Simplifying asset managers

Financials sector

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Martyn graduated in economics from Cambridge University in 1983 and began his career in commodity and financial futures broking. After four years he moved into equity fund management and enjoyed considerable success with funds at MGM Assurance, Lloyds Investment Managers, and finally Kleinwort Benson which became RCM under the ownership of Allianz of Germany. For 12 years before joining Edison he was focused on company research within the European financial sector with RCM as a senior analyst and director. He has been a non-executive director of Independent Minds Research.

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Edison investment research

Simplifying asset managers

Identifying winners in the asset management sector is fraught with difficulties given the multitude of factors that impact performance. It is not surprising then that the spread of sector valuations is reasonably tight, giving the impression that investors are unwilling, or indeed unable to look too far into the future. In this report we attempt to identify the key factors to look for as an indication of sustainable growth potential. We believe the managers most likely to succeed will be those that can generate consistent fund performance and develop new products to match investors' demands, and have the distribution capabilities to effectively sell these products and the operational efficiency to convert this revenue growth into profit growth.

Focusing on sustainable growth drivers

At a sector level, it is not just the share prices of asset managers that typically show a high degree of sensitivity to overall investment conditions; those same conditions directly affect assets under management, investor confidence and the ability to generate new fund inflows. At the company level, the factors that influence revenue performance and profitability are multifarious and, to a large extent, are equally difficult to predict. Instead of trying to forecast market performance, foretell investor trends or predict fund performance, we have focused on identifying the factors that support sustainable growth. We believe these are (1) investment performance, (2) distribution, (3) product portfolio and (4) operational efficiency.

Emerging markets exposure: Good while it lasts?

Investor appetite for emerging market debt and equity has been relatively strong compared with interest in struggling developed economies with burdensome government debt positions. This has helped support Aberdeen Asset Management's and Ashmore Group's sector-leading total share return over recent years. We review these managers in more detail and conclude that, while we remain confident of near-term growth from emerging markets exposure, at current levels this is largely factored into share prices.

Who will be the winners and the losers?

Since the financial crisis, performance across the asset management sector has been mixed, with those managers that have been able to grow assets under management and maintain and/or improve revenue and operating margins finishing on top. We favour Henderson Group, which, having largely completed its consolidation and rationalisation plans, is trading at a notable discount to its peers and generating a FY13e dividend yield of 6.7%. Though we like Aberdeen's and Schroders' emerging markets exposure, their broad distribution networks and product portfolios and favourable investment performance, we think this is already reflected in share prices. In regards to Man Group, we maintain our fair value of 67p as we believe Man Group's share price will come under increasing pressure unless it is able to rectify the performance in its underlying funds.

15 November 2012

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Companies in this report

Aberdeen Asset Management
Ashmore Group
Henderson Group
Jupiter Fund Management
Man Group
Schroders

Priced as at 13 November 2012

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Investment summary

In this report we attempt to identify the key factors to look for as an indication of sustainable growth potential. We do not believe that there is any reason to expect a sustained sector re-rating; nor do we believe that asset managers can achieve sustainable growth by cutting costs. It follows, therefore, that sustainable growth must be based on revenue performance, combined with sufficient cost discipline that balances the need to invest in the business (and its employees) with the goal of translating revenue growth into profit growth.

Four key drivers

We focus on the following four key factors as indications of sustained growth potential:

- **Investment performance –** This is the overriding objective of fund management and has a large influence on fund flows, management fees and highly profitable performance fees. Although past performance is not a prediction of future performance, it still influences investors' decisions.
- **Product portfolio –** While it is important to have a decent performance, it is just as vital to ensure this is in the products that investors want. Product diversification also generates more consistent revenue growth as it is difficult to foresee when investor demand will change. Asset mix also has a significant impact on revenue margins.
- **Distribution –** Product and performance alone are not enough to drive revenue growth without the distribution networks to sell them. Either through direct to market or third-party relationships, these strategies can be key to supporting a manager's long-term sustainable growth.
- **Operational efficiency –** The need to invest in the business and reward employees must allow for profit growth while at the same time being flexible enough to protect profits when revenues fall.

Recent performance: Emerging markets exposure delivers

Since the end of 2008 when the full extent of the financial crisis was becoming apparent in the aftermath of the Lehman collapse, Aberdeen Asset Management and Ashmore Group have been the strongest performers in terms of total shareholder return. Investor appetite for emerging market debt and equity has been relatively strong compared with interest in struggling developed economies with burdensome government debt positions. We look at whether this share price performance (1) is justified by sector performance over the period, (2) is evidence of sustained growth potential, and (3) is adequately recognised by share price valuations. In contrast to our original hypothesis that high emerging market exposure would equate to strong investment cases for Aberdeen and Ashmore, we now conclude that the market has already factored this in, but in doing so has overlooked some of the more traditional self-help stories like Henderson.

Top picks

We believe the managers most likely to succeed will be those that can generate consistent fund performance and develop new products to match investors' demands, and have the distribution capabilities to effectively sell these products and the operational efficiency to convert this revenue growth into profit growth. We favour Henderson, which, having largely completed its consolidation and rationalisation plans, is trading at a notable discount to its peers and generating an FY13e dividend yield of 6.7%. Aberdeen and Schroders are currently best positioned to capitalise on the growth in emerging markets due to their favourable product ranges, strong fund performance and diverse client bases, but current valuations are factoring in the growth continuing for longer than we have forecast. On the other hand, we maintain our negative view on Man Group as we believe its share price will come under increasing pressure unless it is able to rectify the performance in its underlying funds.

Historical growth in assets under management

Growth in assets under management (AUM) is a key driver of revenue growth, as managers get paid a percentage of AUM. Assuming revenue margins remain constant, higher AUM translates directly into higher revenues. A fund manager can generally manage more assets for the same costs, which generates operational leverage. Excluding acquisitions, UK-listed managers have been able to grow AUM by an average of c 13% since December 2009. The majority of this growth came in 2010, when AUM increased c 16%, but this has since reversed, declining c 4% in 2011 and is currently flat year-to-date. In 2011, negative investment performance was the primary driver of outflows, while it has been disappointing net new money (NNM) flows that have restrained asset growth year-to-date. The following table highlights the growth in AUM since December 2009 and includes all recent acquisitions.

Exhibit 1: Recent progression in AUM (£bn except otherwise stated)

												Annual y-o-y growth	
	Dec/09	Mar/10	Jun/10	Sep/10	Dec/10	Mar/11	Jun/11	Sep-11	Dec/11	Mar/12	Jun/12	Dec/10	Dec/11	Ytd
Aberdeen AM	144.1	170.9	164.8	178.7	173.9	181.2	185.8	169.9	173.9	184.7	182.7	20.7%	0.0%	5.1%
Ashmore ($bn)	31.6	33.0	35.3	41.6	46.7	50.3	65.8	58.9	60.4	65.9	63.7	47.8%	29.3%	5.5%
Henderson	58.1	60.3	56.4	59.2	61.6	60.5	74.4	65.4	64.3	66.7	63.6	6.0%	4.3%	(1.0%)
Jupiter	19.5	21.1	19.8	22.2	24.1	24.5	24.8	22.3	22.8	24.2	23.4	23.5%	(5.3%)	2.5%
Schroders	148.4	167.9	164.0	181.5	196.7	201.4	204.8	182.2	187.3	199.6	194.6	32.5%	(4.8%)	3.9%
Man ($bn)	42.4	39.4	38.5	40.5	68.6	69.1	71.0	64.5	58.4	52.7	60.6	61.8%	14.9%	3.8%

Source: Company data, Edison Investment Research

Since the financial crisis, McKinsey has found global AUM growth has come almost exclusively from investment performance (McKinsey: June 2011). The report showed total global AUM grew by c 23% over three years (31 December 2008 to 31 December 2011), but global net inflows contributed only c 0.6% to this growth.

We have analysed the six largest listed fund managers in the UK over the same time period and have found the difference has been less pronounced. Over the past three years, total AUM among our sample group has grown on average 39%, with 10% of this coming from NNM flows and 14% from absolute fund return. The remaining 15% was derived from acquisitions during that period, most notably Henderson, Man Group and Ashmore. The following table gives a breakdown of AUM growth and where it was derived.

Exhibit 2: FY12e AUM growth generation – three years to FY12e

	NNM flows	Absolute fund return	Acquisitions/other	Total AUM growth	Revenue growth
Aberdeen	1%	16%	9%	26%	101%
Ashmore Group*	98%	18%	40%	156%	64%
Henderson Group	(18%)	12%	20%	14%	53%
Jupiter	19%	12%	0%	31%	5%
Schroders	25%	14%	0%	39%	51%
Man Group	(27%)	10%	66%	49%	(50%)
Total	10%	14%	15%	39%	--

Source: Company data, Edison Investment Research. Note: * FY12 actual.

Ashmore has been able to grow its AUM the most over the last three years due to a combination of positive NNM flows and its acquisition of Emerging Markets Management LLC in 2011 ($10bn). Schroders' consistent fund inflows and stable investment performance helped it to grow AUM by 39%, while Jupiter benefited from large flows into its retail-oriented products. Surprisingly, Aberdeen had net inflows of only 1% during the period as large flows into its equity products were offset by large outflows from its fixed-income mandates. Man Group has experienced net outflows during 13 of the last 16 quarters, which has resulted in NNM outflows of 27%. Henderson has also had outflows over recent years, due to high investor churn post-acquisition and large outflows from its life assurance business Phoenix. The following table illustrates the volatility in NNM over recent quarters.

Exhibit 3: Quarterly net new money flows

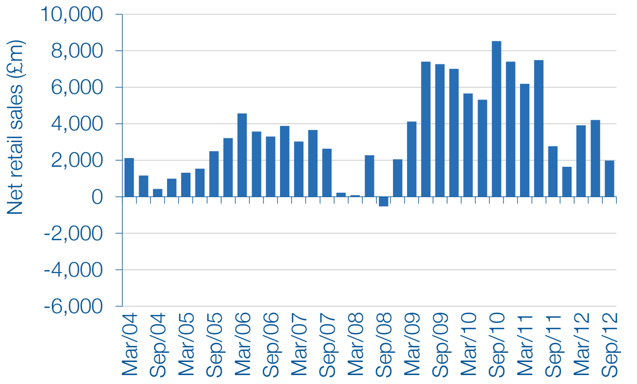
													Annual growth		
	Dec/09	Mar/10	Jun/10	Sep/10	Dec/10	Mar/11	Jun/11	Sep/11	Dec/11	Mar/12	Jun/12	Sep/12	Dec/10	Dec/11	Ytd
Aberdeen	(1.8%)	1.9%	0.2%	1.3%	(0.5%)	0.0%	0.4%	(0.9%)	(1.7%)	1.4%	0.2%	0.3%	2.9%	(2.1%)	1.9%
Ashmore	1.0%	2.5%	8.8%	9.6%	12.5%	4.9%	9.1%	0.3%	0.8%	2.0%	(0.9%)	0.9%	37.6%	15.8%	2.0%
Henderson	(0.9%)	(1.0%)	(1.2%)	(0.5%)	0.0%	(0.2%)	(4.6%)	(2.6%)	(2.4%)	(1.3%)	(1.8%)	(1.8%)	(2.7%)	(9.4%	(4.9%)
Jupiter	3.3%	2.6%	1.4%	3.7%	3.5%	1.4%	1.4%	1.2%	(1.0%)	(0.5%)	(0.8%)	2.5%	11.7%	3.0%	1.2%
Schroders	4.2%	6.5%	3.8%	3.3%	3.1%	1.6%	1.0%	0.0%	(1.0%)	0.9%	0.6%	1.3%	17.8%	1.5%	2.8%
Man	(2.5%)	(3.5%)	(2.5%)	(1.6%)	(2.5%)	0.9%	5.4%	(3.8%)	(3.9%)	(1.7%)	(2.4%)	(4.2%)	(9.7%)	(1.7%)	(8.1%)

Source: Company data, Edison Investment Research

Where have these asset flows come from?

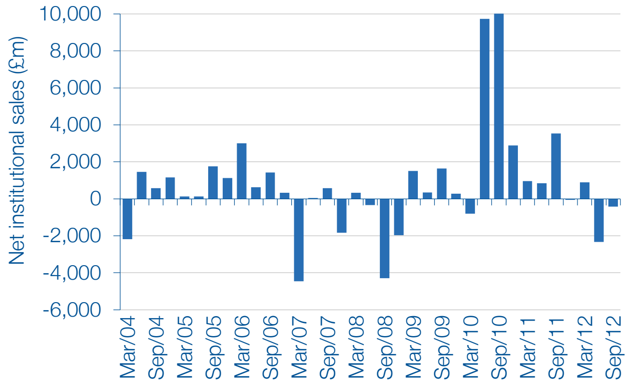
Over the past four years, global retail AUM has fallen while institutional AUM has remained flat (McKinsey, June 2011). The retail segment, still a major source of assets and profits globally, has shrunk c 2% annually since 2007. This has been led by developed markets, especially those within Western Europe where retail AUM fell more than 3% annually (annual NNM outflows c 2%). In contrast, the UK remains one of the only markets globally in which retail funds have increased. The following exhibits highlight the positive net inflows into UK retail funds and the marginal net flows into UK institutional mandates. Institutional sales have fallen sharply recently due to large monthly outflows from equity products.

Exhibit 4: Net quarterly UK retail fund flows



Source: Investment Management Association

Exhibit 5: Net quarterly UK institutional fund flows



Source: Investment Management Association

Focusing on the sustainable growth drivers

In this section we expand on what we believe are the key requirements for a fund manager to generate superior returns. To do this we review managers' underlying fund performance, analyse fund flows and the potential drivers of future trends and examine the breadth and depth of their product line up. This is followed by a section that looks at the managers' revenue margins and operating margins to identify those with the most efficient corporate structures and determine how sustainable these competitive advantages are. Then to conclude we assess the valuation metrics for each manager, both relative to historical values and peers. In addition, we focus on emerging markets (EM) and analyse to what extent they have helped drive performances over recent years. We investigate this further in the second section and the sustainability of these trends.

