AUSTRALIAN

RESEARCH

INDEPENDENT INVESTMENT RESEARCH

Managed Accounts Holdings Limited (MGP)

Initiating Coverage

April 2014

INDEPENDENT INVESTMENT RESEARCH

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Indicative Timetable	
Opening date for public offer	7 April 2014
Closing date for public offer	2 May 2014
Issue & Allotment of shares	7 May 2014
Expected date for shares to commence trading	15 May 2014
Expected ASX Code	MGP

Board and Management

Don Sharp: Executive Chairman
Colin Scully: Non-Executive Director
Paul Collins: Non-Executive Director
David Heather: CEO

Major Shareholders Post Capital Raising	
Minimum Subscription	
Colin Scully	19.1%
Don Sharp	19.1%
Paul Collins	18.0%
David Heather	3.5%
Argo Investments Limited	9.6%
Maximum Subscription	
Colin Scully	17.1%
Don Sharp	17.1%
Paul Collins	16.2%
David Heather	2.9%
Argo Investments Limited	8.6%

Distribution Profile FY'15 (unfranked)	
November 2014	$0.002
February 2015	$0.002
May 2015	$0.002
August 2015	$0.002
Total	**$0.008**

*At an issue price of $0.20 this represents a yield of 4%.

MDA OPERATOR SET TO TIP $1B FUA WITH NEW BUSINESS

Managed Accounts Holdings Limited is a Managed Discretionary Account (MDA) operator with custody seeking to list on the ASX (expected to be listed with the code MGP). The company was established in 2004 and has grown funds under advice (FUA) to ~$900M, with FUA set to exceed $1B over the coming months.

KEY POINTS

- **Capital Raising & IPO:** The company is seeking to raise up to $5M through the issue of up to 25M shares at $0.20 per share and list on the ASX. The ASX code is expected to be MGP. The capital raised will be used to support the company's ASIC NTA requirement under the proposed revisions of RG179 (CP200) regulations and improve the working capital position. If the maximum subscription is filled, the company will have in excess of $8M of cash on hand. This puts the company in a good position to pursue growth opportunities and is well placed in the event the proposed increased NTA requirement for MDA operators by ASIC are implemented.
- **Business Model:** MGP provides MDA services for managed accounts. The company provides administration and custody services. It does not provide advice to clients. Advisory Groups are moving towards managed accounts for clients due to the increased flexibility and improved efficiency of managed accounts. MGP's revenue comprises a percentage of FUA for providing the service, transaction fees and other fees. The percentage of FUA makes up the majority of revenue, therefore FUA scale is directly linked to revenue growth.
- **Funds Under Advice (FUA):** The company's FUA is set to exceed $1B across 21 Advisory Groups. Revenue growth is directly driven by growth in FUA, therefore FUA growth is a focus of the company. The company has aggressively grown FUA, with FUA almost doubling since the beginning of 2011, at which time the company focused its operations on advisory groups.
- **Managed Account Industry:** The managed account industry is gaining momentum with managed accounts providing an alternative to managed funds, with the benefits of increased control and flexibility over an investors portfolio. MGP's services are marketed through advisory groups. The MDA model of advice eliminates the need for advisors to complete and get approval of a statement of advice (SOA) for clients for transactions, with the exception of changes to the investment strategy, allowing advisors to move more swiftly with respect to investment decisions and reduce the administrative burden of the advisor.
- **RG179 (CP200) Proposed Regulation Changes:** ASIC has proposed changes to the RG179 (CP200) regulation for MDA operators, the most significant of which is an increase in the NTA requirements of MDA operators. Some of the smaller operators may not be able to meet the increased requirements. This provides an opportunity for MGP to offer their services to these operators which would enable the operator to retain their MDA license given they would meet the requirements through the use of MGP's services. ASIC recently announced they will not be proceeding with the proposal until there is more certainty regarding the FOFA regulations and the Financial Services Industry review is completed. Given the increased assets in managed accounts we expect the proposed revisions to be implemented at some point in the future.
- **Experienced Board & Management Guiding the Way:** The board and management team has extensive experience in the financial services industry. Two of the three Board members co-founded Bridges Financial Services Pty Ltd, which established one of the first platform solutions for portfolio management in Australia. With their knowledge and team they have been able to devise a business model whereby minimum FUA is required to be pledged and an initial fee is paid to set up and tailor the MDA service to the Advisory Groups needs.
- **Profitable in FY'14:** Based on a 28bp gross profit margin on FUA and fixed operating expenses, the company will breakeven at the EBITDA line at ~$850M FUA. The company has surpassed this and is therefore expected to be profitable in FY'14 and beyond.

