putting further pressure on small- and medium-sized IFAs. MTW has headroom of c £2.3m above its capital requirement, meaning the changes can be more than accommodated.
- The appointment to assist in winding up The Freedom SIPP is indicative of MTW's standing in the market.
- The growth demonstrated by the group is impressive.

Broadening product range and acqusitions

MTW has always been more than just a core of SSASs and SIPPs. Of the H111 group revenue of £7.4m, the contributions were: pension consultancy and administration, £4.3m; investment planning, £2.5m (of which structured products were £0.6m and investment commissions £1.5m); and property syndicates, £0.6m. It is clear that further diversification is planned, especially in discretionary wealth management and corporate schemes.

Discretionary funds management

MTW has £177m of client funds in equities that currently receive advice from their own MTW consultant. The MTW view is generated by the in-house research, which is then reviewed by the MTW investment committee, but it is customised for each client. Many of these clients have a long track record of taking MTW advice. Only around 20% of the customer base took up the recent offer of internet access, which enabled clients direct access to a real-time valuation of their equity funds. MTW is of the view that many these clients would be open to a discretionary management product, which would be both higher margin and less compliance heavy. Its plans assume a 30% take up (ie £60m of funds moved from advisory to discretionary). While pricing has yet to be finalised, it would not be unreasonable to assume c £300k incremental revenue for an incremental cost of one admistrator.

Corporate schemes/Employee Benefits

Group schemes currently have clients assets of £157m (a balance not included in MTW total reported funds under trusteeship given its very different revenue model). Management has indicated that corporate pensions should provide excellent growth opportunities, especially as the auto-enrollment of all employees is progressively extended across all companies. MTW currently generates most of its group schemes from SSAS relationships, but is looking at ways to better access this market and wider employee benefit consultancy.

Acquisition risk

As can be seen in the exhibit below, MTW has completed a number of acquisitions in its core area over the past five years. Assuming the group's overall cost/income ratio may be applied to these fully integrated deals, after about three years MTW has generated accumulated pre-tax profits broadly in line with the consideration. While we do not like acquisition as a differentiating factor/strategic direction, regular, modest, tactical in-fills into areas of core competency are better than most, and MTW's track record proves it can add value.

Exhibit 2: MTW acquisition track record

Note: * Fees and investment commissions (excludes banking, property syndicates and structured products).

Acquisition	G.Bernstei	Sufk Life	PCL	JBFS	Polaris	CP	City
Plan type	SSAS	SSAS	SSAS & SIPP	SSAS & SIPP	SSAS & SIPP	SSAS & SIPP	SSAS & SIPP
Date of acquisition	Jun 05	Jan 06	Jul 07	Feb 08	Feb 08	Apr 10	Aug 10
Schemes acquired	93	170	348	247	289	294	1088
Retention	67%	77%	89%	85%	72%	99%	99%
Annual revenue* per scheme at acquisition	£1,505	£2,078	£2,006	£2,356	£808	£1,177	£564
Annualised H111 revenue* per scheme	£2,263	£2,699	£2,226	£3,377	£1,864	£1,396	£608
Est. total consideration	£0.40m	£0.71m	£1.84m	£1.87m	-	£1.08m	£1.85m
Aggregate revenue* since acquisition	£0.91m	£1.97m	£2.73m	£2.12m	£1.20m	£0.23m	£0.22m

Source: MTW interim results presentation

Looking forward, the consolidation of SSIP and SSAS markets is likely to see further in-fill opportunities and we would expect MTW (and IFG) to be active consolidators. However, to meet its strategic objectives, it appears that MTW is more likely to aim for:

- larger deals, perhaps in the region of £5-10m consideration (none so far have exceeded £2m); this is still evolutionary rather than transformational, but integration will be more challenging, as well as increasing the financial risks; and
- deals with overlapping business areas rather than core – while a discretionary wealth management target may have a SSAS/SSIP business, its core business is not the same as that of MTW.