Investment performance: Success breeds success

Investment performance is the overriding objective of fund management and has a large influence on fund flows, management fees and highly profitable performance fees. Although past performance forms little relationship with future performance, it still has a large influence on investors' investment decisions. Due to different calculation methods and reporting standards it is difficult to compare the relative outperformance of the managers' underlying funds. Below we have summarised each manager's most recent fund performance.

Very good performance

Aberdeen Asset Management – Performance, both short- and long-term, has been excellent in Aberdeen's key global and emerging market products, which has helped drive high AUM growth over recent years. As at 31 August 2012, we estimate 88% of equity and 69% of fixed-income products have outperformed their stated objectives over the last three years. However, in 2008 Aberdeen's fixed-income funds endured a difficult year due to their exposure to troubled US asset- and mortgage-backed securities. After partially recovering, performance has since been disappointing due to its view that government bonds are overpriced, which has weighed on performance ever since early 2011.

Jupiter – One of Jupiter's key strengths has been its ability to consistently generate investment outperformance. Over the key three-year period, at the end of June 2012, 60% of its mutual funds (weighted by AUM) are in the first quartile of performance among peers, while a further 16% are in the second quartile (66% first and second quartile in 2010). Looking over a one-year period that has been fraught with high market instability, 84% of its mutual funds delivered first- and second-quartile investment performance (2010: 55%). Although there is no set in-house investment process, the funds have tended to be more defensively positioned, which has been beneficial recently.

Good performance

Henderson – Henderson's fund performance has been strong this year. As at 30 June 2012, 61% and 66% of its funds weighted by assets outperformed their benchmarks over one and three years respectively. Performance over three years has been very strong in its fixed-income funds (98% outperforming), while its equity funds (66%) have also fared relatively well. However, in an uncertain environment its property funds (outperforming: 48% one year, 23% three years) have lagged their stated objectives.

Schroders – Schroders' fund performance remains strong, with 63% and 68% of funds outperforming their benchmark or peer group over the last one and three years to September 2012. However, in some important areas where market fund flows have been strong, performance has not been as good.

In particular, its corporate bond funds (c €10bn in FUM) have underperformed over the important one-, three- and five-year periods. According to the Investment Management Association (IMA), corporate bonds have been among the bestselling retail funds over recent years.

Ashmore Group – Although performance at the end of June 2012 was disappointing, with 77% of FUM underperforming over the last 12 months, it appears performance has since recovered somewhat. One of the main drivers of this has been its approach of increasing its portfolio's risk exposure as it positions funds for a longer-term market recovery. This is supported by its long-term fund performance where 86% of FUM have outperformed over the last three years. In particular, its largely dollar-denominated external, corporate and blended debt mandates have performed strongly and continue to appear attractive relative to developed world debt

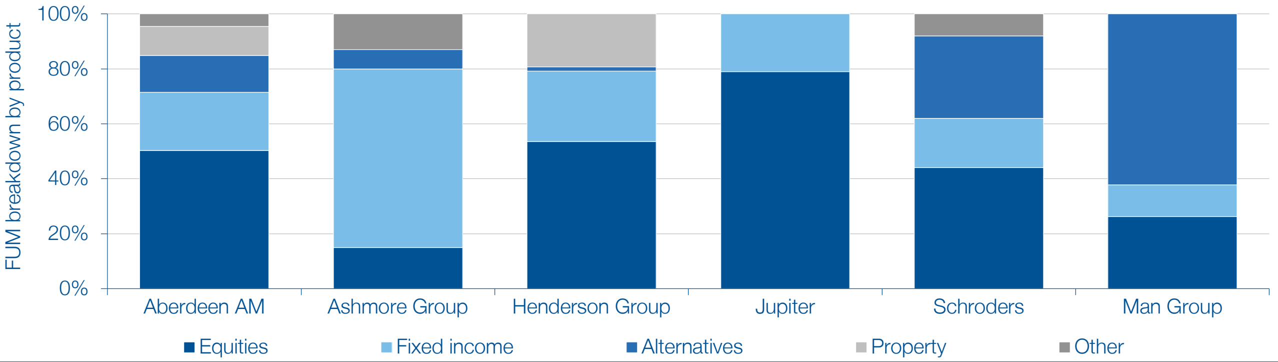
Disappointing performance

Man Group – AHL's performance peaked in 1999, when it generated an average net return of 30% per year from 1997-99, but has steadily fallen since to an average 3% per year as at September 2012. Recent performance has continued to disappoint (-7.3% one-year to 28 September 2012 vs MSCI World: 16.3%) as it has underperformed peers (Winton: -3.4%, Aspect: -6.9%, BlueTrend: 1.3%) and global markets (MSCI World: 16.3%). As a trend-following strategy, AHL is expected to perform best when markets exhibit a clear trend in either direction. However it has struggled during recent periods of high market volatility, as its fast trading systems have meant AHL is whipsawed at each turn of the market and is unable to identify any clear trends. As at 30 September 2012, AHL was on average 14% below its peak on a weighted-average basis, while c 20% of GLG's performance fee eligible AUM was more than 5% below its high water mark. In addition, the recently acquired FRM business is also on average c 10% below its high water mark.

Product portfolio: Investors' needs are always changing

In an increasingly volatile market companies will need to be agile in terms of both product and client focus. Changes in investment trends, the impact of new regulation and the macroeconomic cycle all have an influence on how funds perform and where funds flow. Over recent years, institutions have shifted away from equities and into bonds, and from regional products into global mandates. The latter can be seen by the large inflows out of regional products and high inflows into global and emerging markets. In retail, corporate bond funds and multi-asset products have been the bestselling over the last eight years. Exhibit 6 breaks down managers' AUM by asset class.

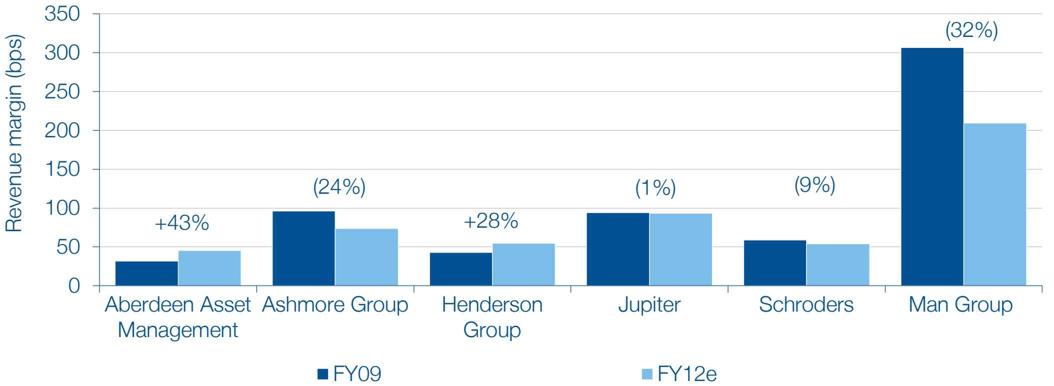
Exhibit 6: AUM breakdown by asset class



Source: Company data, Edison Investment Research. Note: Aberdeen as at 31 March 2012, Ashmore as at 31 December 2011, all others as at 30 June 2012.

Aberdeen, Henderson, Jupiter and to a lesser extent Schroders have the majority of assets invested in equity products. This means they are relatively more exposed to the performance of equity markets. In contrast, the majority of Ashmore's AUM is in fixed income, primarily emerging market debt, while Man Group is heavily exposed to alternatives. Having a concentrated asset base can be highly advantageous when that sector is in demand, but given the frequency with which trends reverse, fads change and models cease outperforming, a more diversified strategy enables growth when markets move in the wrong direction.

Exhibit 7: Revenue margin progression (% change)



Source: Company data, Edison Investment Research

A manager's asset mix also has a considerable influence on its revenue margins due to the variations in fees charged to manage different products. Man Group and Ashmore have the highest revenue margins due to their focus on higher-margin products, while Jupiter has been able to maintain high margins due to its focus on retail clients, which generally pay higher fees. However, Man Group has seen its revenue margins fall 32% over the past three years due to large outflows from its highest-margin products. Ashmore's has also fallen due to large flows into its lower-margin currency and overlay products, which, although supported by NNM inflows of 98%, only increased revenues by 64%. In contrast, Aberdeen has been able to improve its revenue margins by 43% as it has received significant flows into its emerging market and global equity products, which are higher margin.

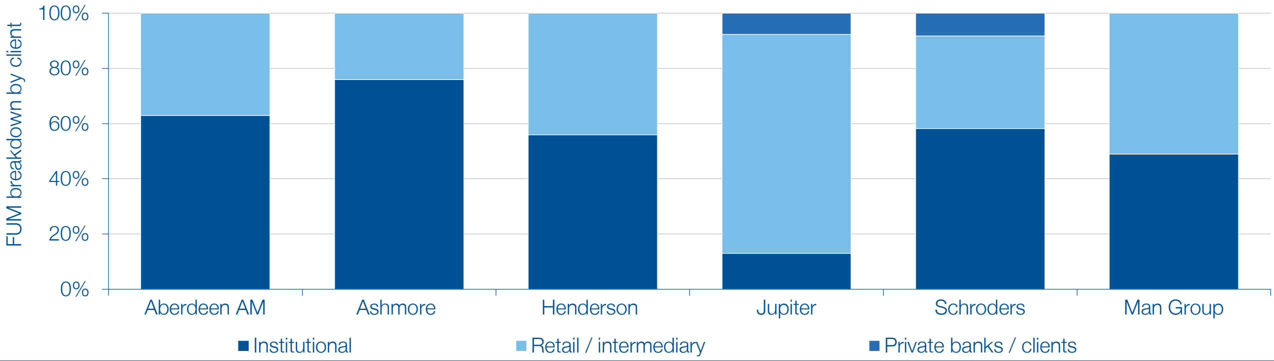
Distribution: Increasing sales accelerates organic growth

Alongside good fund performance and the right products, a well assembled distribution network is required to attract new money. Whether a manager's strategy is focused on distributing its products to one market, such as Henderson on Europe, to one client type, such as Jupiter on retail investors, or a more global approach, such as Schroders, it is important that it has been properly matched with the manager's strengths and products. Without this, there is the risk of targeting the wrong markets and/or clients, limiting NNM inflows, or overspending, limiting profitability. It is very hard to quantify or validate each manager's distribution capabilities, so instead we have focused on where asset flows may originate from.

Over recent years, acquisition-led growth has been a key source of AUM growth for many managers due to the length of time it takes to build AUM organically. But given the inconsistency of these flows, we have focused on analysing organic asset flows. In many countries, institutional flows remain the primary driver of net new money; however, the UK stands out as one of only a few countries showing any meaningful retail inflows.

Exhibit 8 gives a breakdown of each manager's AUM by client type. From this it is clear that the majority of managers have a fairly even split between retail and institutional clients. Jupiter is a clear outlier, with its c 80% retail client base. Focusing on the UK retail market has been particularly beneficial for Jupiter as the UK has experienced positive inflows over recent years. Henderson also has a large retail base following its recent acquisition of Gartmore, although it did not benefit from these market inflows as much as Jupiter due to high investor churn post-acquisition. The other outlier is Ashmore, which has a c 75% institutional client base. Ashmore has been actively targeting sovereign wealth funds and central banks in emerging markets as it believes they will be a key source of AUM growth in future years. Schroders has one of the broadest distribution networks out of all of the companies in this report, which puts them in a very strong position to maintain growth in existing markets and capitalise on the growing wealth in emerging markets, while mitigating a slowdown in NNM flows from any one market.

Exhibit 8: AUM breakdown by client type



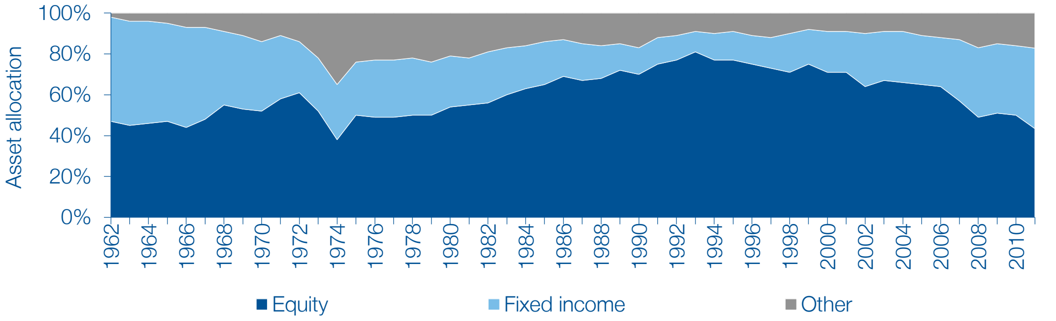
Source: Company data, Edison Investment Research. Note: Aberdeen as at 31 September 2011, Ashmore as at 31 December 2011, all others as at 30 June 2012.

Which clients to sell to: Institutions vs retail

A manager's focus on a particular client type can be an important driver of NNM flows due to the ever-changing needs of investors. From the launching of new products through to implementing new advertising campaigns and hiring new sales teams, asset managers are in a constant struggle to ensure they are best placed to capitalise on what may be in demand in the future. But due to the influence of a wide range of factors, from global macroeconomic events down to individual investor needs, these trends are exceedingly difficult to foresee.

In the UK, institutional funds remain the cornerstone of many asset managers' portfolios. The Investment Management Association (IMA) found in its recent survey that c 80% of assets managed in the UK are institutional based (£2.6tn at December 2011) (c 18% retail and c 1% private clients), with the majority from pension funds and insurance companies. Over the last two decades these institutions have shifted away from equities and into bonds. As can be seen in Exhibit 9, UK pension funds have materially cut their holdings in equities from a peak in 1994 of 77% to their current level of 50%. This transition away from equities and into bonds has been driven, among other things, by the introduction of new regulation, falling interest rates, increased risk aversion and a desire to better match the liabilities of pension funds with their assets.