OVERVIEW

- Managed Account Holdings Limited (MGP) is a MDA operator with custody seeking to list on the ASX. The company is undertaking a capital raising to raise up to $5M. The funds will be used to support the proposed increased ASIC NTA requirements and improve the working capital position.
- The company was founded in 2004 and since this time has grown its FUA to $900M as at 31 December 2013 across 18 Advisory Groups. This is set to increase to in excess of $1B over the coming months with the addition of three new Advisory Groups in early 2014.
- The company is focused on providing a full administration service for managed accounts, taking advantage of the growing popularity of managed accounts as an alternative to managed funds, in particular for SMSFs. As detailed in the below report, direct equities are also experiencing significant growth compared to investment with investment managers which provides growth prospects for managed accounts and thus, MGP.
- MGP has no affiliation with any platform or wealth group, with Advisory Groups able to choose the portfolios they wish to use and who they wish to transact with. It is estimated approximately 15% of advisors hold their own AFSL and are not affiliated with product manufacturers (wealth groups). This represents ~2,700 advisors. If you were to look at this percentage as a portion of SMSFs this accounts for $76B, although we expect the actual market for unaffiliated advisors to be smaller than this. This provides a large market opportunity for MGP.
- The company has an experienced board & management team guiding the way, with a collective 85 years experience in the financial services industry between the three board members and significant experience with developing solutions for advisors. The CEO, David Heather, has over 26 years experience in the financial services industry the last six years of which he has spent with MGP as the Head of Distribution, before being appointed CEO in February 2014.

FINANCIAL POSITION

At 31 December 2013, the company had $4.2M in cash, no debt and net assets of $5.2M. Post the capital raising, the cash position will be boosted to in excess of $8M if the full subscription is achieved.

$'000	As at 31 December 2013	Minimum Subscription Filled	Maximum Subscription Filled
Cash & Cash Equivalents	4,166	5,672	8,468
Total Assets	6,556	8,077	10,892
Total Liabilities	1,397	1,397	1,397
Net Assets	5,159	6,680	9,495
Shares on Issue	67,506	130,210	145,210

BUSINESS MODEL

- MGP is an independent MDA operator, whereby the company provides administration and custody services for retail and wholesale managed accounts. The company offers a service tailored to the needs of each of the advisory groups and their clients.
- ASIC defines MDA services as discretionary trading arrangements undertaken by operators where:

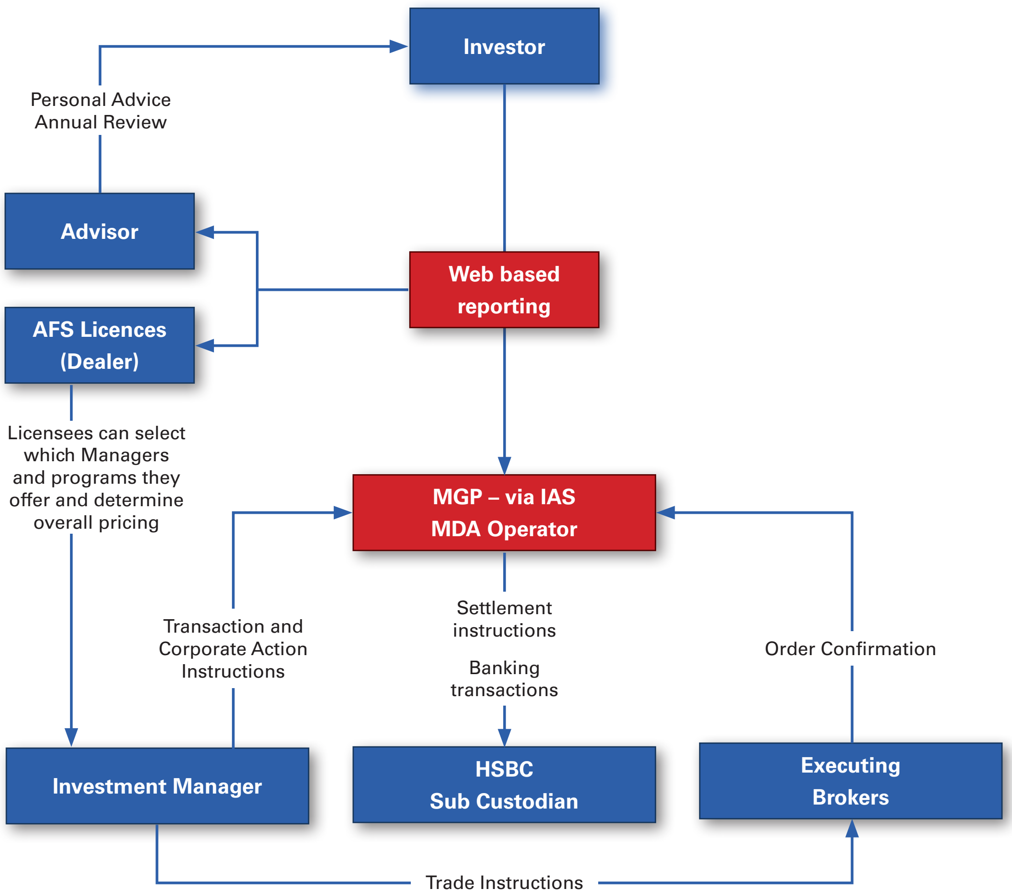
  i) the client gives to the MDA operator access to their assets;

