

## EQUITY RESEARCH

Thursday, 19<sup>th</sup> September 2019

### PC Classification & Overview

Objective: **Growth & Income**

**ADAM** is a London, AIM quoted pan-Asian diversified investment company, specialising in small & medium sized private businesses (SMEs), typically with an Enterprise value of less than US\$500m. There are around 25,000 Asian SMEs, which suffer from traditional business funding difficulties, which is where ADAM's investment opportunities arise. Investments are typically between US\$2.5-5.0m in value and are held for between 3-5 years.

### Company Details

EPIC: **ADAM.L**

Share Price\* (mid): **30p**, NAV/ Share 87p

Index & Sector: **LSE AIM, Financial Services**

No. of Shares & Free Float: **88.7m, 22%**

Market Cap: £27m LTV: **N/A**

Next Results: Full Year 2019

Source: ADAM plc, Broker Forecasts. \* Share Price correct at 10am, 13 Sept-19

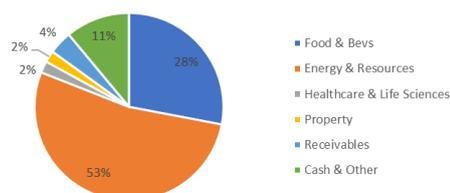
### Share Price (p)



Source: Thomson Reuters DataStream

### Asset activity split:

ADAM Sector Exposure



Source: H1-FY19 Results

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## ADAMAS FINANCE ASIA LTD

Geared for Growth

Adamas Finance Asia Limited (ADAM.L), the Asian SME investment company, recently reported half-year (H1-19) results. Most importantly, cash income improved sharply to US\$1.25m (US\$0.05m H1-18) which augurs well for the future, and possible dividend payments.

Net asset value (NAV) increased 3.7% to US\$96.5m, albeit NAV/share declined 5% to US\$1.09 (about 87p).

ADAM's business strategy is to invest in high growth, income paying Asian SMEs where 'speciality finance' is required, ADAM's niche business area. Opportunities abound, as demonstrated by recent and expected new investments.

At 30p/share (mid), ADAM is trading at a 66% discount to current NAV/share, which significantly undervalues this business we believe.

- Opportunities Abound.** Adamas Finance Asia Limited (ADAM) is focused on investing in small and medium sized, mainly privately owned Asian companies. Typically, these businesses have strong management teams with firm corporate governance principles and are in growth sectors which require 'specialist situation' funding. Opportunities abound, with an estimated US\$2.7 Trillion funding gap and around 25,000 Asian SME businesses seeking finance to grow.
- Income & Growth Focus.** By Sector, ADAM's portfolio is evolving towards high growth and reliable income sectors such as Healthcare, Food & Beverages, Leisure & Real Estate. This strategy has delivered strong H1-19 results, with income reaching US\$1.25m, a figure which we expect to grow sharply.
- Double Digit Return Focus.** Through a combination of current investment sales, and new capital issuance, ADAM is likely to have significant fresh capital to reinvest at its target income yield level of 12% (8% cash income + 4% payment-in-kind).
- Valuation.** ADAM's current NAV is US\$1.09/share (around 87p). With its share price at 30p - representing a 66% discount - the share price is already reflecting a number of risk factors we believe; such as disposal & reinvestment risk, relative illiquidity of the shares and the wide bid-offer spread, plus the possibility of fresh equity issuance. If dividend payments commence in the foreseeable future - which we expect - ADAM investors could find themselves holding an attractive investment in terms of both capital and income growth potential.