Exhibit 9: Asset allocation by UK pension funds since 1962



Source: National Statistics (until 1995), WM (1996 onwards), reported in UBS Pension Fund Indicators 2012

It is also very difficult to reach conclusions as to what determines retail investors' savings behaviour. But given the higher margins that they generally pay to invest their funds, they are potentially an attractive source of new money flows for managers. IMA data suggests that mixed-asset funds were the best-selling products in 2011, reflecting their increasing popularity over recent years, while global equity funds made up the largest proportion of total equity AUM. This is only the second time this has occurred since 1992 and reflects the preference by investors for global mandates over regional mandates. Meanwhile flows into fixed-income funds have focused on corporate bond funds as investors continue to search for yield.

As there are a diverse range of retail investors with different reasons for savings, it would be imprudent for us to try and forecast where flows will be directed in the future. This has been compounded by the internet, which has significantly increased the availability of information, and online brokers, which have made it easier to buy and sell funds and invest in other asset classes. This enables investors to be far more proactive with their investments and ultimately increase the speed at which they can transfer between various asset classes. Fund managers have experienced an increase in investor churn over recent years. In 1997, the average implied holding period of retail investors was 8.0 years, but by 2011 this had fallen to 4.2 years.

New regulation: The importance of a broad and flexible distribution network

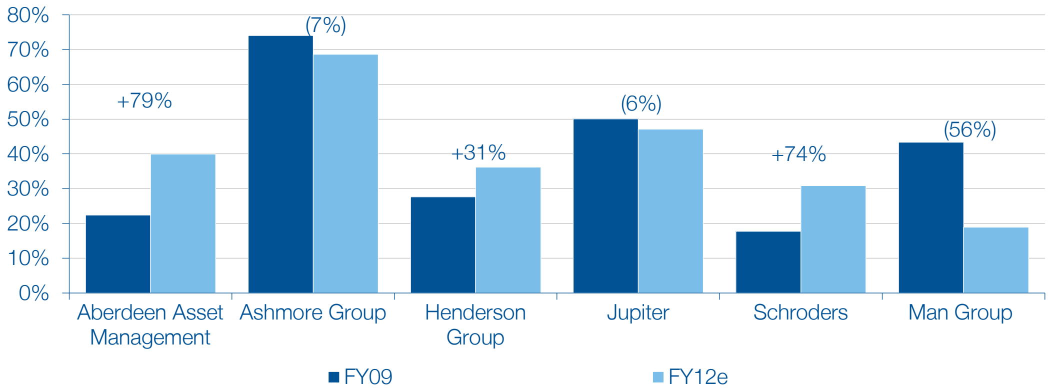
In 2013 the UK government is set to introduce legislation that will require automatic enrolment of employees by employers in a pension. The statutory minimum contribution will be 8% of gross qualifying earnings for those eligible workers. As can be seen in other markets that already have this, such as Australia, the US and New Zealand, etc, the growth in the pension market can be quite significant. For the asset management industry, this will provide both opportunities and challenges that will need to be navigated to capitalise on this growth. The majority of asset managers will remain providers to a variety of schemes and platforms, while a small group is planning to offer more tailored investment-only services (eg target date funds). This should help support new fund inflows for most of the managers within this report, but as they are likely to be lower-margin products, they will have a much smaller impact on profitability.

The UK's Retail Distribution Review (RDR) is due to be implemented on 1 January 2013. Its stated objectives are to improve the clarity with which firms describe their services to consumers; address the potential for advisor remuneration to distort consumer outcomes; and increase the professional standards of investment advisors. For fund managers, this will prohibit their ability to rebate a proportion of the annual management charge to advisors as trail commission and, as such, IFAs will have to agree their fees upfront on every transaction with their customers. This may potentially be extended to exclude trail commission being paid to platforms. Despite the imminent effective date, a number of rules are still to be finalised. This will undoubtedly affect the way in which many managers market their products to advisors and the wider retail market. Jupiter, and to a lesser extent Henderson, will be the most exposed to these changes due to their large UK retail client bases; but how much this will affect fund flows is unknown. Nevertheless, those managers that are going to strive post-RDR are going to be those with the best fund performance, strong brands, clear and competitive price structures and well-constructed distribution networks.

Operational efficiency: Driving profitability

Although revenue growth is important, if the company is paying too much for this then its profit growth will be adversely affected or muted. To measure this we analyse the managers' adjusted operating margin (EBIT adjusted for exceptionals and non-recurring items/total revenue), which reflects the managers' ability to maintain tight cost controls while continuing to grow. A manager's ability to quickly reduce costs during periods of slow or even falling revenue growth is especially important to mitigate the effect on earnings growth. Those managers with a high proportion of variable compensation costs will be best placed to achieve this, as compensation is generally the largest expense for asset managers.

Exhibit 10: Operating margin analysis (% change)



Source: Company data, Edison Investment Research

Ashmore has the highest operating margins due to its focus on higher-margin products and tight cost controls. However, these have come under pressure as the group funds its international expansion plans and increases its distribution capabilities. By focusing on the UK retail market, Jupiter has one of the highest operational margins in its peer group. But as distributors take an increasing share of fees and the effects of RDR materialise, we expect this to come under pressure and fall 1-2% over coming years. Aberdeen has benefited from being able to charge higher fees for some of its products as they reach capacity. This, coupled with tight cost controls, has enabled Aberdeen to significantly improve its operating margin. Schroders has also maintained good cost controls, while growing and investing in the business, with operating margins improving from 16% in FY08 to 35% in FY11. But we forecast this to fall to 31% in FY12e due to lower performance fees and an increase in operating expenses. The latter is largely due to a major upgrade of its IT systems and taking advantage of the dislocation in markets to make strategic hires. While these investments lower margins in the near term, management is confident they will position the firm well for the long term. Henderson's operating margins have also steadily improved, from 28% to 36% in FY12e, as a result of integrating the New Star and Gartmore businesses at a higher margin along with continued cost control. In contrast, Man Group's operating margin has fallen the most due to a significant reduction in its performance fees earned and its above-normal operating costs. Man Group is attempting to counter this downtrend by cutting $195m from operating expenses over the next 18 months, but cost-cutting alone will not be sufficient to generate sustained earnings growth.

Valuation: Paying for growth

Historical performance volatile

Leading up to the financial crisis, most managers that were listed during that period outperformed the market due to positive asset growth, rising investor confidence and strong market returns. This then reversed during the financial crisis as a combination of falling AUM, rising risk aversion and weak fund performance led to a reduction in top line revenues. Since then, those managers that have recorded good fund performance in the products investors want, have had the distribution capabilities to sell these products, and have maintained or improved operating margins have recorded the highest total returns.

Exhibit 11: Three-year historical performance summary

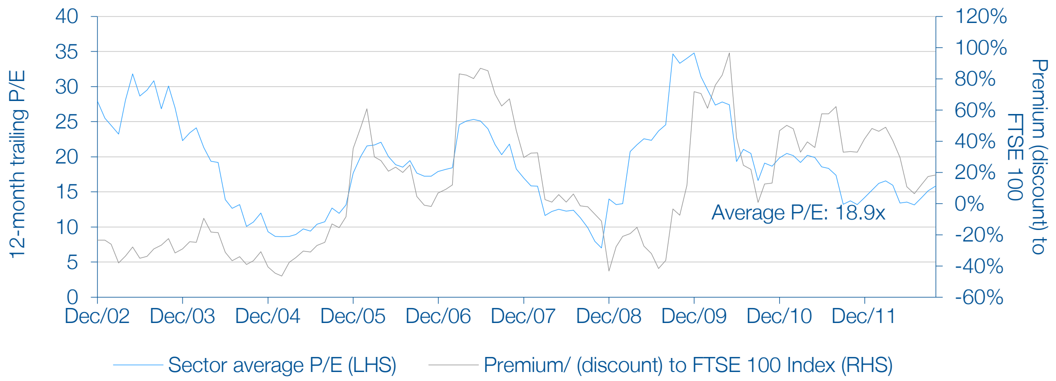
	FY12e 3yr AUM growth	FY12e 3yr total revenue growth	FY12e 3yr op. exp. growth	FY12e 3yr adj. EBIT growth	FY12e 3yr adj. EPS growth	3yr total share return (31/10/12)
Aberdeen	26%	101%	57%	259%	426%	178%
Ashmore Group*	156%	64%	91%	52%	67%	51%
Henderson Group	14%	53%	35%	100%	61%	6%
Jupiter**	31%	5%	11%	25%	38%	44%
Schroders	39%	51%	30%	164%	159%	49%
Man Group	49%	(50%)	(29%)	(78%)	(84%)	(65%)

Source: Edison Investment Research, Bloomberg. Note: * FY12 actual; ** Two-year revenue and earnings growth, TR from 30 July 2010.

Over the past three years to FY12e, Aberdeen has grown its total AUM by 26%, improved its operating margin from 22% to 40% and increased its adjusted EBIT by 259%. Ashmore benefited from a 156% increase in AUM, but due to a reduction in its revenue and operating margins, its adjusted EBIT gained only 52%. The decline in Ashmore's margin was largely due to its changing asset mix and new segregated mandate subscriptions at lower margins. Schroders also rallied as it benefited from its consistent NNM inflows and improving margins. Although Henderson increased adjusted EBIT by 100%, its total return share price increased only 6% during the period as concerns were raised about its net new money outflows. But now that its consolidation and rationalisation programmes are largely complete, we believe Henderson's share price should re-rate to reflect its good earnings growth and improving revenue and operating margins. Man Group's total share return was negative during the period due to the underperformance of its flagship fund, which led to large outflows and affected profitability. Man's 'black-box' hedge fund AHL, which generated over two-thirds of Man's management fee income in 2011, has underperformed both its peers and equity markets since the 2008 financial crisis, thus creating notable headwinds for its sales teams and limiting highly profitable performance fees. As a result, Man has lagged its peers and underperformed the market since the financial crisis.

The following chart illustrates the average 12-month trailing P/E ratio for the managers in this report weighted by market cap, and plots it relative to the FTSE 100 Index. Over the last five years, these managers have traded at an average 14% P/E ratio premium to the FTSE 100, while over the last three years this has grown to a 37% premium. Over the past year this premium has fallen to 17% and is also c 20% below its long-term historical level of 18.9x.

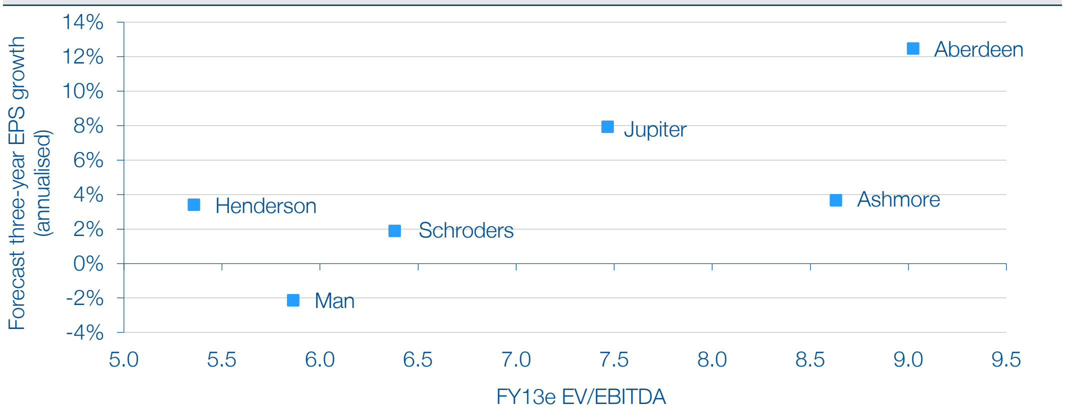
Exhibit 12: Sector average P/E ratio relative to FTSE All-Share Index



Source: Bloomberg. Note: Sector average is calculated using the Bloomberg consensus average 12-month trailing P/E ratio for the managers in this report weighted by market cap. As at 31 October 2012.

The following graph plots our forecast annual EPS growth for each manager for the next three years relative to its FY13e EV/EBITDA ratio. From this, we can see Aberdeen and Ashmore have two of the highest forecast growth rates, which we ascribe to their emerging markets exposure. In the following section we explore the relationship between emerging markets and the premium rating attributed to Aberdeen and Ashmore.

Exhibit 13: Paying for growth



Source: Bloomberg, Edison Investment Research

Emerging markets exposure: Good while it lasts?

As we have shown in the previous section, over the last three years (to 31 August 2012) the three stocks that have been the best-performing have been Aberdeen, Ashmore and Schroders. Whereas Schroders trades in line with peers, reflecting its slowing growth forecasts, Aberdeen and Ashmore trade at a premium to peers. In this section, we are going to analyse Aberdeen and Ashmore in more detail in the context of our road map for the sector in an effort to ascertain whether the premium valuations these stocks have reached are justified by underlying business performance and whether this performance itself is sustainable. As a reminder, our four key drivers of the sector are (1) investment performance, (2) distribution, (3) product portfolio and (4) operational efficiency.

Investment performance: Not a guarantee of future performance

Investment performance is the overriding objective of an asset manager due to its influence on fund flows and management fee income (AUM times revenue margins). In this context we believe it is important to look at whether emerging markets have lived up to expectations of higher returns relative to developed markets and also whether Aberdeen and Ashmore have been able to deliver attractive relative performance on these funds.