  ii) the MDA operator agrees to carry out trading in financial products using client contributions without prior reference to the client for each transaction; and

  iii) the MDA operator agrees to manage the clients investments as a discrete portfolio belonging to that client.

- The company gains clientele through the Advisory Groups who wish to implement an MDA service model. The Advisory Group gets approval from clients to implement the MDA service. It's important to note that the client signs an agreement with the MDA operator, not the Advisory Group. The MDA operator acts on investment advice given by the Advisory Group on behalf of the client.
- The company has a gross profit of ~28bps of FUA (with a minimum fee per licensee), fees per transaction and implementation fees for designing and implementing the service. The primary source of revenue is the percentage of FUA.
- Gross operating margins are high with the cost of sales dependent on FUA, however to date revenue has not covered the fixed operating expenses. Scale in FUA is required to increase revenue to cover the fixed cost base.
- Assuming the operating expenses remain fixed and a gross profit margin of 28bps, the company needs ~$850M FUA to breakeven at the EBITDA line. The company has exceeded this level of FUA with a positive EBITDA expected for FY'14 and beyond.
- The company has appointed HSBC as the custodian, who take a percentage of FUA and transaction fees for providing these services.
- The company has outsourced its IT development to SS&C, a NASDAQ listed company. SS&C currently provide IT services to 6,900 financial services organisations, covering $26 trillion assets.
- The below diagram outlines the investment process that is undertaken using the MDA service. As detailed below, the client agrees to the use of the MDA service and the advisor is charged with providing investment advice on behalf of the client. The advisor then appoints an investment manager, which is generally the advisor. The investment manager manages the investments as per the clients request. The investment manager may transact with a broker of their choice. All portfolio and account information is available to advisors and their clients via the web based portal, which includes comprehensive reporting.