Sensitivities

- Equity markets.
- Interest rates – rises in interest rates up to c 3% are likely to be shared about evenly with customers. On MTW sponsored cash of £179m, a 50bps increase in base rate could be worth £0.45m of profit.
- Tax regimes – major changes in the tax allowability of pensions or personal tax rates could affect business flows.
- Regulatory regimes – while we believe most regulatory pressure will be felt on the smallest players, there is likely to be an ongoing increase in compliance expenses.
- Financial Services Compensation Scheme costs are indicated at £120k, c 2% of FY11e profits less than peers due to the diverse source of revenues especially those MTW generate from being a personal investment firm (rather than asset manager).

Financials

As can be seen in the exhibit below consensus estimates are for 40% revenue growth FY13 on FY10. The gearing in the model sees this drop through to 74% EPS growth over the period.

Exhibit 3: Financials

Note: EBITDA and PBT adjusted for amortisation of acquired intangibles. Most brokers have not published their 2013 forecasts yet.

Income statement	2009	2010	2011e	2012e	2013e
Revenue	13.28	13.68	15.46	17.01	19.12
EBIT	4.04	4.47	4.56	5.55	6.74
Operating profit	4.04	NA	4.90	5.60	NA
EBITDA	4.29	4.72	5.16	6.19	7.27
Pre-tax profit	4.13	4.51	4.88	5.72	6.94
Net Income	2.96	3.25	3.84	4.70	5.65
Per share data					
EPS	17.11	18.73	21.30	25.55	32.60
Dividend per share	3.90	4.35	4.85	4.90	5.40
Cashflow per share	NA	15.63	25.23	30.17	35.69
Balance sheet					
Net asset value	16.46	18.98	20.64	24.57	29.35
Net cash	4.80	5.79	2.35	3.80	NA
Book value per share	95.26	109.60	126.40	143.90	169.90
Returns					
ROA (%)	NA	14.63	15.40	16.66	17.53
ROE (%)	19.39	17.73	18.81	20.10	20.79

Source: Thomson

Appendix 1: Mass market companies to consider

There are a range of other companies with exposure to the more mainstream market pension and savings trends we have identified in this report. Exhibit 1 below gives the latest data for retail funds and ISAs while Exhibit 2 shows who is most active in individual pensions.

Exhibit 1: Largest retail fund and ISA managers (December 2010)

Rank		Retail FuM		Total ISA funds
1	Invesco Perpetual	£37,062,681,236	HBOS Investment Fund Managers Limited	£7,333,017,898
2	M & G Securities Limited	£27,674,266,472	FIL Investment Management Limited	£7,148,511,789
3	FIL Investment Management Limited	£23,474,227,490	Legal & General (Unit Trust) Managers Limited	£6,723,244,908
4	Threadneedle Investment Services Ltd	£19,714,066,298	Scottish Widows Unit Trusts Managers	£6,042,401,366
5	Jupiter Unit Trust Managers Limited	£18,757,870,009	Invesco Perpetual	£5,575,592,631
6	Legal & General (Unit Trust) Managers Limited	£17,290,120,457	St James's Place Unit Trust Group Ltd	£4,033,254,029
7	SWIP Fund Management Ltd	£16,390,772,722	M & G Securities Limited	£3,760,241,967
8	St James's Place Unit Trust Group Ltd	£15,545,188,967	HSBC Global Asset Management (UK) Limited	£3,439,616,228
9	Schroder Investment Management Ltd	£14,041,963,682	Jupiter Unit Trust Managers Limited	£3,247,325,142
10	BlackRock Investment Management (UK) Limited	£13,500,602,940	Santander Asset Management (SAM UK)	£3,184,955,587
11	Capita Financial Managers Limited	£12,876,568,115	CIS Unit Managers Ltd	£1,879,567,441
12	First State Investments (UK) Ltd	£12,098,830,221	Henderson Global Investors	£1,734,842,939
13	Henderson Global Investors	£11,059,470,757	Virgin Money Management Services Ltd	£1,626,781,299
14	BNY Mellon Fund Managers Limited	£9,960,606,720	Aviva Investors UK Fund Services Limited	£1,448,775,381
15	JP Morgan Asset Management	£9,373,394,997	Threadneedle Investment Services Ltd	£1,350,137,538
16	Investec Asset Management Ltd	£9,098,469,935	Gartmore Investment Management Plc	£1,273,260,992
17	Aberdeen Unit Trust Managers Limited	£8,996,255,719	Schroder Investment Management Ltd	£955,761,990
18	Aviva Investors UK Fund Services Limited	£8,460,170,691	JP Morgan Asset Management	£868,790,563
19	Artemis Fund Managers Ltd	£8,295,533,780	BNY Mellon Fund Managers Limited	£850,980,854
20	HSBC Global Asset Management (UK) Limited	£8,175,453,902	F & C Asset Management Plc	£803,137,276