The rationale for higher growth in emerging market economies relative to their more developed peers is strong. Emerging countries make up 82% of the world's population (UN, June 2012) and 36% of the world's economic output (IMF, December 2011). According to the IMF's April 2012 estimates, emerging markets are expected to grow two to three times faster than developed markets. This accelerated growth is being driven by their relatively young working-age populations, low labour costs, low government/personal debt and in a lot of cases an abundance of natural resources. At the same time, developed nations' populations are ageing, production costs are rising and ballooning debt levels have stifled growth. While the current slowdown in global growth has reduced overall growth levels, it is still expected that emerging markets will be one of the key drivers of global economic growth. Recent figures from the IMF indicate emerging market GDP growth will slow to 5.6% in 2012 (2013: 5.9%, from 6.2% last year). This remains well above the estimated 2012 growth of 1.4% (2013: 1.9%) in developed counties, but is notably below the pre-crisis levels of 8%.

Despite visibly higher growth in emerging market economies, many studies have found there is very little relation between economic growth and share market performance. This is reflected by the underperformance of emerging market equities relative to developed markets over recent years. Emerging market equities have also been the most volatile, with an annualised standard deviation of 25% and 22% over five and 20 years respectively, which is notably above both global equities (17% and 15%) and the FTSE All-Share (18% and 15%). The following exhibit illustrates how global markets have outperformed emerging markets over the last three years.

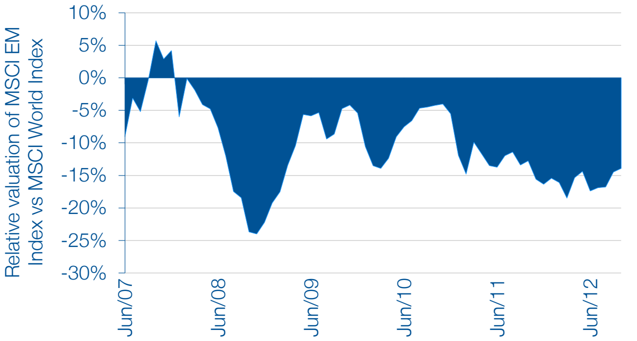
Exhibit 14: Annualised historical performance

£	3 months	Year to date	1 year	3 years	5 years	10 years
Equity:						
MSCI Emerging Markets Index	2.0%	7.0%	2.6%	6.0%	1.6%	15.1%
MSCI World Index	1.6%	7.9%	9.4%	8.6%	2.2%	6.3%
FTSE All-Share Index	4.4%	9.3%	9.8%	9.1%	1.0%	7.7%
Fixed income:						
Emerging Market Debt Index*	0.5%	11.2%	16.3%	13.2%	15.7%	11.8%
Global Bond Index**	(1.1%)	0.3%	3.4%	5.3%	11.6%	6.4%

Source: Bloomberg. Note: Data as at 31 October 2012. Performance longer than one year is annualised. *JPM EMBI Global TR Index. **JPM Global Aggregate Bond Index.

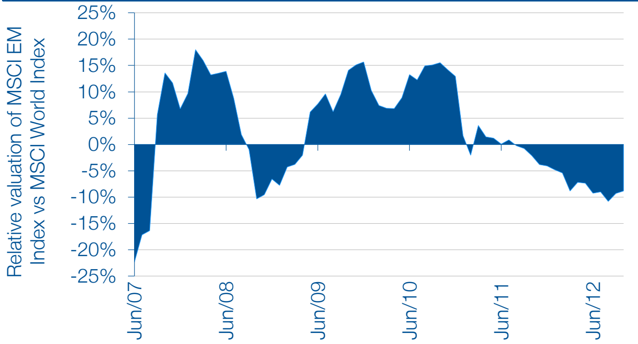
The MSCI EM Index is now trading at sizeable discount to the MSCI World Index. Exhibit 15 shows the price to 12-month forward earnings of emerging markets relative to the MSCI World Index since 2007, while Exhibit 16 shows price to 12-month forward book value per share. On both measures, the discounts are now at one of the widest levels since the financial crisis in 2008. With economic growth forecasts now notably lower and valuations at sizeable discounts to their more developed peers, emerging market equities could provide a more compelling investment opportunity. Given its strong investment performance and well-known brand, we believe Aberdeen will benefit most if emerging market equities outperform and/or fund flows remain positive into the sector over the medium term. Schroders should also benefit from this due to its broad distribution network and reputable brand.

Exhibit 15: Price to 12-month forward earnings



Source: Bloomberg. Note: As at 31 October 2012.

Exhibit 16: Price to 12-month forward book value per share

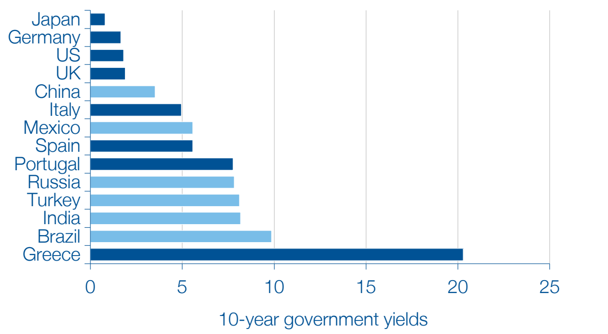


Source: Bloomberg. Note: As at 31 October 2012.

In contrast, emerging market bonds have generated higher total returns than global bonds. This has been supported by stronger economic data, largely due to fiscal and monetary reforms, and favourable secular and demographic trends. In addition, their credit markets have weathered the financial crisis and recent volatility far better than their more developed peers. Since the height of the credit crunch in 2008, emerging market sovereigns have received a total of 171 upgrades, which is in stark contrast to that of developed sovereigns, which only received one (JPM: January 2012).

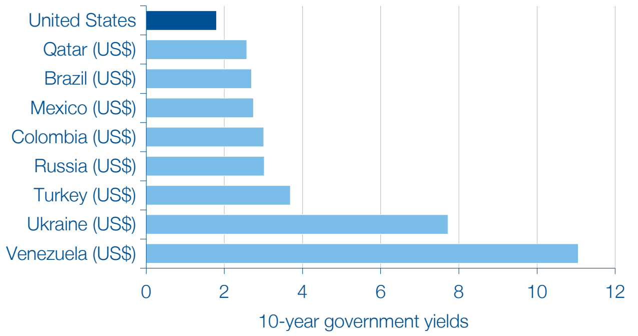
Over recent years, emerging market debt has also benefited from the adoption of low interest rate policies in developed markets. Emerging economies have generally weathered the credit crisis far more successfully as their more developed peers have struggled under the weight of rising debt levels. This has incentivised investors to scour the globe for yield and has lured them to the higher yields generated by emerging economies. The following exhibits show the relatively higher yields that can still be earned in emerging markets, although these have shortened noticeably over recent years due to the strong performance of emerging market debt. This means the potential upside for emerging market debt is not as great as it once was due to these lower yields.

Exhibit 17: 10-year sovereign yields (local currency)



Source: Bloomberg. Data as at 13 September 2012.

Exhibit 18: 10-year sovereign yields (US$)



Source: Bloomberg. Data as at 13 September 2012.

Although Ashmore's fund performance at the end of June 2012 was disappointing, with 77% of FUM underperforming their stated objectives over the last 12 months, it appears performance has since recovered somewhat. One of the main drivers of this has been its approach of increasing its portfolio's risk exposure as it positions funds for a longer-term market recovery. This is supported by its long-term fund performance where 86% of FUM have outperformed over the last three years. Despite this, the recent volatility in performance, high investor risk aversion and the strong rally of fixed income and lower yields may restrict NNM inflows. Furthermore, Ashmore is more exposed than most should institutional funds start reallocating away from fixed income and back to equities to the long-term average. However, the visibility of these trends is notoriously low as so many extraneous factors affect the operating environment in these markets.

Product portfolio: Capacity constrains can limit growth

In the previous sections we have reviewed the investment performance of Aberdeen and Ashmore. Although these managers have strong long-term fund performances, it is just as important that they have the right products that investors want. Over recent years, both Aberdeen and Ashmore have benefited from the large flows into emerging markets as investors have favoured the asset class. This in turn has led to capacity constraints for Aberdeen as its strong investment performance and well-known brand have led to sizeable inflows.

Capacity constraints in emerging market equities

Liquidity is generally always an issue for large managers, but it is more pronounced in emerging markets. Less developed economies generally consist of smaller companies with lower free floats (large private ownership) and often have investing restrictions imposed by local governments limiting foreign ownership. As a result, the investable universe of emerging markets is fundamentally smaller than their more developed peers. Based on market cap data from FTSE and adjusted for free-float (31 July 2012), the investable universe of emerging market equities (US$3.2tn) is c 90% smaller than developed markets (US$25.5tn). There are also far fewer listed emerging companies (793) than developed (2,078).

According to data compiled by EPFR Global, emerging market equities experienced inflows of $95.6bn in 2010, but outflows of $47.4bn in 2011 as investors shifted into bonds and more defensive equity sectors. Despite this volatility in global fund flows, those managers with well respected names and good track records have had to limit flows into some of their funds to avoid materially affecting investment performance. Seven funds operating in the sector have been forced to soft-close as huge inflows have led to issues of liquidity. Aberdeen is the latest group to restrict access to its top-performing Emerging Markets and offshore Global Emerging Markets Equity funds and in January First State closed its Greater China Growth, Latin America, Indian Subcontinent, Asia Pacific Sustainability and Global Emerging Markets Sustainability funds to new money. Aberdeen has been closed to new segregated Asia mandates for over seven years and to new emerging market mandates for two years.

Capacity is highly dependent on the manager's investment strategy and its flexibility in enforcing it. To try and mitigate this Aberdeen has been limiting flows into its most capacity-constrained funds by charging higher-margin retail fees and by actively selling its smaller emerging market regional products that have not reached capacity. These initiatives have helped Aberdeen increase its revenue margins and improve profitability, but these large fund flows may still affect investment performance.

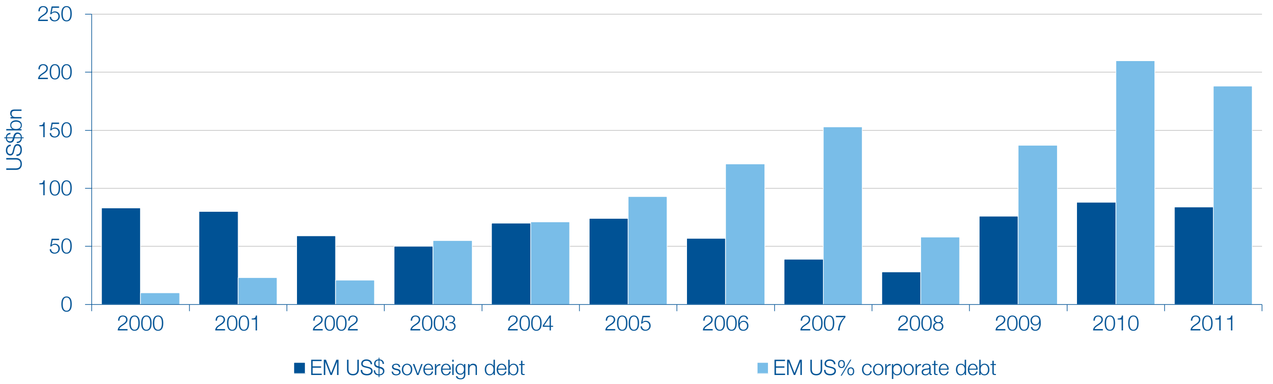
EMD growth largely unaffected by capacity constraints

Capacity in emerging debt markets has been less of an issue due to the accelerated growth of debt issuance over recent years. This has contributed to the development of more liquid, deeper and longer-maturing debt markets, which have led to an increase in participation by investors in emerging market debt.

Historically, emerging market debt issuance has been dominated by sovereign issuers, while corporates tended to borrow from banks. Since 2005, however, corporate issuance has grown notably and now accounts for more than twice the level of sovereign debt issuance. The following chart (Exhibit 19) illustrates the growth in emerging market debt as an asset class and, in particular, the accelerated growth of corporate debt issuance over recent years. According to research conducted by

Lazard, it now accounts for c 20% of global bond market capitalisation in 2012. This growth has meant Ashmore has not had to limit fund flows into its most popular products.

Exhibit 19: Recent EMD issuance growth driven by corporate



Source: Ashmore Group

Based on JPM's estimates, total emerging market sovereign debt has more than tripled to $7.3tn since 2000. In addition to issuing more debt, emerging markets are now issuing more alternative kinds of debt. EM sovereigns continue to issue dollar-denominated bonds, however increased demand from home-grown pension and retirement funds over the course of the decade has driven a fourfold increase in local currency debt to $5.9tn. As highlighted in Exhibit 19, US dollar-denominated corporate debt is now one of the fastest growing sectors. Including debt from partially state-owned enterprises, JPM found the total market size of US dollar EM corporate debt to be of comparable size to that of the US high-yield market (c $1tn). These factors have helped emerging market debt transition from being a short-term tactical investment for sophisticated investors into a strategic asset class. The question now remains whether this accelerated growth continues or whether we enter a period of consolidation as investors come to grips with these larger allocations to the sector.

Distribution: Growing emerging market client base

Over the last four years, annual AUM growth in emerging markets (+6.4%) has considerably outpaced that of developed markets (-0.5%) (McKinsey: June 2011). While this divergence may narrow over time, we believe it will be a valuable source of AUM growth for those managers with distribution networks in these markets. Aberdeen, Ashmore and Schroders have actively targeted these markets to supplement AUM growth and diversify their client bases. To achieve this, they have been establishing local asset management subsidiaries and forming strategic relationships with domestic operators in these markets, while at the same time looking for further acquisitions that will extend geographic and asset class breadth. The following exhibit gives a breakdown of the managers' client geographic split. We believe it will be those managers with established distribution networks in emerging markets (ie Ashmore, Aberdeen and Schroders) that will be best positioned to capitalise on this growth.