Investment Process Using MDA Service

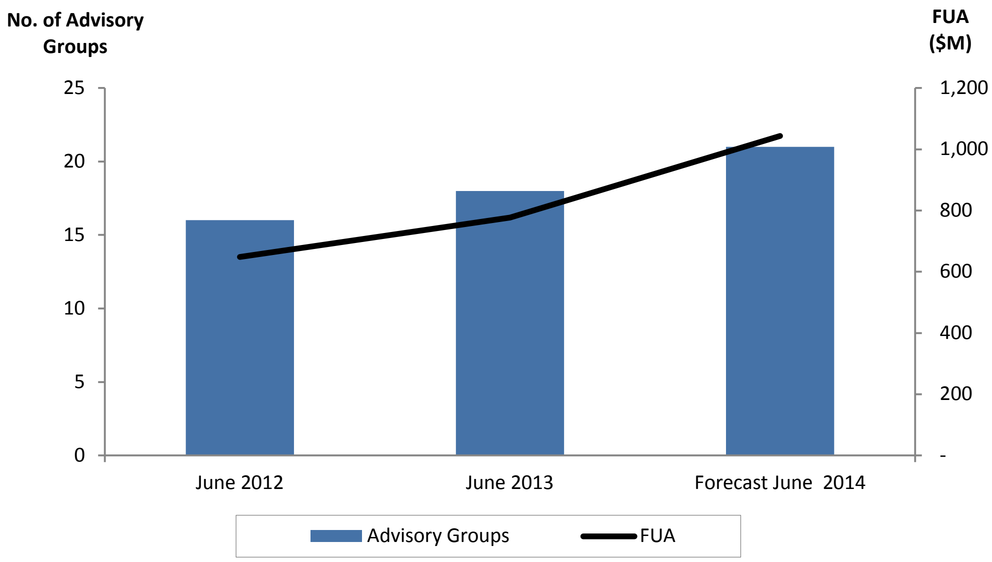


Source: Managed Accounts Holdings Limited

ADVISORY GROUPS

- The company currently has 21 Advisory Groups, adding two new Advisory Groups in 2013 and securing a further three Advisory Groups thus far in 2014.
- The three additions thus far in 2014 are Affinity Wealth Services, Redgum Wealth Group and GPS Wealth. Affinity Wealth Services and Redgum Wealth Group combined have ~$550M of assets under advice. Affinity will be transferring ~$180M to the MDA system over the next 12-18 months, while the amount transferred from Redgum to the MDA platform will be dependent on the number of clients that opt to utilise the MDA model. GPS Wealth was started in 2012 and has 50 financial advisors across QLD and NSW.
- MGP are targeting those Advisory Groups who:
  - Have a strong penetration of SMSF;
  - Provide advice on listed securities either through broker recommendations or through model portfolios; and
  - Those who may be adversely impacted by regulatory changes (CP 200).

Growth in Number of Advisory Groups



ADVANTAGES OF MGP MODEL

- Investment managers able to transact with the broker of their choice.
- The system offers full web-based reporting for clients.
- The company is independent of any wealth management groups and can be tailored for the needs of advisory groups. The company doesn't act as an investment manager.
- Eliminates conflicts of interest that exist with platform providers and investment offerings.
- Ability to label the reporting system in any way the licensee desires.
- Ability to integrate system with existing financial planning systems for Advisory Groups.
- Service is competitive from a pricing point.

DISADVANTAGES OF MGP MODEL

- MGP's service is limited to independent/unaffiliated advisory groups. Post the institutionalisation of many advisory groups this has resulted in a limited number of independent groups surviving, with only 15% of advisors expected to be unaffiliated. That said, albeit limited there is still a significant market opportunity within this group.

MANAGED ACCOUNT INDUSTRY

- A managed discretionary account (MDA) is a service where a portfolio of investments is maintained for an investor and the investor or licensee provides discretion to an investment manager to make decisions about the portfolio on your behalf. MDAs are regulated by ASIC and MDA service providers must have MDA authorisation under their AFSL.
- The managed account industry is growing in popularity as an alternative to managed funds. This is in part due to the influence of the sizable SMSF industry, in which accountholders have chosen to manage their superannuation funds personally as opposed to investing in an institutional superannuation fund.
- As an alternative to a platform or wrap, managed accounts provide investors the ability to invest in portfolios or direct investments with the added bonus of owning the investments in their name and not having to absorb the embedded tax liabilities of a unitised fund.
- The licensee can appoint an investment manager of their choice and can use any model portfolio of their choice. Model portfolios provide a professionally managed portfolio of equities, hybrids, fixed income, term deposits or property.
- Managed discretionary accounts (MDAs) come primarily in two forms: (1) Separately Managed Accounts (SMAs); and (2) Individually Managed Accounts. The below table provides some differences between the feature of SMAs, IMAs and managed (unitised) funds.

Feature	IMAs	SMAs	Managed Funds
Portfolio Management	Yes	Yes	Yes
Customised Portfolio Construction	Yes	No	No
Client Retains Beneficial Ownership	Yes	Yes	No
Transparency	Yes	Yes	No
Avoid Embedded Capital Gains	Yes	Yes	No
In-Specie Transfers	Yes	Yes	No

- According to ASIC as at August 2012, 193 AFS licence holders were authorised to operate an MDA or give advice on MDAs. This number grew 25% from January 2011, signalling the growth in interest in the industry. While the managed account industry is starting to gain traction, platforms still dominate the industry with the large wealth providers seeking to preserve their value chain, although an increased number of platform providers are offering an SMA service.