Source: Investment Managers Association, December 2010

Exhibit 2: Ranking by total UK net premiums in 2009

Individual Pensions Business				Occupational Pensions Business		
2009	(2008)			2009	(2008)	
1	(2)	Lloyds Banking Group		1	(2)	Standard Life plc
2	(1)	Aviva plc		2	(4)	Legal & General
3	(3)	Legal & General		3	(3)	Aegon NV
4	(5)	Aegon NV		4	(1)	Prudential
5	(63)	Standard Life plc		5	(10)	Lloyds Banking Group
6	(8)	Old Mutual plc		6	(-)	Pension Insurance Corporation
7	(7)	Prudential		7	(8)	Resolution
8	(15)	Resolution		8	(12)	Metlife Inc
9	(11)	Royal London Mutual		9	(16)	Aberdeen Asset Management plc
10	(12)	Swiss Re		10	(15)	Lucida
11	(4)	AXA		11	(5)	Canada Life
12	(10)	Zurich Financial Services		12	(7)	AXA
13	(18)	Deutsche Bank		13	(14)	Zurich Financial Services
14	(17)	AIG		14	(20)	HSBC Holdings
15	(-)	Sun Life of Canada		15	(9)	Royal London Mutual
16	(30)	Equitable Life Assurance Society		16	(21)	UNUM Group
17	(22)	National Farmers Union Mutual Insurance		17	(13)	Threadneedle Pensions
18	(21)	Co-operative Financial Services		18	(-)	FIL Ltd
19	(29)	Patnership Life Assurance Company Limited		19	(11)	Aviva plc
20	(25)	Munich Re		20	(23)	RBS Group

	2009	2008		2009	2008
Share of top 5 companies	64.18%	71.84%	Share of top 5 companies	78.96%	72.24%
Share of top 10 companies	88.66%	102.20%	Share of top 10 companies	94.65%	88.51%
Share of top 20 companies	97.82%	116.74%	Share of top 20 companies	103.78%	97.72%
Product share of total market	39.53%	35.72%	Product share of total market	28.11%	23.58%

Source: Association of British Insurers, Long Term Premium Income Rankings

Life companies

Life companies will benefit from the mass market's appetite for any form of long-term savings. Looking in more detail at some of the larger names:

- Legal and General: In H110 annuities delivered £141m net cash generation and £106m of operational cash generation out of the group totals of £358m and £402m respectively. Savings accounted for a further £72m and £38m respectively. With less geographic diversity L&G is most concentrated in the areas covered in this report.
- Standard Life: In H110 the UK accounted for 41% of group IFRS operating profit with UK retail assets under administration of £74bn at 30 September 2010 (group £192bn).
- Aviva plc: Of H110 global sales of £36bn, total UK long-term savings sales were £8.8bn of which UK pensions were £3bn and annuity sales £2.2bn.
- Resolution: In its third quarter interim management statement Resolution announced UK individual regular premium pension sales were £5.4m out of a total of £396.6m. The position in single premiums was more material (£174m in individual pensions and

£208m of annuity premiums out of the group total of £3.1bn). Corporate pensions were much more material.