Exhibit 20: Client geographic split

	Aberdeen	Ashmore	Henderson	Jupiter	Schroders	Man Group
UK	29%	12%	69%	91%	37%	19%
Europe	32%	21%	16%	6%	19%	38%
ME/Africa	9%	18%		2%	3%	10%
Americas	18%	20%	9%		14%	10%
Asia-Pacific	12%	29%	6%		27%	23%
Other				1%		

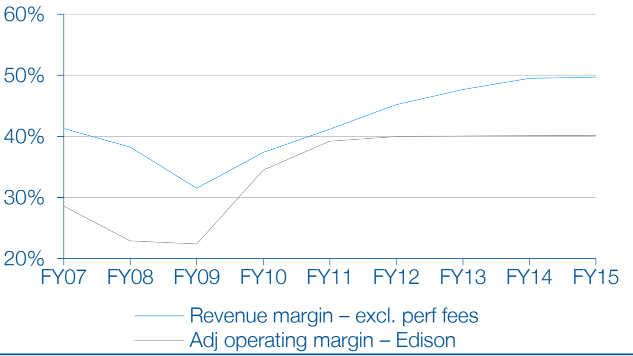
Source: Company data, Edison Investment Research

Operational efficiency: Revenue growth vs profit growth

The following exhibits illustrate both Aberdeen's and Ashmore's margin progression. While Ashmore's revenue margins are higher, they have come under increasing pressure due to large inflows into its lower-margin products and new segregated mandates being won at lower margins. Ashmore still commands the highest operating margins of all the companies in this report, reflecting its high operating efficiency and its preference to keep remuneration flexible by paying a large proportion of total compensation by way of flexible bonuses.

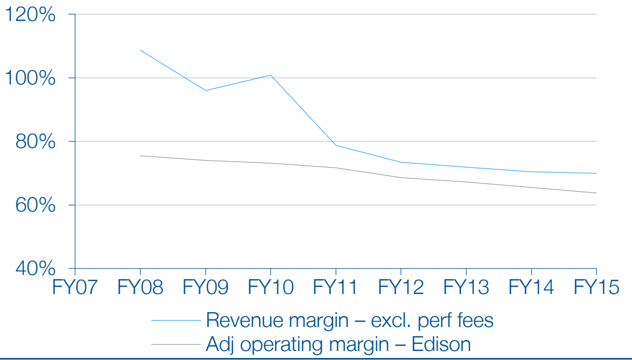
Aberdeen on the other hand has been able to improve both its revenue and operating margins over recent years due to large outflows from its more generic lower-margin bond funds and smaller inflows into its higher-margin more specialised fixed-income products such as emerging market debt and Asian debt. Aberdeen also remains closed to new segregated accounts, which have lower margins, and instead is receiving large flows into its higher-margin pooled funds.

Exhibit 21: Margin progression – Aberdeen



Source: Company data, Edison Investment Research

Exhibit 22: Margin progression – Ashmore



Source: Company data, Edison Investment Research

Valuation: Superior growth not reflected in small premium

Although emerging market equities have underperformed over recent years, they are now trading at a notable historical discount to their more developed peers, which should generate interest if investor sentiment improves. We believe Aberdeen is in the best place to capitalise on this due to its favourable product portfolio and strong fund performance and, therefore, should continue to trade at a justifiable premium to its peers.

In contrast, the strong performance of debt over the past decade, particularly emerging market debt and the much lower yields means the outlook for emerging market debt is less clear. The performance of this sector will also be heavily influenced by the asset allocation decisions of institutions, which have undergone a significant repositioning of their portfolios. As a result, Ashmore's recent fund volatility and concentrated product portfolio leaves it more exposed than the other managers to these potentially negative trends. Despite this, Ashmore is still trading at a premium to its peers.

Who will be the winners and the losers?

Identifying sustainable winners in the asset management sector is fraught with difficulty. At a sector level, it is not just the share prices of asset managers that typically show a high degree of sensitivity to overall investment conditions; those same conditions directly affect assets under management, investor confidence and the ability to generate new fund inflows. At the company level, the factors that influence revenue performance and profitability are multifarious and, to a large extent, are equally difficult to predict.

In this note we attempt to identify the key factors to look for as an indication of sustainable growth potential. We believe the managers who are most likely to succeed will be those that can generate consistent fund performance and develop new products to match investors' demands, and have the distribution capabilities to effectively sell these products and the operational efficiency to convert this revenue growth into profit growth. We also particularly like developing markets as a source for asset inflows, where growing wealth, the lack of existing retirement provision and an existing savings culture give clearer opportunities. We believe it will be those managers with established distribution networks in developing countries (ie Ashmore, Aberdeen and Schroders) that will be best-positioned to capitalise on this growth. We conclude that the market has already factored much of this in, but, in doing so, has overlooked some of the more traditional self-help stories like Henderson. Exhibit 23 provides a valuation summary of the sector.

Exhibit 23: Valuation summary table

	Price (£)	FY13e Fair Value	% upside/ downside	EV/EBITDA			Price/earnings			Dividend yield		
				2013	2014	2015	2013	2014	2015	2013	2014	2015
*Aberdeen	3.41	3.75	10%	9.1	7.5	6.3	15.0	13.2	11.9	3.2%	3.6%	4.0%
*Ashmore	3.58	3.53	(2%)	8.5	7.5	6.6	13.8	13.6	12.5	4.3%	4.5%	4.8%
Henderson	1.16	1.34	21%	6.1	5.0	4.1	9.0	8.2	7.5	6.7%	7.4%	8.0%
Jupiter	2.61	2.78	7%	7.6	6.6	5.7	13.5	12.3	11.2	3.6%	5.2%	6.3%
Schroders	15.69	16.72	6%	8.2	7.1	6.1	13.8	12.7	11.9	2.9%	3.1%	3.3%
Man Group	0.80	0.67	(19%)	5.3	4.3	3.9	13.5	10.6	10.2	6.5%	8.0%	7.8%
Mean				**7.5**	**6.3**	**5.5**	**13.1**	**11.8**	**10.9**	**6.3%**	**5.1%**	**5.7%**
Median				**7.9**	**6.8**	**5.9**	**13.6**	**12.5**	**11.5**	**4.0%**	**4.8%**	**5.6%**

Source: Edison Investment Research, Bloomberg. Note: As at 13 November 2012. *Calendarised.

Since the financial crisis, performance across the asset management sector has been mixed, with those managers that have been able to grow AUM and maintain and/or improve revenue and operating margins finishing on top. Aberdeen, Ashmore and Schroders have been the top performing, generating total share returns of 178%, 51% and 49%, respectively, over the last three years. As a result, these managers are generally trading at a premium to peers in FY13e, but in the case of Aberdeen this premium quickly fades due to its higher growth rates. In the previous section we reviewed Aberdeen's and Ashmore's exposure to emerging markets to ascertain whether this growth was justifiable and sustainable. We concluded that while Aberdeen's high growth appears sustainable over the next two to three years, the bond bull market of late, low relative yields and its recent fund underperformance mean the outlook for Ashmore is less clear. Furthermore, the lack of visibility of these trends limits our ability to forecast these in the longer term. This has an undue effect on our fair value estimates as growth further out is discounted due to its high unpredictability.

Although Henderson's NNM flows have been disappointing over recent years, we believe its new structure satisfies our four key drivers for sustainable growth. Furthermore, its FY13e dividend yield of

6.7% (covered over 2x by EBITDA) should provide sufficient support for investors waiting for the market to recognise these factors and reduce its 20% FY13e EV/EBITDA discount to peers. The following table summarises the managers within this report in terms of fund outperformance, product range, distribution focus and forecast growth rates for the next three years. We have then summarised our investment views on each of the individual managers below.

Exhibit 24: Summary of Edison forecasts (FY12e to FY14e)

	% AUM outperforming (3yr)	Product portfolio	Distribution focus	Forecast AUM growth from NNM (pa)	Forecast revenue growth (pa)	Forecast EPS Growth (pa)
Aberdeen	76%*	Diversified	Global & emerging	2%	11%	12%
Ashmore	86%	EMD focus	Global institutional	5%	4%	4%
Henderson	66%	Diversified	Europe	2%	2%	3%
Jupiter	76%	Equity focus	UK retail	4%	5%	8%
Schroders	66%	Diversified	Global & emerging	3%	4%	2%
Man Group	**	Alternatives focus	Global	(3%)	(7%)	(2%)

Source: Edison Investment Research. Notes: *Weighted by number of funds; **Data not available.

Top pick (Henderson)

Henderson – Consolidating the acquisitions of New Star and Gartmore and rationalising the newly expanded product range has restricted organic growth over the last three years. However, we expect operating margins to have improved 850bp to 36% in the three years to end 2012 due to the acquisition of these higher-margin businesses. It seems that this improvement of profitability has not been recognised by the market yet. We believe this could reverse if Henderson's gross fund inflows, supported by its brand and investment performance, begin to show through in net new AUM gains. Henderson is currently trading at a 20-30% discount to its peers, which reflects its historically weak NNM flows and EPS growth. Now these acquisitions have been consolidated and fund performance remains strong, we believe Henderson should be trading more in line with its peers. Using the sector average FY13e EV/EBITDA of 7.5x, our sum-of-the parts analysis generates a fair value of £1.34.

Stocks to watch (Aberdeen, Schroders)

Aberdeen – Aberdeen has grown into one of the largest UK-listed asset managers in the UK, with £185bn in assets under management (September 2012). Its broad distribution and product portfolio combined with good fund performance in high-margin areas has helped it to grow earnings despite volatile markets. These factors and its strong emerging markets presence, both in terms of product range and client base, should help drive sector-leading annual adjusted EBIT growth (forecast 12% vs peer average 1%) over the medium term. However, we believe the majority of this is already reflected in its share price as its FY13e EV/EBITDA of 9.1x is 20% above peers (7.5x). In our DCF we assume this growth fades to 3% over the long term, which generates a fair value of £3.75.

Schroders – Strong brand recognition, good long-term fund outperformance and a global distribution network have helped Schroders grow AUM by 39% over the last three years to FY12e. We forecast this growth, combined with tight cost controls, has helped Schroders increase adjusted EBIT 164% during this time. Schroders' large surplus capital dilutes operational gearing and profitability, but supports the conservative nature of the brand and could be used for opportunistic, value-enhancing acquisitions. We forecast adjusted EBIT to fall 14% in FY12e due to lower performance fees and reduced operating margins, but to then grow c 10% pa as revenue growth more than offsets rising operating expenses. Schroders currently trades at a slight premium to peers (FY13e EV/EBITDA: 8.2x vs peers: 7.5x), which we believe is justified given strong NNM inflows, but allows for a reduction in margins. Our sum-of-the-parts analysis generates a fair value of £16.72.

Neutral (Ashmore, Jupiter)

Ashmore – Ashmore's shares have been some of the top performing in the asset management sector since December 2008, supported by a combination of large NNM inflows, top-quartile operating margins and the exposure to emerging markets. It has grown AUM by 156% and adjusted EBIT by 52% over the three years to end FY12. However, the most recent reported fund performance has been disappointing, notably equity and local currency debt products, which contributed to flat overall growth in FY12 adjusted EPS. While we are attracted to Ashmore's high margins and emerging markets focus, we believe this is already reflected in its share price and the recent underperformance of its funds may hinder NNM flows in the near term. Our sum-of-the-parts analysis generates an FY13e fair value of £3.53.

Jupiter – Jupiter's track record of organic AUM growth is one of the strongest of all the managers in this report. Supported by some of the highest margins in its peer group, we forecast Jupiter to grow adjusted EBIT 25% over the last three years to FY12e. Jupiter looks well placed to continue to grow its market share in the UK retail space due to its strong brand name and consistent fund performance. But with 79% of its AUM sourced from retail clients, it remains exposed to a market that has historically been more volatile than institutional clients. We expect a changing product mix and rising variable costs to restrain both revenue and earnings growth this year. This leaves it trading on an FY13e EV/EBITDA ratio of 7.6x (peers: 7.5x) and generating a dividend yield of 3.4% (peers: 6.3%), which appears fairly valued relative to peers. Our sum-of-the-parts analysis generates a fair value of £2.78.

Stocks to sell (Man Group)

Man Group – A disappointing performance from Man Group's (MAN) flagship fund and large outflows have led to a sharp decline in profitability over recent years. MAN's 'black-box' hedge fund AHL, which generated over two-thirds of MAN's management fee income in 2011, has underperformed both its peers and equity markets since the 2008 financial crisis, thus creating notable headwinds for its sales teams and limiting highly-profitable performance fees. In our base-case scenario, we envisage AHL's performance will stabilise, but not enough to prevent net fund outflows continuing, most notably from its higher-margin products. We reiterate our fair value of 67p, believing MAN's share price will come under increasing pressure without an improvement in performance at AHL.

Model assumptions

AUM growth:

- **Net new money inflows:** We forecast 3% NNM inflows as the long-term average across all sectors beyond our four year forecast period.
- **Absolute investment returns:** Our long-term forecast of absolute investment returns is 5%. Over the near to medium term, these have been adjusted to reflect higher or lower growth expectations.

Income statement:

- Adjusted EBITDA excludes all exceptionals. Share-based payments are not excluded as they are used regularly and form a large part of compensation.
- Adjusted EBIT excludes all exceptionals, impairment of intangibles and amortisation of management contracts, distribution contracts and acquired intangible assets.
- Adjusted PBT excludes all exceptionals, non-recurring items, impairment of intangibles and amortisation of management contracts, distribution contracts and acquired intangible assets.
- Adjusted NPAT: The average tax rate for the company is applied to adjusted PBT to calculate adjusted NPAT.