REGULATORY CHANGES

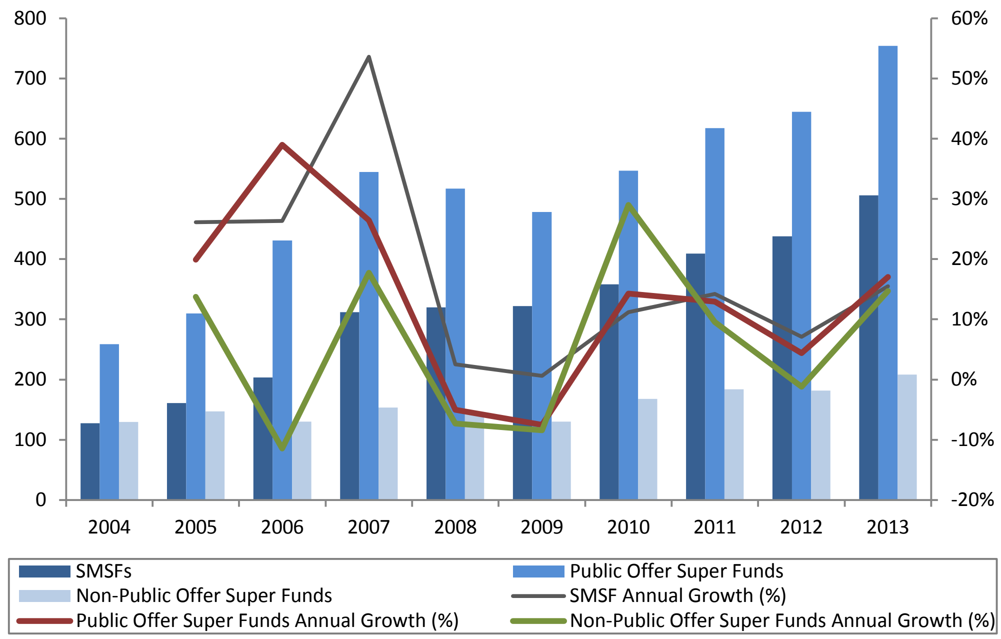
- ASIC are proposing an increase in the financial requirements for MDA operators after revising RG179 (CP200).
- ASIC is proposing revised NTA requirements in line with the requirements imposed for responsible entities. Under the revised requirements, MDA operators that do not provide custodial and depository services must hold at all times minimum NTA of the greater of:
  - $150,000;
  - 0.5% of the average value of client's portfolio assets up to $5M NTA; or
  - 10% of your average MDA operator revenue with no maximum NTA.
- MDA operators that do have custodial and depository services must hold at all times the minimum NTA of the greater of:
  - $10M;
  - 10% of the average MDA operator revenue with no maximum NTA.
- MGP does provide custody services, however the company has informed us that because the company has appointed an external custodian that meets the NTA requirements, the company has satisfied the regulation.

- Post the capital raising, MGP will be well placed to meet the new NTA requirements in the event they are implemented and will be well placed to take on some of the services for smaller operators that can't meet the requirements, assisting them with maintaining their MDA license.
- The proposal is currently on hold pending the outcome of FOFA regulations and the completion of the Financial Services Industry review, however we expect the proposed revisions to be implemented at some point given the increasing number of MDA operators and expected asset growth in managed accounts.

SELF MANAGED SUPER FUNDS (SMSFs)

- As at 30 June 2013, $506B of the $1.62 trillion of superannuation assets was held in SMSFs with an average fund size of ~$1M and an average account balance of $524k.
- The below chart shows the asset growth for the three major super fund classes. SMSFs have experienced the greatest growth from June 2004 to June 2013, with assets increasing 397% over the period. Unlike the other two classes of super funds, SMSFs have not experienced a negative period of asset growth.