- Prudential. We do not believe the UK individual pensions market will be the key driver to Prudential's share price. In H110 UK total UK annual premium equivalent (APE) sales were £1.7bn of which just £0.4bn came from the UK. Asian APE sales of £713m and growing 36% on H109 is more likely to drive investor sentiment than the issues in this report.
- Old Mutual: At 30 September 2010 UK wealth management FuM were £32bn out of the group total of £307bn and ytd. UK wealth management APE sales were £272m out of the group's £1.2bn.

Banks

The banks have huge wealth management and private banking divisions and their retail arms should benefit significantly from the mass market trends identified within this report. Five of the top 10 ISA providers are bank subsidiaries. However, wealth divisions are generally dwarfed by the other businesses in these groups, and it is macro issues such as the political interference, trends in global capital markets and the overall credit environment that will drive near-term share price performance.

Exhibit 3: Banks benefitting from asset allocation trends

Note: * Annualised to December year end. PE at 16 March 2011

Company	2011 P/E	Comment
Barclays	9.6	In 2010 Barclays Wealth's divisional pre-tax profits were £163m out of the group's £6.1bn. It is a very large wealth manager (total AuM £164bn) but in group terms the division is not material.
HSBC	11.3	UK wealth management is not a material element of the group. In H110 out of the group pre-tax profit of $11.1bn, European private banking was 3%. Undoubtedly there are other profits in the Personal Financial Services divisions, but UK wealth management is not the key driver to HSBC's share price.
Investec *	8.9	While Rensburg Sheppards was until recently one of the largest quoted wealth managers, it forms <5% of Investec group and is not the driver to that company's share price performance.
Lloyds	10.5	Of the UK banks, Lloyds Banking group has the highest proportion of earnings from long-term savings. Its contribution to current profits is important – of the £1.6bn H110 group pre-tax profits the wealth division accounted for £156m and the total UK life, pensions and investments £243m (down 17% on H109) but the banking profits remain depressed. The share price will be driven by a recovery in that sector (including Ireland) and macro issues such as the sale of the government stake.
RBS	12.7	RBS has c 260,000 UK Wealth customers and, with Coutts, the number one position in UK private banking. Its wealth division generated £143m in operating profit in H110. However, in relation to the macro issues affecting the group this is not material.

Source: Company announcements, Thomson consensus P/E

Specialist asset managers

There are several specialist asset managers who will benefit from asset allocation decisions of both private investors and corporate schemes.

Exhibit 4: Specialist asset managers benefitting from asset allocation trends

Note: * Annualised to December year end. PE at 16 March 2011

Company	2011 P/E	Niche	Comment
Ashmore *	13.5	Emerging markets	AuM $41.6bn, of which over two-thirds is fixed income. It has large cash balances, a strong balance sheet, operating margin c twice asset management peers, but currency risk high.
Charlemagne Capital	11.5	Emerging markets	AuM $3.4bn (Sept). EMEA (Europe, Middle East, Africa) regions nearly 60% funds so less exposed to BRIC. Highly volatile performance
City Of London Investment Group *	11.5	Emerging markets and natural resources	FuM £3.6bn (Dec 2010). Every one of CLIG's Closed End Fund institutional accounts outperformed the Morgan Stanley Emerging Markets Total Return Index in the year ended 31 December 2010.
Impax Asset Management *	15.9	Environmental	£2bn AuM, also does private equity investments, Driven by investor demand for clean tech. Low stock liquidity.
Man Group	16.9	Hedge funds	AuM $67bn. Global leader giving economies of scale, excluding recent GLG acquisition c two-thirds is retail. GLG acquisition looks expensive and cut excess capital from $1.5bn to $300m. Share price volatile and responds to AHL performance.
Polar Capital *	14.2	Boutique	AuM $3.1bn (Sept), c 70% long only, 30% long short. Strong balance sheet, very strong earnings growth expected. There is a dependence on key portfolio managers.
Record *	10.1	Currency	Record is a specialist currency manager and provider of currency hedging services for institutional clients. AuM equivalent £20.1bn (Dec 2010) from 47 clients.

