Looking Back: Coronation Fund Managers

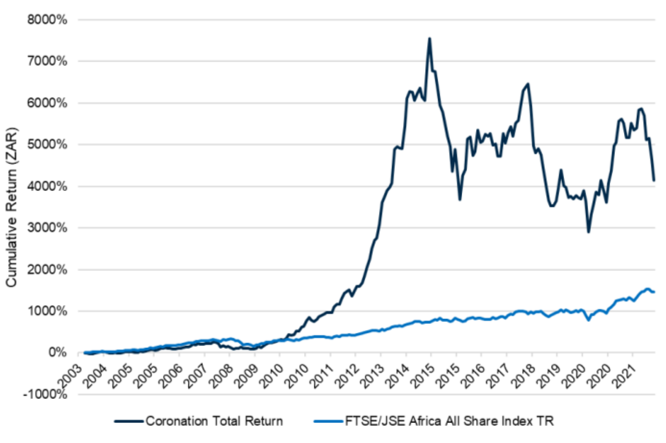
BLUEALPHA INVESTMENT MANAGEMENT

In 1993, 15 investment professionals orchestrated a mass walkout of Syfrets Managed Assets. With zero clients and zero assets this small group started Coronation Fund Management. Listing in 2003 with AUM of R53bn. Coronation has grown exponentially over the years, as of March 2022 Coronation now manages R625 billion in client Assets.

It's easy to think that investing in an asset manager is a proxy for the equity market as a whole, after all their revenue is largely a function of assets under management (AUM). We examine why this isn't the case by taking a look at SA's third largest asset manager, Coronation.

As you can see in the graph below, Coronation has outperformed the market handsomely, but after its peak in 2014, assets stopped growing. We are going to take a deeper look at the headwind's asset management companies face.

Figure 1: Coronations versus the market

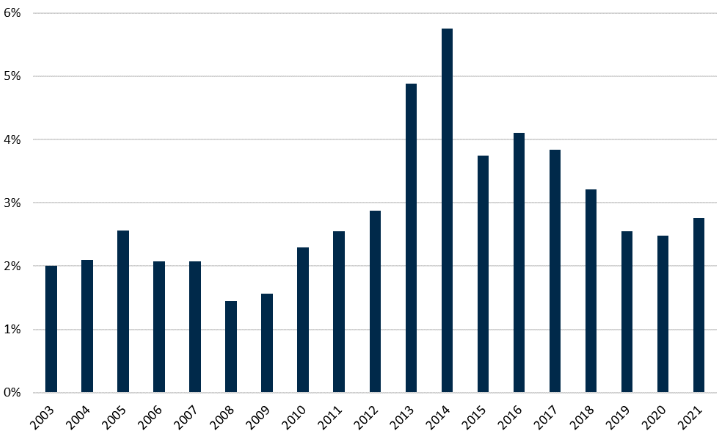


Source: Bloomberg

Investing in the Investors

Market capitalisation relative to assets under management (AUM) is a widely used ratio to assess the value of asset management firms. The below graph shows Coronations market cap/AUM through time.

Figure 2: Coronations Market Cap to AUM



Source: Bloomberg

Put simply, a market cap/AUM of 3% translates to a Price/sales of 3 (assuming gross fee of 1%). This would imply that the market is pricing in no growth and a margin of 50 bps (asset managers typically have a cost to income ratio of 50%). This would also be our view of Coronation and other vanilla asset managers. Rarely should they be seen of as premium rated businesses. Yes the cash flow is good but your assets (being staff and funds under management) are not stable. At one stage RMB asset management was one of the biggest independent managers and it now no longer exists. And of course, that 1% gross fee has still got room to fall.

The above graph shows the company re-rating from 1.5% of AUM in the market low of 2008 to a high of 5.8% in 2014. Through this period, the company was attracting significant asset inflows, expanding its global reach, and rising fee generation. The market thought that Coronation was destined to keep growing. However, after the peak in 2014, the rating nosedived and has moved in a horizontal fashion since.

So where are the headwinds coming from?

Share price performance for companies like Coronation is a function of AUM, fees, ratings, fund performance and employee costs. The first two have the biggest effect on Coronation's profits as employee costs tend to be variable with margins.

Continued...

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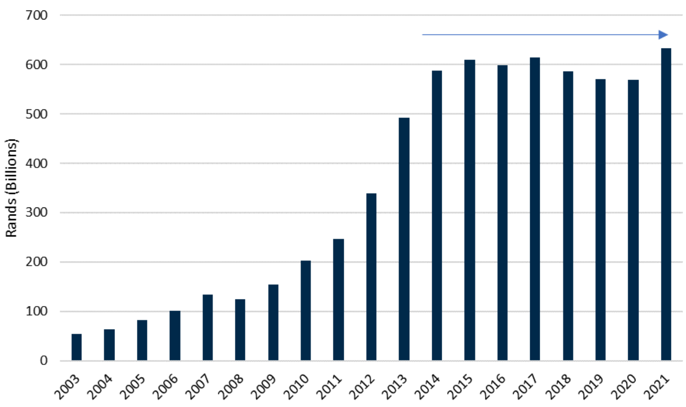
1.Asset Growth Stopped

Like many things in life, size matters, and this couldn't be truer for the asset management industry. Larger AUM means a larger fee base which means more revenues. However, the bigger you are, the harder incremental growth is to come by. Coronations' asset growth stopped in 2014 as illustrated below. Without additional client inflows, AUM growth is limited to the performance of your AUM less fees.