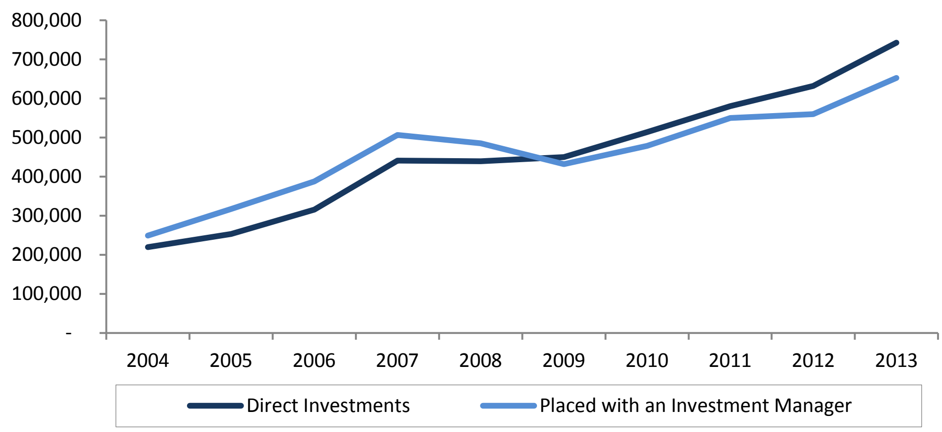
Super Fund Asset Growth



Source: APRA/Independent Investment Research

- The below chart illustrates the investment trend that has been occurring within super funds. We note the below does not include funds placed with life funds. The below chart shows that the within super funds the growth of direct investments has outpaced that of funds placed with investment managers. We attribute the correlation of the growth in direct investments with the growth in SMSFs, with a high positive correlation between growth in SMSF assets and growth in direct investments of 0.95.
- The growth in SMSF assets and the use of direct investments bodes well for MGP, given these are primary drivers for managed account growth. 70% of MGP's client base are SMSFs.

Investment Trends



Source: APRA/Independent Investment Research

ASX-LISTED PEERS

- There are two primary peers for MGP that are listed on the ASX: (1) HUB24 (ASX: HUB); and (2) Praemium (ASX: PPS).
- HUB provides SMA and platform services and PPS provides SMA and portfolio administration services in Australia, Asia and the UK. Unlike MGP, both HUB and PPS offer model portfolios and investment menus for clientele in addition to administration services. MGP is focused purely undertaking the administration side of the business with the licensee appointing the investment manager to make investment decisions and use portfolios of their choice.
- Given the differing business models between the companies, MGP has only to focus on its relationship management and technology and system development, whereas the other companies have to focus on product development for their platform businesses.
- One of the other advantages of the MGP business model compared to other models is that the licensee or investment manager can choose the investments in the mandate they manage and who they transact with. This offers significant flexibility for independent advisory groups.
- The below table provides a comparison of the three companies with respect to a number of metrics using the most recent data available. We have provided ranges for MGP based on the minimum and maximum capital raising outcomes. MGP has surpassed HUB with respect to FUA and is quickly catching PPS.

Peer Comparison			
As at 25 March 2014	**HUB**	**PPS**	**MGP**
Share Price ($)	0.945	0.145	0.20*
Number of shares on issue (M)	47.1	378.7	130.2-145.2
Market Capitalisation ($M)	44.5	54.9	26.0-29.0
Cash at bank	16.5**	7.95**	5.7-8.5
FUA ($M)	635**	1,200**	900**
NTA per share (cents)	3.4	3.8	6.2-7.5

* MGP is yet to be listed. Assumes capital raising price of $0.20 per share.

** As at 31 December 2013.

CAPITAL STRUCTURE

PRE-CAPITAL RAISING

- As it currently stands there are 120.2M ordinary shares on issue. Directors and management own 70% of the shares on issue.

POST-CAPITAL RAISING

- In the event the maximum subscription is achieved, an additional 25M shares will be issued taking the total number of ordinary shares on offer to 145.2M, of which directors and management will own 54.6%.
- In the event only the minimum subscription is filled, an additional 10M ordinary shares will be issued, of which directors and management will retain 60.9% of shares on issue.
- One of the substantial shareholders post the capital raising will be Argo Investments Limited (ASX: ARG). In the event the maximum subscription is achieved, ARG will have an 8.6% shareholding in the company.