### Adamas Finance Asia Limited Summary Financials & Data

Yr To December US\$ 000's	2018A	2019 Interim	2019E	2020E	2021E
<b>Summary Financials</b>					
Report income (Cash + Accrued Income)	364	1,248	1,925	4,315	9,599
Operating Profit (Loss)	-3,501	-157	-760	1,168	5,905
Basic EPS (US\$)	-0.04	0.00	-0.01	0.01	0.03
DPS (GBP)	0.00	0.00	0.00	0.30	1.06
Basic NAV / Share (US\$)	1.13	1.09	1.09	0.79	0.69
Basic NAV / Share (GBP)	90.3	87.2	87.0	63.3	55.5
<b>Valuation &amp; Ratio</b>					
P/NAV (x)	0.33	0.34	0.34	0.4	0.54
Premium (discount) to NAV	-67%	-66%	-66%	-53%	-46%
Dividend Yield (%)	0.0%	0.0%	0.0%	1.0%	3.5%

Source: Pello Capital Estimates, Adamas Finance Asia Report & Accounts. FX Assume GBP:US\$ 1.25

## ADAM'S INVESTMENT PORTFOLIO, SOME KEY HIGHLIGHTS

The table on the following page shows the key investments in ADAM's portfolio, and demonstrates how we think this portfolio could grow both in capital and income terms over the coming 2-3 years, justifying dividend payments to equity shareholders.

### **Asset Valuation Growth of 3.7% Year on Year (Y/Y)**

ADAM's gross asset value position at 30 June 2019 was US\$96.7m, ahead some 3.7% on last year. Net asset value (NAV) was US\$96.5m, up a similar amount. The table on the following page shows the breakdown of the asset values plus portfolio cash and receivables. Importantly, we make assumptions for the full year 2019 and also for the coming 2-3 years in terms of how the portfolio could reshape as Harmony Capital, ADAM's investment manager, sells more of the legacy assets and reinvests the proceeds in accordance with its 'growth & income' remit across Asian small and medium sized, mainly privately owned businesses (SMEs).

### **Income is Important**

Looking at the full year 2019, we forecast Income of US\$1.9m (comprising of income received and accrued income). Assuming NAV remains constant at US\$96.5m, this gives an annualised income yield of around 2%. Looking forward however, we expect this to grow significantly as Harmony Capital manages the ADAM portfolio with both a growth & income remit.

### **Distributable Income Likely To Grow Strongly**

Looking forward to the period 2020-2022, we assume that ADAM's portfolio composition changes significantly, such that a number of legacy assets are sold, and the proceeds reinvested in income producing, high growth businesses. We also assume that ADAM raises fresh capital (we assume US\$25m in 2020/1, and another US\$25m in 2021/2) which is also reinvested, again driving up the portfolio's distributable income stream.

Our forecasts suggest a 2020 distributable income of US\$1.2m, followed by a strong increase to US\$5.9m in 2021 as shown in the table. If we then assume that some 50% of this is paid out as a dividend, and also factoring in a greater number of shares in existence and at today's share price, the dividend yield is 1% and 3.5% respectively.

### **Some Key Assumptions**

Important for investors to recognise that in making these financial forecasts, Pello Capital has made a number of assumptions which may or may not turn out to be correct, and which will of course impact ADAM's distributable income stream and thus the dividend potential. Three of our main assumptions are;

- (i) Harmony Capital, ADAM's investment manager, manages to sell a number of the portfolio's legacy assets at their current valuation, and then reinvests the proceeds in fresh investments, which on average, yield some 12% annually, with 8 percentage points (pp) coming by way of cash income, and 4 percentage points (pp) coming by way of PIK (payment in kind).
- (ii) We assume that ADAM raises fresh equity via new share issuances. We assume that this is done at today's share price of 30p per share, but of course realise that looking forward, the share price could be either higher or lower than today's 30p / share, and thus the amounts raised and the number of new shares issued will vary.
- (iii) We assume that ADAM's board agrees a dividend distribution policy of 50% of distributable income. Reality may be different.

