STOCKS DOWN UNDER

23 JAN 2023

ASX Small Caps Stocks Down Under

It's an honour and a privilege to manage someone else's money. So, we owe it to them to eat our own cooking.

- Rajiv Jain (b. 1968), GQG founder

ASX

EXCHANGE CENTRE

GQG PARTNERS

Beaten, but not down

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Stocks Down Under rating: ★ ★ ★ ★

ASX: GQG
Market cap: A$4.5BN

52-week range: A$1.12 / A$1.89
Share price: A$1.52

Of the 150 or so companies that listed on the ASX in 2021, fund manager GQG Partners (ASX:GQG) was the biggest float of the year, listing with a valuation of nearly A$6bn. Unfortunately for the company's shareholders, GQG has shed roughly a third of its value. It is far from the worst performing fund manager in the last 12 months, but it has suffered a decline despite pre-emptively cutting exposure to sectors that have been the worst performing. What's gone wrong?

Share price chart

Source: Tradingview

Strong FUM growth

The company was founded in 2016 by industry veteran Rajiv Jain and is based in Fort Lauderdale, Florida. It runs four main equity strategies – international shares, global shares, emerging market shares and US shares. You could argue it was better suited to the US markets, but it had some links Down Under. Many of its early institutional clients were Australian, most notably Australian Super was its first. And the company boasted $5.6bn in FUM in Australia when it listed, making Australia GQG's third largest market behind the US and the UK. Additionally, the company's CEO Tim Carver previously ran Pacific Current Group, which is one of GQG's few external shareholders. But we think one of the key reasons for the ASX listing was that the Australian market had a reputation for paying a premium for listed fund managers.

GQG is exclusively focused on equities, but has investments in the US and international markets, including emerging markets. It grew its FUM to over US$90bn in barely five years since its founding. It derives its revenue almost exclusively from management fees rather than performance fees. This means revenue will be less volatile than fund managers that rely more heavily on performance fees. These fees vary from fund to fund, but are typically calculated as a small percentage of Funds Under Management, or Gross Asset Value.

To succinctly answer the question as to what's gone wrong, we think there are two things. Firstly, GQG was hardly a standout performer to begin with. And secondly, it has suffered the fate that many other fund managers have in CY22, i.e. lower performance due to the bear market and, consequently, lower FUM.

But far from a solid performer

In CY21, GQG's global equity strategy returned 17.1%, compared to Morningstar's Global Markets Large Cap Index that gained 18.3% net of fees. Rajiv Jain put this down to the company reducing its exposure to the Tech sector, anticipating that the bubble would burst.

During CY22, GQG did not fare much worse than its peers, but still went backwards. By 30 September 2022, GQG's assets had dropped to US$79.2bn, because of poor market conditions and clients withdrawing their money. The latter was particularly the case in the UK thanks to the short-lived Truss government's budget, which caused a surge in long-term bond yields and required a fair number of margin calls to be met.

Cheap multiples, but are you getting a bargain?

With the dour conditions in equity markets in 2022, GQG could not deliver outperformance. Therefore, like its peers, investors were no longer willing to pay the premium they had in the last decade. GQG is currently trading at 12.9x P/E for FY23, which is a premium to many of its peers – beaten-down Magellan is trading at just 8.9x P/E for FY23 while Perpetual trades at 12.8x.

Consensus estimates for CY22 are actually predicting growth in revenue and EBITDA – by 7% and 1% respectively. For 2023, $632.3m is expected in revenue and $474.7m in EBITDA (2.7% and 0.2% growth respectively). CY24 is forecast to see a substantial improvement with $715.6m in revenue and $544.6m in EBITDA, implying 13% and 15% growth respectively.

The average 12-month price target among the 8 analysts covering the stock is $1.88 - a 24% premium to Friday's closing price of $1.52. Analysts are implicitly expecting things to turn around eventually on the back of improving equity markets, but there may still be some short-term volatility.

Not the best time, but we think it will bounce back (eventually)

We are not the first to observe that the fund management sector is not an ideal place to invest in right now, so that is enough of a reason not to look at this company right now. Even if you disagree with us here, one thing some investors may not like about GQG is that it has heavy exposure to traditional energy companies. This helped minimise the downside in performance in 2022, given the performance of the energy sector in the aftermath of Russia's invasion of Ukraine, but it does not help its reputation with ESG investors. Notwithstanding, we are giving GQG four stars, because we think it is well positioned to bounce back in 2023.

We think there are a few things to like about the company compared to other fund managers. These include its low reliance on performance fees, the long escrow period of 7 years for founding shareholders and the fact that over two thirds of the company is owned by its CEO. One particularly noteworthy thing about GQG is that it employs both traditional and non-traditional analysts to investigate potential investments. The latter group includes investigative journalists that look into non-financial risks of a company –by contacting and interviewing current and former employees and management. We also like that the company has limited exposure to high-risk growth stocks that dragged down many competitors' performance and are likely to be slow to recover as the market rebounds.

These factors, along with the company's track record, give us confidence that investor sentiment to this company will improve over the next 12-18 months, hence our four star rating.

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