	Minimum Subscription	Maximum Subscription
Current shares on issue	120.2M	120.2M
Shares issued	10M	25M
Total shares on offer	130.2M	145.2M
Director & Management ownership	60.9%	54.6%

INVESTMENT CASE

- The company provides an opportunity to invest in an MDA operator taking advantage of the growing popularity of managed accounts, largely driven by the growing SMSF market.
- There is a high positive correlation between the growth in SMSF assets and the growth in direct investments by superannuation funds. Managed accounts are supported by the desire for investors to invest directly in asset classes. 70% of MGPs client base are SMSFs.
- The MDA model is an attractive model for advisors given that it reduces the administrative burden for the advisor and the MDA model does not require SOAs to be produced for every change to an investors portfolio. SOAs only need to be produced for significant changes to an investors portfolio. This allows advisors to move more swiftly when implementing investment decisions.
- The company has exceeded the breakeven FUA level required to be EBITDA positive, therefore the company is expected to be profitable from FY'14 onwards, with the company committing to an unfranked dividend of $0.008 per share in FY'15.
- The company is headed by an established board and management who have significant experience in the financial services industry.
- MGP has been able to monitise the service through charging an upfront fee of up to $30k to tailor a service for a licensee and the requirement for a minimum amount of FUA to be placed or the equivalent fee payable.
- Funds, in particular SMSF funds, tends to be "sticky". With the majority of FUA SMSF funds and this being a target market for the company, unless there is a significant disruption to services there should be minimal reduction in FUA. The major risk comes from retirees who withdraw lump sums from their super accounts.

RISKS

- **Loss of FUA:** The company's profitability is a direct result of FUA. A decline in the FUA will result in a decline in profitability. This may result from a licensee removing the funds from the system or a decline in the market.
- **Competition from Platform Providers:** Platform providers have a captive market given many advisory groups are now affiliated with the platform providers. There is a risk that platform providers will take on or seek to increase their MDA service capabilities and limit the market opportunities for MGP. Increased competition may also result in downward pressure on fees, adversely impacting revenue.
- **Failure in Operating Systems:** The company's operating system are key to the business. Failure/downtime in the system may have irreparable reputational damage for the company.
- **Increase in Operating Costs:** The company currently has agreements in place for software and custodial activities, whereby payment includes a percentage of FUA. To remain competitive it will be difficult to increase the percentage of FUA taken as revenue, therefore In the event the costs of these services increases this will likely erode profitability.

BOARD & MANAGEMENT

Don Sharp - Executive Chairman: Mr. Sharp is highly experienced in the financial services sector. Mr. Sharp co-founded Bridges Financial Services Ltd, which established one of the first platform solutions for portfolio management in Australia. Mr. Sharp is currently a director of Countplus Ltd and CEO of the Payment Advisor group of companies.

Colin Scully - Non-Executive Director: Mr. Scully has extensive experience in the financial services industry. Mr. Scully co-founded Bridges Financial Services Ltd with the Chairman. Mr. Scully is currently a director of numerous private companies and was previously a director of the Financial Planning Association and IWL Limited.

Paul Collins - Non-Executive Director: Mr. Collins has over 25 years experience in the financial services industry. Mr. Collins held positions with IBM and ComputerPower before establishing a consulting business. Mr. Collins provided consultation services to government and financial organisations, specialising in software development, operational and relationship management. Mr. Collins was the Development Manager at IOOF before becoming a co-founding IWL Ltd. Mr. Collins was a founding Director of MGP.

David Heather - Chief Executive Officer (CEO): Mr. Heather has over 26 years experience in the financial services industry, specialising in managed accounts for the last 12 years. Mr. Heather has held senior positions at Permanent Trustee, Trust Company and Aegis Equities Research. Mr. Heather joined MGP in 2008 to assist with the integration of managed accounts into their existing business models and was appointed CEO in February 2014.

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For further information, please contact IIR at: client.services@
independentresearch.com.au

Independent Investment Research (Aust.) Pty Limited

SYDNEY OFFICE
Level 10, 50 Pitt Street
Sydney NSW 2000
Phone: +61 2 8001 6693
Main Fax: +61 2 8072 2170
ABN 11 152 172 079

MELBOURNE OFFICE
Level 7, 20–22 Albert Road
South Melbourne VIC 3205
Phone: +61 3 8678 1766
Main Fax: +61 3 8678 1826

DENVER OFFICE
1011 S Valentia 138
Denver Colorado 80247
Phone: +1 161 412 444 724

MAILING ADDRESS
PO Box H297 Australia Square
NSW 1215