## ADAM'S INVESTMENT PORTFOLIO, SOME KEY HIGHLIGHTS

Adamas Portfolio Income & Yield Outlook					Current		1-2 Years Outlook					2-3 Years Outlook				
	Cash		Original	Annualised	Current	Current	Cash	Coupon /	PIK	Cash	Total	Cash	Coupon	PIK	Cash	Total
Pro Forma Yield Per Annum	Coupon	PIK	Inv.	Coupon	Valuation	Yield	Assum Valn	Div	Coupon	Yield	Running Yield	Assum Valn	/ Div	Coupon	Yield	Running Yield
	USD MM		USD MM		USD MM											
Future Metal Holdings	0.0%	17.0%	2.0	0.0	42.6	0.00%	42.6	1.00	0.00	2.35%	2.35%	0.0	0.00	0.00	0.00%	0.00%
FLMH	3.0%	2.0%	26.5	0.8	26.9	2.96%	26.9	0.81	0.54	3.00%	5.00%	26.9	0.81	0.54	3.00%	5.00%
Infinity Capital Group	17.5%		2.0	0.4	2.4	14.58%	2.4	0.42	0.00	17.50%	17.50%	2.4	0.42	0.00	17.50%	17.50%
DocDoc	4.0%	4.0%	2.0	0.1	2.2	3.64%	2.2	0.09	0.09	4.00%	8.00%	2.2	0.09	0.09	4.00%	8.00%
Meize Energy Industrial Holdings			6.7	NA	8.2	0.00%	8.2	0.00	0.00	0.00%	0.00%	0.0	0.00	0.00	0.00%	0.00%
Greater China Credit Fund			2.8	NA	2.7	0.00%	2.7	0.00	0.00	0.00%	0.00%	0.0	0.00	0.00	0.00%	0.00%
<b>New Investments - Recycled Capital</b>	8.0%	4.0%	0.0	0.0	0.0	0.00%	0.0	0.00	0.00	0.00%	0.00%	53.5	4.28	2.14	8.00%	12.00%
<b>New Investments - Capital Raised</b>	8.0%	4.0%	0.0	0.0	0.0	0.00%	25.0	2.00	1.00	8.00%	12.00%	50.0	4.00	2.00	8.00%	12.00%
<b>Investment Total</b>			42.0	1.2	85.0	1.44%	110.0	4.32	1.63	3.92%	5.40%	135.0	9.60	4.77	7.11%	10.64%
Cash + Receivables + Other items					11.5		12.9					19.1				
<b>Total</b>			42.0	1.2	96.5	1.27%	122.9	4.32	1.63	3.51%	4.83%	154.1	9.60	4.77	6.23%	9.32%
Management Fees @ 1.75% of NAV								-2.15					-2.70			
Fixed Costs, likely to remain constant								-1.00					-1.00			
<b>Distributable Income (US\$ million)</b>						<b>-1.33</b>	<b>122.9</b>	<b>1.17</b>	1.63	0.95%	2.27%	<b>154.1</b>	<b>5.91</b>	4.77	3.83%	6.93%
Possible Dividend, % Distributed	50%					0.0		0.58					2.95			
Current share price (GBP)						0.30										
No. Shares Outstanding (NOS) (m)						88.7		88.7					155.4			
Possible New Share Issuance (m)								66.7					66.7			
<b>Total NOS Outstanding (m) at year end</b>								<b>155.4</b>					<b>222.1</b>			
Possible Dividend per share (GBP)						0.00		0.003					0.011			
<b>Possible Dividend Yield (%)</b>						<b>0.0%</b>		<b>1.0%</b>					<b>3.5%</b>			

**H1-19 reported net asset value, showing the possible growth in NAV over the coming years as ADAM makes business disposals and reinvests in line with its growth strategy.**

**Possible future dividend yield**

The table above shows ADAM's key portfolio investments currently, but also how the portfolio is likely to evolve over the coming 2-3 years as some of the current investments are sold, and the proceeds reinvested in line with ADAM's growth & Income strategy. To augment the growth rate, we expect ADAM to raise fresh equity capital too, which will also be reinvested at ADAM's targeted return rate of 12% per annum, coming from eight percentage points (pp) of income, plus four percentage points contribution from payment in kind (PIK).