Source: Company announcements, Thomson consensus P/E

General asset managers with material retail businesses

Employers will still make contributions to their employees' pension funds and the roll out of auto-enrolment will bring millions of new members. We believe these funds will be managed on an institutional basis and will provide new business to these managers. They will of course be faced with lower defined benefit mandates as these schemes mature, but this is a 50-year trend not a short-term one.

Exhibit 5: Specialist asset managers benefitting from asset allocation trends

Note: * Annualised to December year end. PE at 16th March 2011

Company	2011 P/E	Comment
Aberdeen Asset Management*	13.4	c 75% institutional, AuM £179bn (Sept). Operational leverage from acquisitions of part of CS/RBS asset management divisions but weaker balance sheet and serial acquirer
F&C Asset Management	11.5	AuM £108bn (Sept). Fixed income driven (nearly two-thirds funds), activist shareholder interest, £63bn of AuM subject to LT contracts maturing in 2013-15. Relatively highly debt.
Henderson Group	15.1	£59bn AuM (Sept), half equities, third fixed income, following New Star acquisition institution and pension funds dropped to c 40% AuM.
Jupiter Fund Management	14.3	90% equities, 76% in mutual funds. Good track record of superior asset inflows (no single quarter outflows in 10 years), tradition of star fund managers leading to concentration risk.
Schroders	14.7	AuM £181bn Sept, just over half institutional, and nearly 40% retail. Broad spread of asset classes with nearly a fifth in 'alternative assets'. Strong balance sheet.

Source: Company announcements, Thomson consensus P/E

Appendix 2: Retail Distribution Review by the FSA

Summary of the proposals

Acres of forest have already been cut down since 2006 when the FSA launched the consultation process on its major Retail Distribution Review (RDR). The new framework will come into effect at the end of 2012 and will apply to all advisers in the retail investment market, regardless of the type of firm they work for (eg banks, product providers, independent financial advisers or wealth managers). The overall objectives are to:

- improve the clarity with which firms describe their services to consumers;
- address the potential for adviser remuneration to distort consumer outcomes; and
- increase the professional standards of investment advisers.

As a result of the changes the FSA expects to:

- improve the standing of, and consumer trust in, the adviser community by introducing new minimum standards of qualifications and professionalism;
- change the way advisers and customers (both individual and corporate) agree on the services to be provided and how these will be paid for;
- make sure providers compete for business based on the quality of their offering for the consumer; and
- encourage new forms of streamlined advice which will give customers, including those with modest earnings, greater access to advice.

Timetable

The RDR is due for implementation from the end of 2012 although there are areas of further consultation.

Exhibit 1: Summary of RDR timetable

2012	Q1	Policy Statement on platforms
	Q2	Policy Statement on using Group Personal Pensions (GPPs) for auto-enrolment and consumer protection
		Membership of professional body encouraged Next EC publication on Packaged Retail Investment Products (PRIPs)
2012		Further tightening up/monitoring of indirect benefits Revised instructions issued for submitting data to Comparative Tables Full detail on PRIPs
	By 31/12/2012	To be deemed competent by their employer all existing advisers must be qualified at Level 4 and, where appropriate, all 'gap filling' completed by structured continued professional development (CPD) All advisers must be ready to operate adviser charges Product providers will be unable to offer products with commission All advisers must describe their services as independent advice or restricted advice All independent advisers must comply with the new independence and product requirements
2013	1 January	All firms affected by the changes report under the new rules and guidance
2013	31 December	Deadline for Personal Investment Funds (PIFs) to satisfy new prudential requirements

Source: FSA

Scope

- The RDR affects a number of product ranges.
- For individual retail business: all packaged products, including pensions, annuities, onshore and offshore bonds and collective investments. Discretionary fund management is NOT included although there are some issues around the use of platforms. Advisory fund management is caught by the RDR.
- For corporate pensions: group personal pensions, group stakeholder and group self-invested personal pensions. Insurance contracts linked to occupational defined contribution schemes are also affected.
- Although not originally in scope, the FSA is now consulting on how to apply some of RDR principles to protection markets and also to mortgages.

