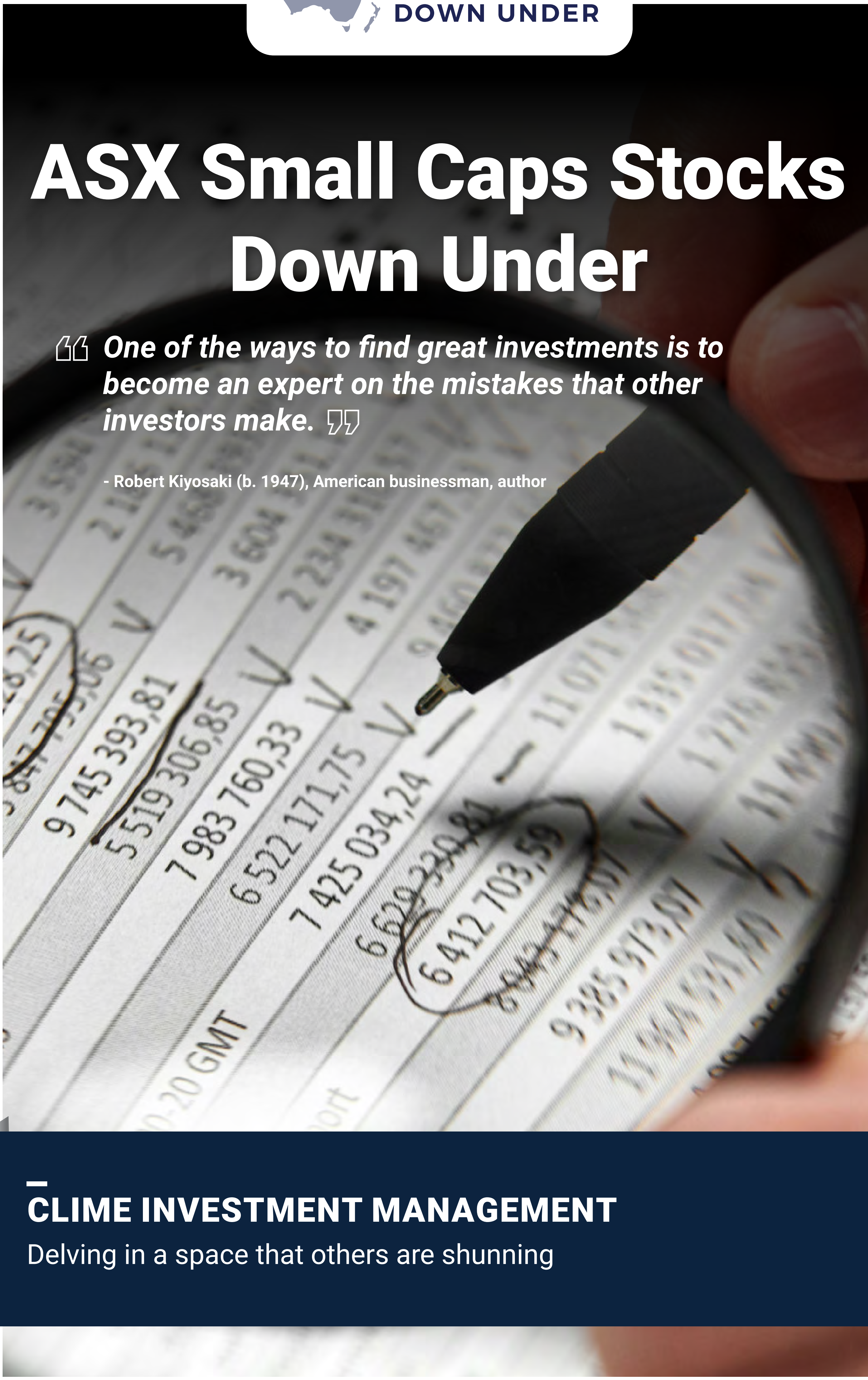
STOCKS DOWN UNDER

20 MAY 2022



ASX Small Caps Stocks Down Under

> *One of the ways to find great investments is to become an expert on the mistakes that other investors make.*

- Robert Kiyosaki (b. 1947), American businessman, author

CLIME INVESTMENT MANAGEMENT

Delving in a space that others are shunning

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Stocks Down Under rating: ★★★★

ASX: CIW
Market cap: A$41.2M

52-week range: A$0.56 / A$0.69
Share price: A$0.57

The money management space on the ASX has been through difficult times. Industry giants Magellan (ASX: MFG) and Pinnacle (ASX: PNI) are both down over 50% from 12-month highs and their portfolios have taken a hit from the recent sell off. But the share price of Clime Investment Management (ASX: CIW) has been relatively robust in recent months and it is for good reason.