### Some Key Assumptions

In constructing the above table, we assume that;

- (i) ADAM can sell a number of its current portfolio assets and reinvest the proceeds at a 12% annual return (Income+PIK).
- (ii) ADAM raises fresh equity capital at 30p per share, the current share price. Important to note that issuing fresh equity at 30p per share is dilutive to NAV / share, as we show in our financial forecasts, but this is already factored into the share price we believe.
- (iii) Some 50% of distributable income is paid out as a dividend.

## STRENGTHS, WEAKNESSES, OPPORTUNITIES, THREATS (SWOT)

The headings below summarise some of the key SWOT factors as we see them, which are important for investors to consider.

### Strengths;

ADAM's investment manager, Harmony Capital has a very experienced team both geographically, across the whole Asian region and in investing up and down corporate structures. Harmony Capital commenced restructuring the ADAM portfolio in May 2017, and through its disciplined due diligence approach, is focused upon delivering a double digit combined income plus capital growth return, being mindful of downside risks. Return of capital is equally as important as return on capital.

The current portfolio's sector exposure is deliberately wide, covering Healthcare, Food & Beverages, Leisure, Real Estate and Technology, with the Mining exposure due to be cut upon the targeted sale of the dolomite magnesium limestone quarry, the key asset of Future Metal Holdings, located in the province of Shanxi, China.

### Weaknesses;

There are few weaknesses in terms of ADAM's investment thesis we believe, but factors such as the relative liquidity of the shares, the wide bid-offer spread and the fact that currently the business does not pay investors a dividend, should be viewed as current investment weaknesses. Harmony Capital is working towards improving all of these factors, and as this is achieved, the attraction of ADAM stock will improve to new and existing investors.

ADAM's investments are both up and down corporate capital structures, ranging from straight equity, to convertible preference shares, to mezzanine debt, which in some cases does make valuing these investments more challenging, and may lead to greater illiquidity in the near term.

### Opportunities;

ADAM's industrial sector agnostic approach provides it with a wide range of investment angles as the Asian economies develop. OECD forecasts suggest that the world's population will grow to over 8 billion people by 2030, with China and India being home to around two-thirds of the global middle class, defined as people who spend between US\$10–US\$100 per day. ADAM is very mindful of this fact.

The US\$2.7trillion funding gap between the funding which Asian SMEs require to grow and the funding which traditional lenders such as banks and stock markets will provide represents a vast opportunity for ADAM, given its focus upon companies and situations which require specialist funding and specialist knowledge.

### Threats;

Threats to the valuation of ADAM's share price and thus the company's value come from such factors as the ability of Harmony Capital to restart the Chinese dolomite quarry during H2-19 and subsequently sell this asset at a price close to or above its net asset value which was US\$42.6m at 30 June 2019. Notable that this value represents some 44% of ADAM's total NAV of US\$96.7m and thus from both a capital and a sentiment perspective, the targeted sale of this asset is very important to the future investment profile of ADAM.

ADAM has one major shareholder, Elypsis Solutions Ltd, which has been a shareholder since 2014 and holds approximately 66% of the equity. We believe that Elypsis is likely to remain a long-term shareholder, but should this company decide to reduce its shareholding percentage, there would be downward pressure on ADAM's share price initially we believe.

## SUMMARY FINANCIALS, IMPORTANT, BUT TIMING HARD TO PREDICT

The table below summarises our financial forecasts for ADAM for the coming three years. Important for investors to note however, that timing events such as the acquisition and disposal of stakes in privately held businesses is hazardous. Such events could occur more quickly, or take longer than expected and as a result, our yearly forecasts must be read while understanding that Harmony Capital nor Pello Capital can predict events in such discreet time periods. What can be done however, is that the direction of travel can be indicated, and this is what we seek to do with these forecasts.