Figure 3: Coronations Asset Growth

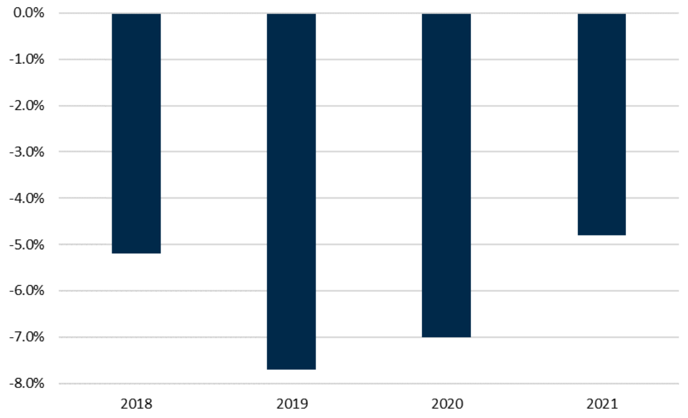


Source: Coronation

2.Net Outflows exacerbate AUM stagnation

AUM can grow in three ways: organically, because of rising markets boosting the value of the assets managed, successful active management resulting in outperformance (alpha), or from investor inflows. More inflows are often the result of good performance. Whether a function of performance, competition or emigration of investors, Coronation have reported net outflows for the last 4 consecutive years.

Figure 4: Net Outflows as a % of AUM



Source: Coronation

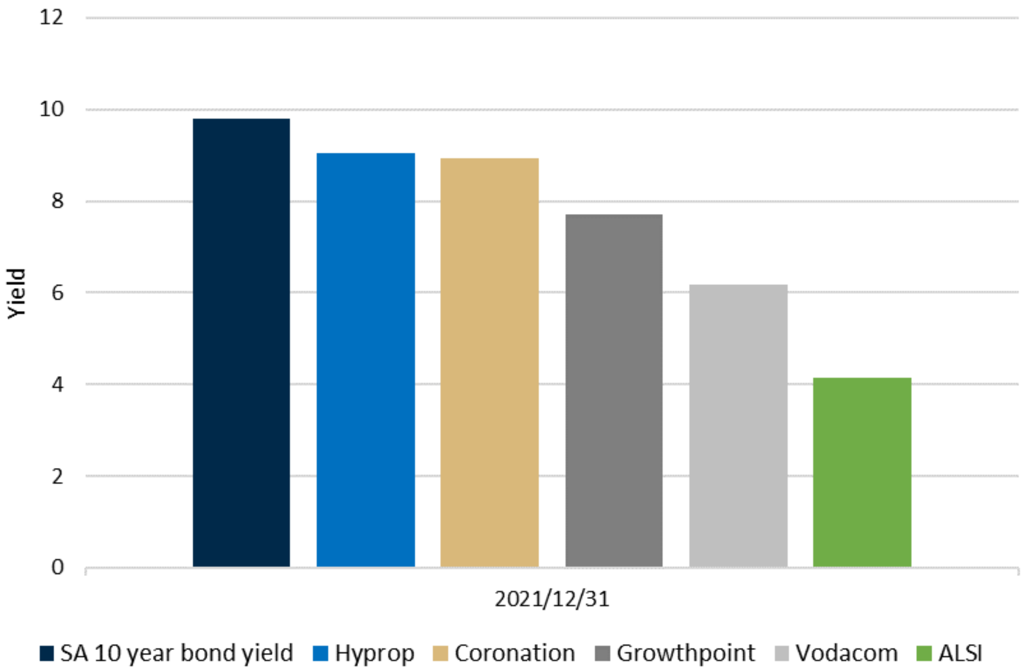
3.The big squeeze: Pressure of fees

Adding further pressure to revenues is the increased pressure on fees. Human capital businesses, by their nature, have relatively low barriers to entry, resulting in a very fragmented industry. With stunted savings growth in SA and increased competition, the only way to attract assets is by lowering fees. There are too many trains and too little gravy! Coronation, like other active managers, is also largely doing away with performance fees, especially on retail funds.

Is the Dividend Yield a Better Way to Value Coronation?

Because asset managers are human capital companies and don't need to invest in fixed assets, they are cash-generative and able to pay out the majority of profits as dividends. For this reason, the dividend yield is also relevant when valuing an asset management firm. Investors argue that Coronation's dividend yield is attractive and by this metric the company looks cheap. At a yield of 8.9% in December 2021, it certainly looks appealing relative to the equity market indices. However, as soon as investors suspect a company is ex growth its dividend yield starts gravitating towards the 10-year bond yield, because of the tax advantage, the dividend yield tends to be lower. Some examples of companies where growth has stopped and have high dividend yields are Vodacom and SA property companies.

Figure 5: Yield Comparison



Source: Bloomberg (December 2021)

Another point to make is that diversified financial companies have different streams of growth that they can rely on, where pure asset managers only have one. So if they fail, they fall out the sky without the parachute of say a banking or insurance division.

Investing in pure play asset managers makes sense if asset inflows are strong but as soon growth dries up it's very hard for asset managers themselves to outgrow the equity index.