Company profiles

Aberdeen Asset Management

Edison investment research

Paying for growth

Asset managers

Aberdeen has grown into one of the largest UK-listed asset managers in the UK with £185bn in assets under management (September 2012). Its broad distribution and product portfolio combined with good fund performance in high-margin areas has helped it to grow earnings despite volatile markets. These factors and its strong emerging markets presence, both in terms of product range and client base, should help drive sector-leading annual adjusted EBIT growth (forecast 12% vs peer average 1%) over the medium term. Aberdeen is currently trading at a c 20% premium to its peers, which reflects its above-average EPS growth. In our DCF we assume EPS growth fades to 3% over the long term, which generates a fair value of £3.75.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/10	638	208	13.5	7.0	25.3	2.1
09/11	784	300	18.7	9.0	18.2	2.6
09/12e	848	334	20.2	9.7	16.9	2.8
09/13e	956	378	23.5	11.3	14.5	3.3

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Strategic acquisitions have expedited diversification

Acquisitions have been a significant driver of FUM growth for Aberdeen, which has acquired £69.5bn in assets since September 2007. These have helped broaden both its distribution reach and product portfolio, but key products remain in equities, primarily emerging markets and global. Although capacity constraints in emerging market equities are of concern, the company is seeing good flows into its more regional emerging market products, which are less constrained by the size of inflows. Furthermore, its global distribution capabilities should help drive strong AUM inflows and capitalise on the growing individual wealth in emerging economies.

Further margin improvement expected

By limiting flows into some funds and focusing on more specialised products, Aberdeen is in the envious position of being able to increase the underlying fees it charges investors. This has helped drive revenue margins up from 32bp in FY09 to an estimated 45bp in FY12. Tight control of its cost base has also ensured its adjusted operating margins have improved drastically from 23% in FY08 to an estimated 40% in FY12. We forecast these trends to continue over the medium term, adding a further 1-2bp a year to revenue margins.

Valuation: Sector-leading growth

Favouring Aberdeen's strong investment performance, enviable product range, successful distribution network and rising margins, we forecast adjusted EBIT to continue to grow 12% pa over the medium term (28% pa since FY07). However, we believe the majority of this is already reflected in its share price as its FY13e EV/EBITDA of 9.1x is 20% above peers (7.5x). Our asset management DCF generates a fair value of £3.75, which represents a FY13e EV/EBITDA of 9.7x, which is a 30% premium to peers.

Price*	341p
Market cap	£3,899m

*Priced as at 13 November 2012

Shares in issue	1,145m
Free float	80%
Code	ADN
Primary exchange	LSE

Share price performance

Business description

Aberdeen Asset Management is an independent asset management group with global distribution and fund management investing across all the main asset classes.

Next event

Annual results	26 November 2012

Analysts

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Investment summary

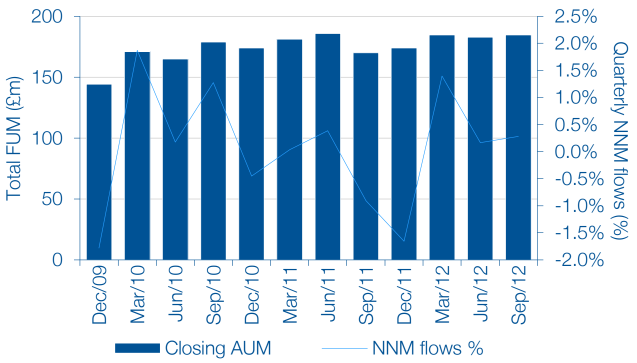
Company description: Benefiting from the growth in EM

Through a number of strategic acquisitions, Aberdeen has grown into one of the largest listed asset managers in the UK. The group is particularly strong in equities and is now one of the leading emerging markets equity managers in the market. It is also strong in bonds, property and alternatives. For the three years to the end of 2012, we estimate Aberdeen has grown FUM by 26%, revenues by 100% and adjusted EBIT by c 260% thanks to its high operational gearing.

Fund flows: Diversified product portfolio

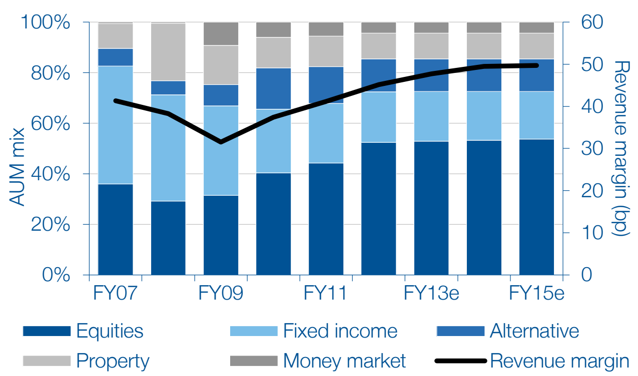
Aberdeen has benefited from its diversified asset base, which it has developed through its selective acquisition-led growth. Recent flows (Exhibit 1) have been characterised by large inflows into its equity products, particularly global, global emerging, and Asia-Pacific, offsetting outflows from its more generic bond funds. However, these outflows have largely been mitigated by inflows into its higher-margin more specialised fixed-income products such as EMD and Asian debt. We forecast total NNM inflows to continue, but at a more conservative growth rate of 3% over the medium term. Exhibit 2 illustrates how equities have grown to form a much larger share of Aberdeen's AUM, which in turn has helped improve its revenue margins.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Asset mix drives margin progression



Source: Company data, Edison Investment Research

Margin progression: Expected to improve further

Since FY09, Aberdeen has been able to increase its adjusted operating margins from 22% to 40% in FY12e. This has been supported by its robust cost controls, changing asset mix and capacity constraints. Like some of its peers, Aberdeen is reaching capacity in emerging markets and has soft-closed some of its funds. Large inflows force the manager to either buy more of the same stocks and/or broaden its investment range. Neither of which are ideal as buying more of the same stocks increases investment risk and is often restricted by foreign ownership laws, while broadening its investment range requires greater resources to research and monitor and can dilute fund performance. To limit this, Aberdeen is closed to new segregated accounts that have lower margins and instead is only accepting flows into its pooled funds at much higher margins. As illustrated in Exhibit 2, this has helped Aberdeen improve its revenue margins over the last five years. We expect this trend to continue over the medium term as management looks to curtail the large inflows into its emerging market equity funds (FY11 AUM: £33.8bn). We forecast FY13e flows into its equity products of c £3bn and total NNM flows of £5.7bn (3%).

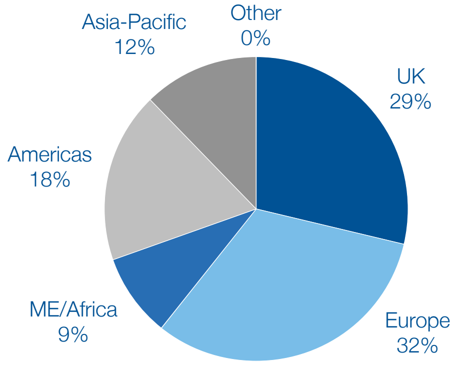
Fund performance: Consistently strong

Performance, both short and long term, has been excellent in Aberdeen's key global and emerging market products, which has helped drive high AUM growth over recent years. However, in 2008 Aberdeen's fixed-income funds endured a difficult year due to their exposure to troubled US asset- and mortgage-backed securities. After partially recovering, performance has since been disappointing due to its view that government bonds are overpriced, which has weighed on performance ever since early 2011. As a result, Aberdeen has experienced large outflows from its fixed-income products. However, this AUM decline has largely been offset by an increase in revenue margins thanks to its focus on more specialised products.

Distribution and product portfolio: Favourable product range

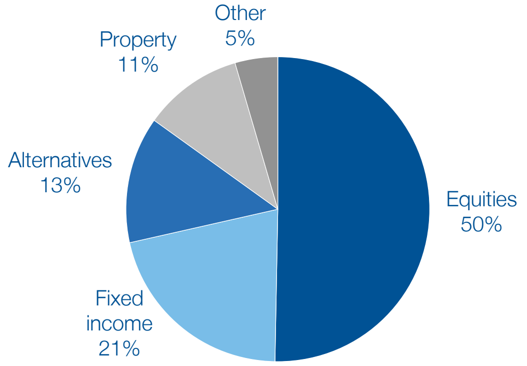
Aberdeen has one of the broadest distribution capabilities and range of funds in the sector, although its key products remain in equities, primarily emerging markets and global. Following its rapid acquisition-led growth, management is now focusing more on organic growth and has identified two significant areas for new FUM. The US is the source of nearly half the world's AUM, but only 18% of Aberdeen's, which creates an ideal avenue for future growth, especially into the higher-margin US retail market. Despite its new focus on organic growth, it may take an acquisition to move this significantly. The second area Aberdeen highlights is emerging market and Asian debt, which it sees as complementing its equity strengths in those regions. Aberdeen currently has £4.7bn invested in emerging market debt (EMD) and only £2.2bn in Asian debt, with expectations that combined these could grow to at least £15-20bn. With forecast FY12 net cash of c £260m growing to c £495m in FY13e, Aberdeen is in a strong position to return funds to shareholders by way of increased dividends if it does not find any earnings enhancing acquisitions that complement its current offering.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix

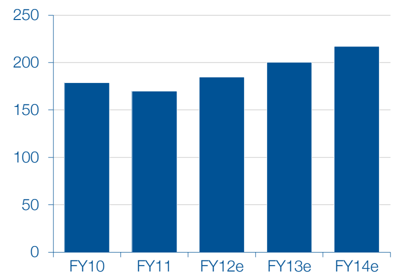


Source: Company data

Valuation

We have used our asset management DCF model to reflect Aberdeen's sector leading forecast adjusted EBIT growth of 12% per year. This model generates a fair value of £3.75 using a 10% discount rate, 6% long-term FUM growth (3% NNM flows and 3% investment performance) and ROCE faded 10% annually over 25 years. This equates to a FY13e EV/EBITDA of 9.7x, which is at a premium of c 30% to its peers. We believe this is justified by its strong investment performance, favourable product portfolio, broad distribution capabilities and enviable positive margin progression.

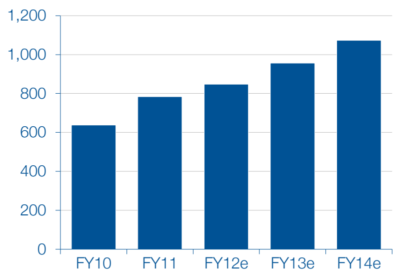
AUM (£m)



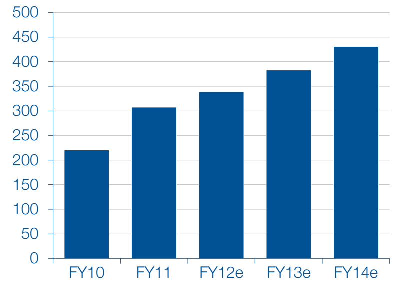
Valuation: Asset management DCF

PVFP (6% LT FUM growth, 10% WACC) (£m)	4,090
NPV of terminal capital (£m)	699
FY13e net debt (£m)	(495)
Equity value (£m)	**4,294**
Number of shares (m)	1145
FY13e fair value	**£3.75**

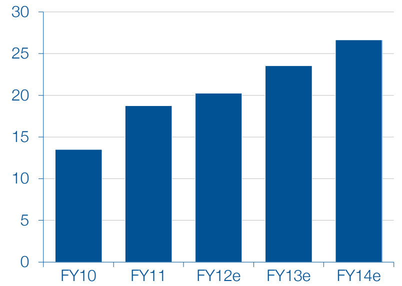
Revenue (£m)



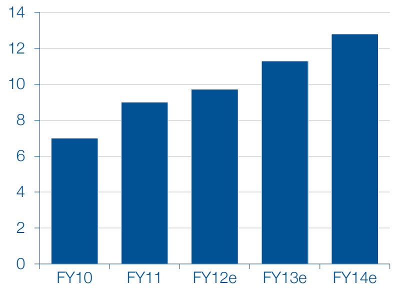
Adjusted EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Edison model

Aberdeen	£'m	2010	2011	2012e	2013e	2014e
Sep		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		**638**	**784**	**848**	**956**	**1,073**
Operating expenses		(410)	(467)	(502)	(567)	(636)
EBITDA (norm)		**228**	**317**	**346**	**390**	**437**
Depreciation & amortisation		(6)	(8)	(7)	(7)	(7)
Operating profit (norm)		**220**	**307**	**339**	**383**	**431**
Goodwill and amortisation of acquired intangibles		(43)	(66)	(71)	(58)	(48)
Exceptionals		(18)	0	0	0	0
Other		(22)	(10)	(0)	0	0
Operating Profit		**138**	**232**	**268**	**325**	**383**
Net Interest		(12)	(8)	(5)	(5)	(5)
Other		0	0	0	0	0
Profit Before Tax (norm)		**208**	**300**	**334**	**378**	**425**
Profit Before Tax (FRS 3)		**126**	**224**	**263**	**320**	**378**
Tax		(18)	(40)	(50)	(61)	(72)
Profit After Tax (norm)		**178**	**246**	**270**	**306**	**345**
Profit After Tax (FRS 3)		**107**	**184**	**213**	**259**	**306**
Average Number of Shares Outstanding (m)		1,144.3	1,144.6	1,144.6	1,144.6	1,144.6
Diluted EPS - Company reported (total)		8.0	14.1	15.9	20.1	23.9
Dilluted EPS - Company reported (clean)		13.3	18.7	21.7	24.8	27.7
Adjusted diluted EPS - Edison		13.5	18.7	20.2	23.5	26.7
Dividend per share - proposed (p)		7.0	9.0	9.7	11.3	12.8
Revenue Margin - AM (%)		37.4	41.2	45.2	47.7	49.5
EBITDA Margin norm. (%)		35.8	40.4	40.8	40.8	40.8
Operating Margin norm. (%)		34.5	39.2	40.0	40.1	40.1
BALANCE SHEET						
Fixed Assets		**1,259**	**1,159**	**1,089**	**1,031**	**984**
Intangible Assets		1,134	1,060	989	931	883
Tangible Assets		20	20	20	20	20
Investments		105	79	79	80	81
Current Assets		**1,887**	**1,727**	**2,151**	**2,427**	**2,733**
Debtors		283	326	352	397	446
Cash		151	209	347	577	834
Other		1,454	1,192	1,452	1,452	1,452
Long Term Liabilities		**(259)**	**(160)**	**(160)**	**(160)**	**(160)**
Long term borrowings		(159)	(82)	(82)	(82)	(82)
Other long term liabilities		(101)	(78)	(78)	(78)	(78)
Current Liabilities		**(1,703)**	**(1,491)**	**(1,771)**	**(1,806)**	**(1,842)**
Creditors		(276)	(330)	(349)	(384)	(420)
Short term borrowings		0	0	0	0	0
Other		(1,426)	(1,162)	(1,422)	(1,422)	(1,422)
Net Assets		**1,185**	**1,235**	**1,309**	**1,492**	**1,714**
CASH FLOW						
Operating cash flow		**213**	**366**	**348**	**387**	**430**
Capex		(7)	(6)	(6)	(6)	(6)
Cash flow from investing activities		(73)	(18)	(1)	(1)	(1)
Dividends		(91)	(106)	(131)	(149)	(167)
Other financing activities		23	(176)	(73)	0	0
Other		0	0	0	0	0
Net Cash Flow		**65**	**61**	**137**	**231**	**257**
Opening net debt/(cash)		**175**	**8**	**(127)**	**(265)**	**(495)**
Decrease / (increase) debt		(91)	(78)	0	0	0
Other		(11)	4	0	0	0
Closing net debt/(cash)		**8**	**(127)**	**(265)**	**(495)**	**(752)**
FUM						
Opening FUM		**146**	**179**	**170**	**185**	**200**
Net new money flows		3	(2)	0	6	6
Investment performance		18	(7)	13	10	11
Other		12	0	1	0	0
Closing FUM		**179**	**170**	**185**	**200**	**217**