Share price chart

Source: Tradingview

Clime Investment Management is a private wealth adviser and money manager that is listed on the ASX in its own right and operates managed accounts, managed funds and one ASX Listed Investment Company (LIC), Clime Capital (ASX: CAM). Clime Capital has likewise been resilient to the market sell off but in today's edition we're focusing on the Investment Management company. As of 31 March 2022, that company had $5.4bn in Funds Under Management and Advice (FUM&A). Even the most experienced investors may not have seen the last part of the acronym added on and there is good reason why this is used. Namely because it is in the financial advisory space.

Others are shunning financial advisory, but Clime is embracing it

Since mid-2020 Clime has been the proud owner of Madison Financial Group (MFG), a financial planning business who now makes up $4.0bn of Clime's funds. Madison provides licensing, compliance, technology and support to approximately 100 financial advisory firms licensed under its Australian Financial Services License (AFSL). The purchase was funded with a $4.5m placement at 46 cents a share – an 8.2% premium to the previous day's price, but over 20% lower than Clime's price today, which suggests to us that the purchase has paid off. At the time of acquisition, Madison had $3bn in funds under advice, in-force insurance premiums of $65m and total gross annual revenue of around $34m.

The Hayne royal commission put a dagger in the heart of the financial advisory industry, causing increased regulation for advisers (most notable a mandatory national exam which had to be completed by January

2022) and costs for consumers. This led to a hefty number of advisors leaving the game. ASIC data shows the number of licensed advisers was over 25,000 in 2018, but this had dropped to just over 20,000 by 2020 and by 2023 it is expected to fall further to ~13,000. This would represent a more than 50% decline in five years, but Clime took a bet that the need for financial advice would remain strong, especially as superannuation and taxation rules become more complex.

And the bet is paying off. Madison has bucked the trend by continuing to recruit financial advisory firms to become licensed under it. For both companies, being a merged entity enhanced the offering for clients by leveraging the other companies' expertise and scalable efficiencies.

Managed Accounts - here's why they're a big deal

Madison's FUM well and truly overshadows Clime's FUM now, although it still has $1.4bn in FUM in its own right – a figure that has nearly doubled in five years. Clime stands out from its peers through its variety of managed funds, but also in offering managed accounts in addition to funds. You'd probably know how managed funds work – investors own units in them, but not the fund assets and the fund manager decides what to invest in. But managed accounts allow investors to have beneficial ownership of the assets and receive all the income albeit with the fund manager still making the decisions and taking a management fee. They can be invested individually or via a self-managed super fund and can be tailored to suit individual financial needs and goals.

Clime's asset management business has had a solid time too, generating robust risk-adjusted returns across the board and maintaining stable and consistent inflows of funds. For instance, the Clime Smaller Companies Fund has made total returns of over 100% from April 2017 to the end of FY21. During FY21, Clime Capital grew its assets to over $150m and generated a $22m NPAT and the Clime Australian Income Fund returned 13.3% in FY21, from a total fund value of $46m. The latter fund was ranked by Morningstar as 1st out of 111 investments in that peer category for CY21 – not an easy feat in a low interest rate environment. Finally, we note Clime has a private wealth advisory service offering tailored advice for wholesale and sophisticated investors.

All this has manifested itself in the company's results. In FY20 Clime Investment Management made only $397k at the NPAT line, as against the $1.45m in FY19. By FY21 NPAT had made it to $2.28m. In FY20, the company's profit shrank due to the income generated by assets held at fair value swinging from $1.1m in the black to $820,000 in the red – thanks to the Corona Crash. However, the performance of Madison and the company's investments brought it to an even better position than it was prior to COVID-19.

It has outperformed the market, but can it still outperform?

It is fair to say recent months have been bumpy in the financial markets and Clime's share price has declined this year, but only by 3% - nowhere near the extent of some of its peers. Its Funds and Insurance Premiums Under Advice only dropped by 0.2% in the March quarter. And in recent months, Clime has positioned itself for growth in FY23 in three important ways.

Most notably, it has merged its Separately Managed Account (SMA) business with Ralton Asset Management. The combined group, of which Clime owns 75%, has $311m in SMA mandates and the enlarged Ralton will tender for new mandate opportunities. Clime has also entered into a strategic agreement with Torica Capital to provide licensing, administration and operating infrastructure services. Torica specialises in fixed income and credit management sectors and manages ~$150m in assets. This will position Clime well for the foreseeable future as interest rates rise from record lows. And only yesterday it announced the acquisition of MTIS. MTIS a Melbourne based private wealth business that also has an accounting practice. Clime will be paying $7m for the business, which has $380m in FUM and total gross annual revenue of ~$3m. This deal builds Clime's presence in Melbourne and adds a new service proposition.

It is not a good time to be in the investment space, but we think the company has held up reasonably well, is positioned for growth in the years ahead and is undervalued. Clime's market capitalisation is less than 1% of its FUM, while Magellan is valued at 4.3% and Pinnacle at 1.8%. On a P/B ratio it is trading at 2.7x, while Pinnacle trades at 3.9x and Magellan at 2.8x. We note the company has a substantial shareholding from Wilson Asset Management and in the last quarter bought back 460,037 shares at an average price of 58 cents a share.

This one gets four stars from us.

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