Adamas Finance Asia Limited Summary Financials 2018 – 2021E					
Yr To December US\$ 000's	2018 Actual	H1-19 Actual	2019 Est.	2020 Est.	2021 Est.
<b>Income Statement</b>					
Interest/Coupon Income	148	677	1,354	4,315	9,599
Accrued Income	216	571	571	0	0
<b>Total Income</b>	<b>364</b>	<b>1248</b>	<b>1,925</b>	<b>4,315</b>	<b>9,599</b>
Realised gain (loss) on sale	-4	-	-	-	-
SG&A	-3,861	-1,405	-2,685	-3,147	-3,693
<b>Operating Profit (Loss)</b>	<b>-3,501</b>	<b>-157</b>	<b>-760</b>	<b>1,168</b>	<b>5,905</b>
Net Finance Income / Other	-	-	-	-	-
Profit (Loss) before tax	-3,501	-157	-760	1,168	5,905
Weighted Av. NOS (Dil)	80,228	86,581	88,000	122,066	188,733
EPS (US\$)	-0.04	0.00	-0.01	0.01	0.03
<b>Cash Flow Statement</b>					
Reported Operating Profit	-3,501	-157	-760	1,168	5,905
Fair Value & GOS adjustment	-360	-1248	-	-	-
Share-based payments	236	-	236	236	236
Change in WC	1301	-3225	1000	1000	1000
<b>Cash Flow from Operations (CFFO)</b>	<b>-2,324</b>	<b>-4,630</b>	<b>476</b>	<b>2,404</b>	<b>7,141</b>
Asset disposals	0	-	0	42,600	10,946
Asset acquisitions	-2,065	-2,453	-2,453	-67,600	-35,946
Others	0	-	-	-	-
<b>Cash Flow from Investing (CFFI)</b>	<b>-2,065</b>	<b>-2,453</b>	<b>-2,453</b>	<b>-25,000</b>	<b>-25,000</b>
Net Equity Issuance (redemption)	0	3,630	3,630	25,000	25,000
Interest Paid on Debt	-	-	-	-	-
Dividends Paid to ADAM Shareholders	0	0	0	-584	-2,953
Debt Issuance (redemption)	-	-	-	-	-
<b>Cash Flow from Financing (CFFF)</b>	<b>0</b>	<b>3630</b>	<b>3630</b>	<b>24416</b>	<b>22047</b>
Opening Cash (net debt)	13,217	8,828	8,828	10,481	12,301
Cashflow	-4,389	-3,453	1,653	1,820	4,189
<b>Closing Cash (Net debt)</b>	<b>8,828</b>	<b>5,375</b>	<b>10,481</b>	<b>12,301</b>	<b>16,489</b>
<b>Balance Sheet</b>					
Unquoted financial assets at fair value	55,519	58,119	58,119	83,119	108,119
Loans & receivables	28,902	33,258	28,122	27,905	29,958
Cash & equivalents	8,828	5,375	10,481	12,301	16,489
<b>Total Assets</b>	<b>93,249</b>	<b>96,752</b>	<b>96,752</b>	<b>123,325</b>	<b>154,566</b>
Total Liabilities	201	231	201	40	500
<b>Net Assets</b>	<b>93,048</b>	<b>96,521</b>	<b>96,521</b>	<b>122,925</b>	<b>154,066</b>
Share Capital	134,054	137,684	137,684	163,208	188,208
Share Based Payment Reserve	2,555	2,555	2,555	3,027	3,263
Revenue Reserves (losses)	-43,561	-43,718	-43,718	-43,310	-37,405
<b>Total Equity Reserves</b>	<b>93,048</b>	<b>96,521</b>	<b>96,521</b>	<b>122,925</b>	<b>154,066</b>
Basic NOS (Year end)	82,465	88,733	88,733	155,400	222,066
NAV/Share	1.13	1.09	1.09	0.79	0.69
<b>Notes to Financial forecasts:</b>					
(1) Under the BVI Business Companies Act 2004, so long as a company's assets are greater than its liabilities and the company will be able to pay its debts as they fall due, a dividend distribution can be made.					
(2) Under BVI Corporate laws and regulations, there is no concept of 'share premium' and all proceeds from the sale of no par value equity shares is deemed to be share capital of the company.					

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