Source: Bloomberg, company data, Edison Investment Research

Ashmore Group

Edison investment research

Uncertain growth

Asset managers

Ashmore's shares have been some of the top performing in the asset management sector since December 2008, supported by a combination of large NNM inflows, top-quartile operating margins and the exposure to emerging markets. It has grown AUM by 156% and adjusted EBIT by 52% over the three years to end FY12. However, the most recent reported fund performance has been disappointing, notably equity and local currency debt products, which contributed to flat overall growth in FY12 adjusted EPS. While we are attracted to Ashmore's high margins and emerging markets focus, we believe this is already reflected in its share price and the recent underperformance of its funds may hinder NNM flows in the near term. Our sum-of-the-parts analysis generates a FY13e fair value of £3.53.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/11	334	246	26.8	14.5	13.4	4.1
06/12	333	247	26.9	15.0	13.3	4.2
06/13e	333	230	25.0	15.8	14.3	4.4
06/14e	376	253	27.5	16.5	13.0	4.6

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Positive fund flows

Ashmore has recorded the highest AUM growth over the last five years among its peers due to organic growth and the acquisition of EMM in 2011. EMM has enabled it to rapidly increase its equity product range, diversify its predominantly fixed-income asset base and access clients in new markets. However, recent fund performance has been disappointing with three-quarters of its FUM underperforming their stated objectives over the last 12 months. Although it appears this has partially recovered recently, the high volatility and investor risk aversion may hinder near-term NNM flows.

Targeting emerging market investors

As part of its growth strategy, Ashmore is looking to diversify its client base by targeting the growing wealth of investors based in emerging markets (currently 21.5% of FUM). Ashmore has already seen substantial interest from government entities and is establishing on-the-ground presences in many of these markets. As investors in these economies grow in wealth and become more financially sophisticated, they are likely to become a notable source of AUM growth in future years. Furthermore, their tendency to favour fixed-income investments over equities also favours Ashmore's product range.

Valuation: Premium rating, but growth uncertain

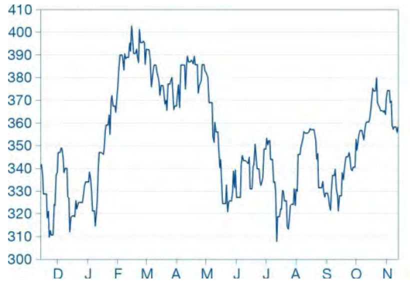
Despite Ashmore's recent fund underperformance, its valuation remains one of the highest in its peer group. While we believe this is justified given the group's favourable product range, global distribution capabilities and strong long-term investment performance, we remain wary of the sustainability of this high growth. As a result of these concerns, we would put Ashmore on a 20% premium to its peers, which equates to a FY13e EV/EBITDA multiple of 9.0x and a FY13e fair value of £3.53.

Price*	358p
Market cap	£2,552m

*Priced as at 13 November 2012

Shares in issue	707m
Free float	46%
Code	ASHM
Primary exchange	LSE

Share price performance



Business description

Ashmore Group is an asset manager specialising in emerging markets. Its primary products are debt funds and currency overlays, with equity funds forming a small part of the business.

Next event

H113 results	February 2013 (estimate)

Analysts

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Investment summary

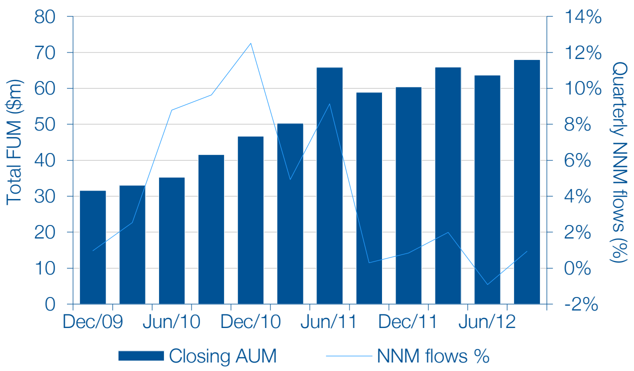
Company description: Benefiting from the rapid growth in EM

Ashmore is a global leader in managing emerging market debt funds and now manages US$68bn (September 2012) in FUM. It was founded in 1992 as part of the ANZ Banking Group and was listed on the LSE in 2006. The group has a clear three-part strategy that is focused on establishing its EM products (now largely completed); diversifying its client base throughout the developed world (underway); and mobilising and accessing capital from emerging markets (begun). This strategy has helped Ashmore to grow its adjusted EBIT c 90% over the last five years to FY12.

Fund flows: Highest NNM flows of all

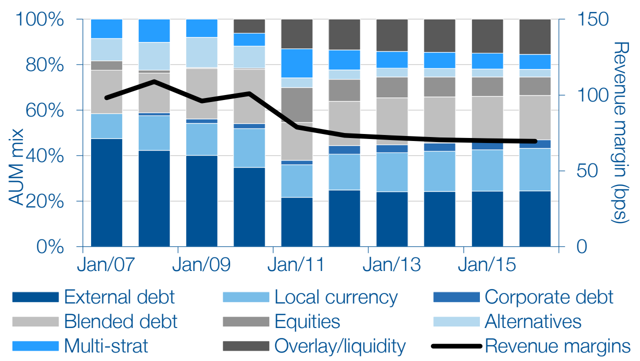
Ashmore has benefited from the strong performance of emerging market debt over recent years and has been able to grow AUM 156% from FY09 to FY12. Most of this growth (98%) was derived from positive NNM flows, while the other 58% was split between absolute fund returns (18%) and the acquisition in May 2011 of EMM (40%), a US-based manager of emerging market equities. NNM flows slowed in FY12 to 2% as positive flows into fixed income products was offset by $2bn outflows from its recently acquired equity funds due to high investor churn and weak fund performance. However, we forecast NNM flows to recover in FY13e to c $4bn, rising to c $6bn by FY15e due to positive flows into its fixed-income products.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Asset mix drives margin progression



Source: Company data, Edison Investment Research

Margin progression: Compromising margins to increase growth

Ashmore's total revenue margin has fallen over the last five years due to its changing asset mix and new segregated mandate subscriptions at lower margins. These included a reduction in AUM of its multi-strategy products, which have higher margins (FY12 122bp) and positive flows into its investment grade corporate debt and overlay products, which have lower margins (FY12 16bp). The group is seeing good interest from sovereign wealth funds and central banks, but these segregated mandates are generally lower margin and often require tailored products, which are very complex. Nevertheless, Ashmore is confident the long-term growth opportunities from this client base will more than compensate for the lower revenue margins. Adjusted operating margins have fallen from 76% in FY08 to 67% in FY12 and are expected to fall further (FY15e 64%) over the long term due to geographic expansion and increased distribution investment. Even after this reduction, Ashmore's operating margin should remain the highest of all managers in this report.

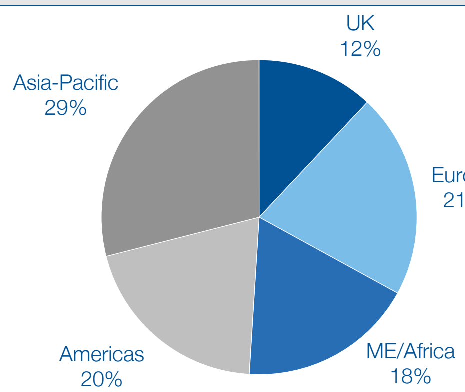
Fund performance: Underperformance may hinder NNM flows

Although performance at the end of June 2012 was disappointing, with 77% of FUM underperforming over the last 12 months, it appears performance has since recovered somewhat. One of the main drivers of this has been its approach of increasing its portfolio's risk exposure as it positions funds for a longer-term market recovery. This is supported by its long-term fund performance where 86% of FUM have outperformed over the last three years. In particular, its largely dollar-denominated external, corporate and blended debt mandates have performed strongly and continue to appear attractive relative to developed world debt. With yields in the developed world at depressed levels and equity volatility remaining high, emerging market debt offers a viable alternative for investors seeking a more stable, income-oriented investment.

Distribution and product portfolio: Large exposure to EMD

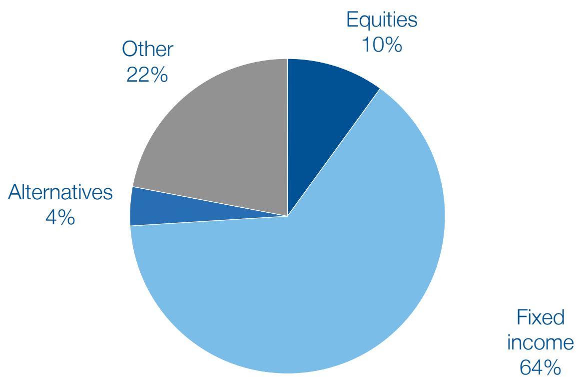
Ashmore is unique among the stocks in this report due to its focus on emerging market debt (Exhibit 4). In keeping with its strategy, it has been one of the key beneficiaries of the increasing development of emerging market debt as an asset class. In addition to the AUM sourced from developed world investors seeking emerging market exposure, Ashmore is targeting those investors within emerging markets. To achieve this, it has been establishing local asset management subsidiaries in many of these markets, while at the same time looking for further acquisitions that will extend its geographic and asset class breadth. Ashmore's strong balance sheet gives it the ability to seed new funds that build on its reputation and capitalise on the growing appetite for emerging market assets. We believe Ashmore is one of the best-placed managers in our sample group to continue to benefit from the growing wealth in emerging markets and those investors seeking higher yielding investments.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix

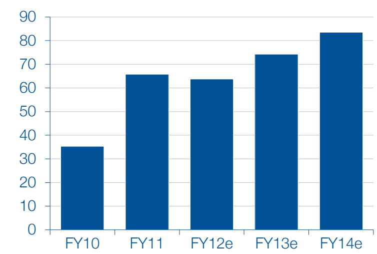


Source: Company data

Valuation

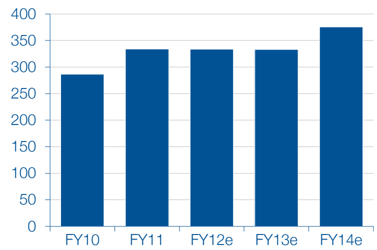
Ashmore currently trades on a premium FY13e EV/EBITDA of 8.5x (peer average 7.5x), reflecting its sector-leading operating margins, strong AUM growth and favourable exposure to emerging markets. Although operating margins are expected to continue to fall, their current above-average level should provide sufficient headroom to facilitate a marginal reduction to win new clients. While we favour management's strategy of targeting emerging markets for growth, we believe this is already reflected in its share price and the recent fund underperformance may hinder NNM flows in the near term. Using a FY13e EV/EBITDA multiple of 9.0 x (20% sector premium), our sum-of-the-parts analysis generates a FY13e fair value of £3.53, which echoes our concerns over the sustainability of this high growth.

