

Dowgate Capital



Dowgate Capital comprises City Financial Associates (NomAd and corporate finance adviser) and Ellis Stockbrokers (private client and corporate stockbroker). Both are focussed on the SmallCap and Microcap sectors of AIM and PLUS markets.

Despite the difficult market environment in the final quarter, when AIM in particular was hit by the fall-out from the US sub-prime scandals and the run on Northern Rock, Dowgate increased profits before exceptional items by more than one-third and paid a maiden dividend. However exceptional costs and a high tax charge reduced earnings per share.

Table 1: Preliminary Results, 2007

Year to end-December	2006	2007
	£000	£000
Turnover	3,569	6,251
Operating costs	(2,745)	(5,123)
Operating Profit	824	1,128
Share-based payments	(85)	(198)
Net finance income	59	169
Other gains/(losses)	17	(15)
Headline pre-tax profit	815	1,084
Exceptional items		(71)
IFRS pre-tax	815	1,013
Tax	(244)	(377)
Profit after tax	571	707
Earnings per share (p)	2.41	1.91
IFRS eps	2.4	1.7
Dividend (p)	0.0	1.0

Company

Dowgate suffered a number of literally exceptional one-off costs, of which it has treated only the costs of the capital reorganisation and of terminating the lease on its old offices as "exceptional". Others, such as the write-down of investments, a significant bad debt and the cost of moving to new larger offices, it has included in normal operating costs. So our figure for Headline earnings per share is in actuality too low.

Reported profits are also affected by the IFRS charge for cost of share-based payments, aka staff share options: this more than doubled although the bulk of the options were under water for most of the year. As the IFRS charge is disallowed by HMRC when calculating tax liabilities for taxation (rightly as it is a transfer of value between existing and future shareholders rather than a payment to third parties), the tax charge as a ratio of IFRS profits was 37%.

Both divisions performed more than respectably in the deteriorating market conditions. Now that the merger has bedded down successfully it is proposed to rename both: CFA will become **Dowgate Capital Advisers** and Ellis will become **Dowgate Capital Stockbrokers**. This will help cross-selling in the future, which is already providing modest benefits through several new clients selecting both CFA as NomAd and Ellis as stockbroker.

Dowgate Capital

DGT

Date:	11.3.08	
Share price p	13.5	
52 week High/Low p	21.6/11.75	
Issued share cap	36.74	
Market cap £m	5.0	
NAV p	7.2	
Year to December	PBT £m	
2004	(0.43)	
2005	0.53	
2006	0.815	
2007	1.084	
Year to December	EPS p	PER
2004	(2.17)	
2005	2.55	
2006	2.41	5.6
2007	1.91	7.1
Year to December	Div p	Yield %
2004	0.00	
2005	0.00	
2006	0.00	0.00
2007	1.00	7.41

Dowgate is quoted on AIM and investors should be aware that shares traded on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

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Much of turnover at Ellis comes from trading on AIM for private clients so its turnover in 2007 fell by £1.02m (22%) compared to 2006, but profit before interest by only £0.12m (14%) from £0.83m to £0.71m. Most of its costs are variable but even so this is impressive and suggests that underlying profitability has significantly improved despite the extra costs involved in improving compliance systems after its acquisition near the end of 2006.

CFA increased the number of retained clients and continued to gain market share. The number of UK companies admitted to AIM in 2007 dropped by 42% relative to 2006: however CFA completed 22% fewer transactions and its turnover declined by just 7%. Profits after significant exceptional costs (writing down investments, bad debts, moving offices) dropped from £0.64m to £0.47m: we suspect that pre-exceptional profits were actually higher.

CFA is gradually and very selectively building up its team - from six at the beginning of 2007 to seven at the end and now nine. In the very short term the increase will add to costs more than profit but we expect gains in market share to first offset and then gradually outweigh the decline in the market.

Prospects for the current year are hazy: those for AIM as a whole seem murky, but we expect Dowgate to make further gains in market share that should offset this to some extent. The recruitment of two high-profile individuals, Dru Edmonstone and Philip Dumas, to head up the city-based corporate broking team for Ellis may initially be dilutive if 2008 remains dull, but should be justified in the medium term.

Depending on the budget's CGT concessions and conditions for the rest of the year profits could be anywhere between just below £1m and a little over £2m. So we assume that earnings will comfortably cover a modest increase on this year's 1p dividend.

Even using my understated figure for Headline eps, Dowgate's current yield is higher than the PER, which would automatically put it on a list of potential "Buys" for most stockbrokers. On any reasonable assumption for 2008, its prospective yield is also higher than its PFER affirming the value proposition we highlighted in our note of August, 2007 that set a 21p / share fair value target.

I certify that this report represents my own opinions
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