Charging fees rather than commissions

It will be for the customer to pay an adviser for advice, product recommendation or service and it must be agreed in advance. Customer fees will replace manufacturer commissions (although, with the provider's permission, it can be deducted from the product through separately identifiable charges). This fundamental shift will be compounded by initiatives to ensure fees are transparent. Product providers will not be able to influence the amount or shape of adviser charge and cannot structure their charges in a way that could conceal from consumers the distinction between the product charges and the adviser charge.

Commission payments can continue for business written before RDR implementation, which includes commission on increments on pre-2013 business. Existing trail commissions are thus grandfathered and, importantly, if the adviser firm, or its book of business, is sold, the trail commission can continue to be paid to the new firm, provided the payments are in line with the original contractual terms. Firms should not renegotiate the commission payable, or seek to impose an adviser charge for a service that has already been paid for through commission.

If both initial and ongoing advice/services are being provided, the charges for each must be agreed and disclosed separately. Advisers will need to make clear to clients at the outset what services are on offer and at what cost. This information will typically be disclosed through an adviser charging a tariff. Adviser firms will need to have systems in place to ensure they deliver on any ongoing commitment, but in effect advisers will be able to charge an ongoing advice fee rather than trail commission.

The FSA is clear that adviser charging should not vary inappropriately according to either the product provider that a firm recommends or between substitutable products. This extends to Distributor Influenced Funds. A firm should not be remunerated more for recommending investment in its own DIF than in an alternative, substitutable fund that is not 'in-house'.

Independent/restricted adviser labels

The main difference between independent and restricted advisers is that independent advisers will be expected to advise on a wider range of retail investment products and solutions. The FSA wants to widen the range of products to make sure that the definition of 'independent' reflects the broader range of investment products consumers would expect to receive under truly independent advice. The new definition of a retail investment product includes a life policy, unit, stakeholder pension scheme, personal pension scheme, interest in an investment trust savings scheme, security in an investment trust, any other designated investment that offers exposure to underlying financial assets in a packaged form which modifies that exposure when compared with a direct holding in the financial asset, and a structured capital-at-risk product. This applies whether or not any of these are held within an ISA or a child trust fund.

The FSA recognises that it is possible to provide independent advice where advisers may be specialising in a narrow and distinct field, and it has given some examples of this. These include retirement planning and ethically and socially responsible investments, although the FSA expects such specialised examples to be relatively rare. A ‘relevant market’ includes all of the retail investment products that are capable of meeting the investment needs and objectives of the consumer within the distinct field. The FSA has said that those advisers will need to make sure their clients understand the limited scope and are not left with the impression that they are receiving independent financial advice on all retail investment products. In this case, provided the whole of that specialised (relevant) market is considered, the advice can still be described as independent. However, if a firm uses a narrower relevant market, it must have systems and controls in place to ensure it does not make a personal recommendation if there is a retail investment product outside the firm’s relevant market that might meet the customer’s needs and objectives.

Platforms

The FSA has published a Discussion Paper (DP) on platforms. It states that an adviser with a ‘varied set of customers’ is unlikely to meet the independence test if using a single platform. The FSA suggests good practice would involve segmenting customers based on needs and circumstances and determining the best platform for each group. The Platforms DP also rejects claims that ‘vanilla’ wrappers replace the need to be able to look across products as well as funds. The FSA’s rules state that “a single product that invests in a number of underlying funds would not of itself meet the requirements for independent advice”.

Advisers can still construct a panel based on suitability for their customers. The FSA requires these panels to be reviewed regularly and if any particular market or class of product is being disregarded, and therefore not considered in individual advice, advisers must be able to demonstrate why it is not suitable for their client base.

Professional standards

Some of the key points are:

- Advisers will be required to possess and maintain a QCF Level 4 qualification (a standard broadly equivalent to the first year of a bachelor’s degree) to provide advice on retail investment products. This compares with the current minimum financial adviser qualification described by Mark Hoban (financial secretary to the Treasury) as the same level as a diploma in shift management offered by McDonalds. Approximately half of advisers are currently qualified to QCF level 4 or above, indicating a material time and cost to bring everyone to the required standard by 2013.
- Advisers will also be required to keep knowledge up to date by carrying out high-quality and regular Continuing Professional Development (CPD) activities of 35 hours per year, with at least 21 being structured learning. FSA research shows that over 70% of advisers are already achieving this amount of CPD. By implication a third are not and

the commitment to a working week of training per year could be especially onerous on smaller providers.

- Accredited bodies should notify the FSA if they identify issues with a retail investment adviser's competence, including their ethical behaviour. Putting the onus and responsibility on the employer will increase compliance costs as companies will need to be able to show they have appropriate systems in place to comply with the standard.
- Statement of Professional Standing (SPS): The Financial Services Authority (FSA) has confirmed that retail investment advisers will need to hold a Statement of Professional Standing (SPS) if they want to give independent or restricted advice after January 2013. The statement will provide customers with evidence that the adviser subscribes to a code of ethics, is qualified, and has kept their knowledge up to date. The SPS will be issued by FSA accredited bodies that satisfy the following criteria: (1) they act in the public interest and further the development of the profession; (2) they carry out effective verification services; (3) they have appropriate systems and controls in place and provide evidence to us of continuing effectiveness; and (4) they cooperate with the FSA on an ongoing basis.

Other regulatory changes

There is a plethora of regulations from both UK and European Commission (EC) orientated bodies that could have an effect on wealth managers. A brief glance at the Investment Management Association 2011 responses is indicative of the pure number and weight of regulatory proposals.

Exhibit 2: Selective list of IMA 2011 regulatory responses

Date	Response to:
7 February	Draft Finance Bill 2011 – Reform of SDRT (Stamp Duty Reserve Tax) on Collective Investment Schemes
2 February	European Commission MiFID (Markets in Financial Instruments Directive) review
2 February	HMRC review to amend The Offshore Funds (Tax) Regulations 2009
31 January	EC consultation on the UCITS (Undertakings for Collective Investment in Transferable Securities) Depositary Function
31 January	EC consultation on Packaged Retail Investment Products (PRIPs)
26 January	HMRC Draft Finance Bill 2011 clauses – pensions
19 January	European Commission proposals for the future taxation of the financial sector
14 January	ESMA (European Sales and Marketing Association) Call for Evidence – AIFMD (Alternative Investment Fund Manager Directive) levels 2 & 3
13 January	Department for Business Innovation and Skills Call for Evidence – A Long-Term Focus for Corporate Britain
10 January	Financial Action Task Force (FATF) consultation on the 40 + 9 recommendations on anti-money laundering and counter-terrorist financing
5 January	Committee of European Securities Regulators (CESR)'s consultation on risk measurement for certain types of Structured UCITS

Source: FSA

Some commentators have suggested that recent EC proposals could even result in a ban on UK investors making their own investment decisions in future within SIPPs, ISAs or other investment accounts. However, the EC's recent proposals are in the context of investors who trade in 'complex' products. When investors want to open up a 'complex' trading account such as a spread betting account, current EC rules require investors to undergo an 'appropriateness test' before they can start trading. This is a one-off test completed at the account opening stage. After an investor passes the test, they are completely free to place ‘execution only’ trades without receiving advice. Hargreaves Lansdown, which would be one of the most affected by any changes, have contacted the EC, which has confirmed that the EC is not looking to insist that clients take advice for every transaction but is considering extending the one-off appropriateness test to other investment products.

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