AUM (£m)

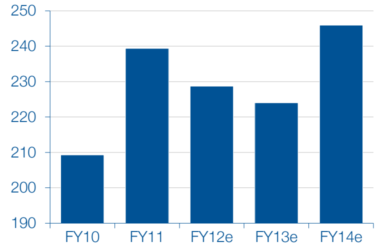


Valuation: Sum-of-the-parts	FY13e EBITDA	Multiple	
Management fees (£m)	234	9.0x	2,092
Add net cash (£m)			422
Implied equity value (£m)			**2,513**
Number of shares (m)			713
FY13e fair value			**£3.53**

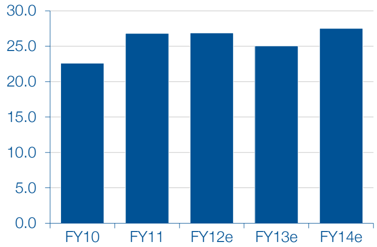
Revenue (£m)



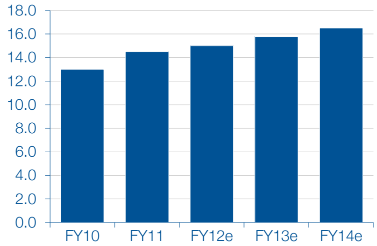
Adjusted EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Edison model

Ashmore	£m	2011	2012	2013e	2014e	2015e
Jun	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		**334**	**333**	**333**	**376**	**419**
Operating expenses		(92)	(100)	(100)	(120)	(143)
EBITDA (norm)		**242**	**234**	**234**	**255**	**277**
Depreciation & amortisation		(3)	(8)	(10)	(9)	(9)
Operating profit (norm)		**239**	**229**	**224**	**246**	**267**
Goodwill and amortisation of acquired intangibles		0	(1)	0	0	0
Other		0	(2)	0	0	0
Operating Profit		**239**	**228**	**224**	**246**	**267**
Net Interest		7	18	6	7	8
Other		0	0	0	0	0
Profit Before Tax (norm)		**246**	**247**	**230**	**253**	**275**
Profit Before Tax (FRS 3)		**246**	**246**	**230**	**253**	**275**
Tax		(56)	(58)	(54)	(59)	(64)
Profit After Tax (norm)		**190**	**189**	**176**	**193**	**211**
Profit After Tax (FRS 3)		**190**	**188**	**176**	**193**	**211**
Average Number of Shares Outstanding (m)		713.3	712.7	712.7	712.7	712.7
Basic EPS - Company reported		28.1	26.8	25.9	28.4	30.9
Diluted EPS - Company reported		26.6	25.8	24.9	27.3	29.7
Adjusted diluted EPS - Edison		26.8	26.9	25.0	27.5	29.9
Dividend per share - proposed (p)		14.5	15.0	15.8	16.5	18.0
Revenue Margin - AM (%)		78.8	73.4	71.9	70.4	70.0
EBITDA Margin norm. (%)		72.5	70.1	70.1	68.0	66.0
Operating Margin norm. (%)		71.7	68.6	67.2	65.5	63.8
BALANCE SHEET						
Fixed Assets		**197**	**181**	**173**	**165**	**157**
Intangible Assets		103	98	90	82	75
Tangible Assets		3	4	4	4	4
Investments		90	78	78	78	78
Current Assets		**479**	**526**	**602**	**690**	**790**
Debtors		68	64	64	64	64
Cash		369	347	422	511	610
Other		41	116	116	116	116
Long Term Liabilities		**(36)**	**(22)**	**(22)**	**(22)**	**(22)**
Long term borrowings		0	0	0	0	0
Other long term liabilities		(36)	(22)	(22)	(22)	(22)
Current Liabilities		**(125)**	**(127)**	**(127)**	**(127)**	**(127)**
Creditors		(95)	(87)	(87)	(87)	(87)
Short term borrowings		0	0	0	0	0
Other		(30)	(40)	(40)	(40)	(40)
Net Assets		**515**	**558**	**625**	**706**	**798**
CASH FLOW						
Operating cash flow		**191**	**181**	**208**	**229**	**250**
Capex		(1)	(3)	(2)	(2)	(2)
Cash flow from investing activities		(52)	(57)	0	0	0
Dividends		(94)	(107)	(109)	(112)	(119)
Other financing activities		(11)	(41)	(22)	(26)	(30)
Other		0	0	0	0	0
Net Cash Flow		**34**	**(26)**	**75**	**89**	**99**
Opening net debt/(cash)		(344)	(369)	(347)	(422)	(511)
Decrease / (increase) debt		0	0	0	0	0
Other		9	(4)	0	0	0
Closing net debt/(cash)		**(369)**	**(347)**	**(422)**	**(511)**	**(610)**
FUM						
Opening FUM		**35**	**66**	**64**	**74**	**84**
Net new money flows		16	1	4	5	6
Investment performance		5	(3)	6	4	4
Other		10	0	0	0	0
Closing FUM		**66**	**64**	**74**	**84**	**94**

Source: Bloomberg, company data, Edison Investment Research

Henderson Group

Edison investment research

Year of consolidation

Asset managers

Consolidating the acquisitions of New Star and Gartmore and rationalising the newly expanded product range has restricted organic growth over the last three years. However, we expect operating margins to have improved 850bp to 36% in the three years to end 2012 due to the acquisition of these higher-margin businesses. It seems that this improvement of profitability has not been recognised by the market yet. We believe this could reverse if Henderson's gross fund inflows, supported by its brand and investment performance, begin to show through in net new assets under management (AUM) gains. Henderson is currently trading at a 20-30% discount to its peers, which reflects its historically weak net new money (NNM) flows and EPS growth. Now these acquisitions have been consolidated and fund performance remains strong, we believe Henderson should be trading more in line with its peers. Using the sector average FY13e EV/EBITDA of 7.5x, our sum-of-the parts analysis generates a fair value of £1.34.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/10	362	100	9.6	6.5	12.1	5.6
12/11	477	159	12.4	7.0	9.4	6.0
12/12e	433	151	11.6	7.0	10.0	6.0
12/13e	466	168	12.4	7.4	9.0	6.7

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Focusing on organic growth

Henderson has used acquisitions to accelerate its growth of AUM within the UK retail market. The integration of these is now largely complete, but the need to rationalise overlapping product sets has led to fund outflows. As this comes to an end, gross inflows should help facilitate AUM growth from a significantly larger base. Henderson's primary focus is now on broadening geographic reach and expanding the product set to meet client demands, primarily through organic development.

Strong fund performance and brand

Henderson has strong fund performance with 61% and 66% of its AUM outperforming their stated objectives over one and three years to June 2012. A strong brand is also very important and Henderson has been running a comprehensive advertising campaign to improve brand awareness. These factors, combined with more competitive revenue margins, should see Henderson grow its retail business, which we believe will support further improvement in its operating margins.

Valuation: Attractive 6.7% dividend yield

Henderson is currently trading at a 20-30% discount to its peers as investors have been disappointed with the lack of organic net new money inflows. But having now largely completed its consolidation phase, rationalised its product offering and expanded its distribution capabilities, we believe Henderson has the ability to accelerate growth and so should trade more in line with peers. Our sum-of-the-parts analysis generates a fair value of £1.34, which, coupled with its FY13e dividend yield of 6.7%, provides a very attractive upside.

Price*	116p
Market cap	£1,235m

*Priced as at 13 November 2012

Shares in issue	1,100m
Free float	94%
Code	HGG
Primary exchange	LSE

Share price performance

Business description

Henderson Group is a diversified asset manager. It gives both institutional and retail clients access to a range of asset classes, including equities, fixed income, property and private equity.

Next events

Q4 trading update	January 2013
Annual results	February 2013

Analysts

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Investment summary

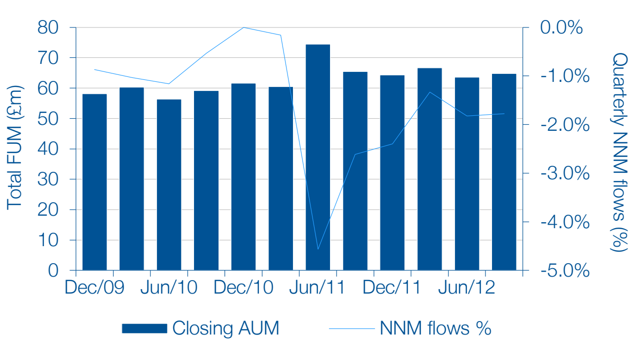
Company description: Consolidated, rationalised, poised for growth

Since it was established in 1934, Henderson's business has evolved and now focuses primarily on asset management with £64.8bn AUM (September 2012). Recent growth has largely been fuelled by its acquisitions of New Star (2009) and Gartmore (2011), which reinforce its strong position within the UK retail market. These acquisitions have contributed to an 850bp improvement in its operating margin and an expected 100% increase in EBIT over the three years to end 2012.

Fund flows: Positioning for NNM inflows

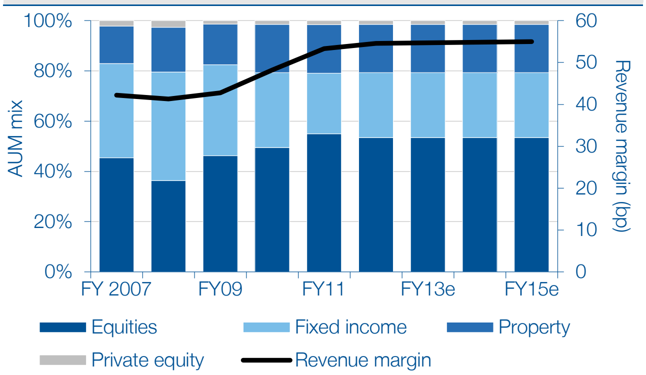
The acquisitions of New Star and Gartmore added £8bn and £12bn respectively to Henderson's assets under management and increased the share of higher-margin UK retail assets. Its organic growth has been less noteworthy, with negative net new money flows over the last six years. High investor churn post-acquisition and large outflows from its life assurance business, Phoenix, have been the primary drivers of asset outflows. On the institutional side, Henderson has experienced outflows from its global equity products in which it is less competitive. However, we believe its broader product range, good fund performance, new strategic alliances and well-known brand should help support a return to positive NNM inflows.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Asset mix drives margin progression



Source: Company data, Edison Investment Research

Margin progression: Further improvement possible

Structural shifts in its asset mix have led to an increase in its average revenue margin by 12.4bp to an estimated 2012 55bp. The largest drivers have been the reduction in its life insurance assets, which have fallen from £28bn in 2006 to £6.8bn (September 2012) and the acquisition of higher-margin businesses. However, its 2012 revenue margin of 55bp remains considerably below the 93bp of its closest rival Jupiter. While this can partially be explained by Jupiter's larger proportion of higher-margin retail assets, Henderson is confident that its pricing structure will be the more sustainable version after RDR as it is coming from a lower base. Its operating margins have also steadily improved from 25% in 2007 to 36% in 2012 (estimated) as a result of integrating the New Star and Gartmore businesses at a higher margin along with continued cost control.

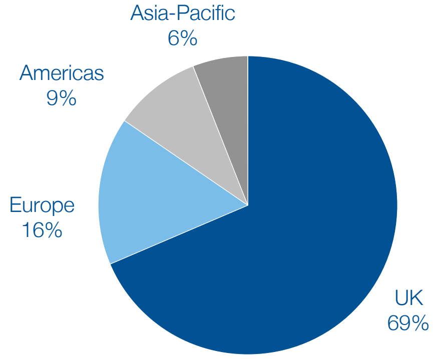
Fund performance: Strong performance in equities and fixed income

Henderson's fund performance has been strong this year. As at 30 June 2012, 61% and 66% of its funds weighted by assets outperformed their benchmarks over one and three years respectively. Performance over three years has been very strong in its fixed-income funds (98% outperforming), while its equity funds (66%) have also fared relatively well. However, in an uncertain environment its property funds (outperforming: 48% one year, 23% three years) have lagged their stated objectives. With the introduction of RDR, strong fund performance is going to be ever more important and a key differentiator for retail advisers as they will no longer be influenced by earning trail commissions. We believe Henderson's fund performance has the potential to facilitate positive NNM inflows.

Distribution and product portfolio: Building diversification

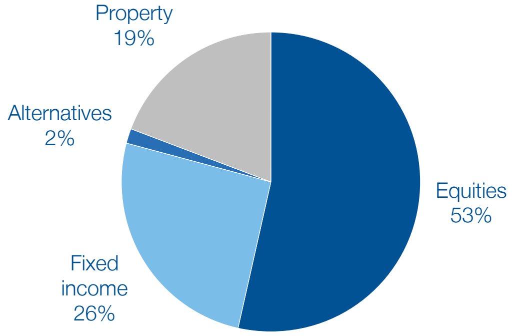
Henderson is now the seventh-largest manager based on retail AUM within the UK (IMA data, August 2012). The group also has an agreement until April 2015 to manage c £6.8bn (September 2012) of assets on behalf of the insurer Phoenix Group, a listed manager of closed life and pension funds. In the run up to RDR, Henderson has formed strategic alliances with key players in the IFA market, completed comprehensive advertising campaigns and launched new products with transparent pricing structures. Combined with its good long-term fund performance, these actions may well help to stabilise outflows that have limited AUM growth, particularly as the market settles post-RDR. Efforts to expand its international offering, namely in Asia and the US, should help reduce its exposure to European markets and dependency on European clients.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix

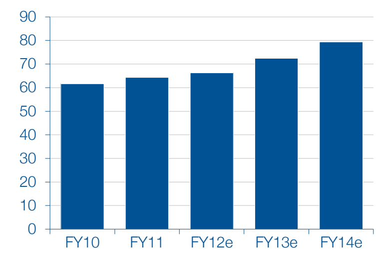


Source: Company data

Valuation

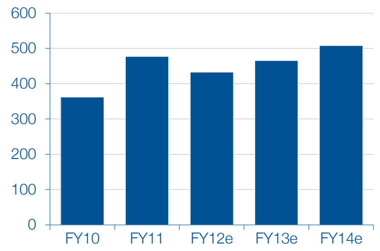
Despite improving operating margins by 31% and growing adjusted EPS by 61% over the last three years, Henderson's total share price return has risen only 6% (as at 31 October 2012), which is notably below the sector average of 44% and the FTSE All Share TR of 30%. Having largely completed its consolidation and rationalisation plans, we believe Henderson is now well positioned to drive organic growth once again; a fact not yet reflected in its FY13e EV/EBITDA of 6.1x price, which is c 20% below the sector average. Using the average FY13e EV/EBITDA multiple for the sector of 7.5x, our sum-of-the-parts analysis generates a fair value of £1.34, which, coupled with its FY13e dividend yield of 6.7%, provides a very attractive upside.

AUM (£m)

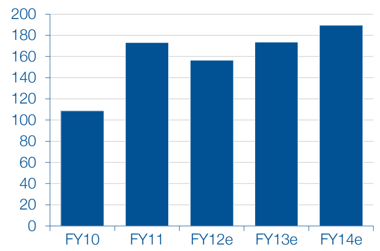


Valuation: Sum-of-the-parts	FY13e EBITDA	Multiple	
Management fees (£m)	177	7.5x	1,323
Add net cash (£m)			157
Implied equity value (£m)			**1,480**
Number of shares (m)			1,108
FY13e fair value			**£1.34**

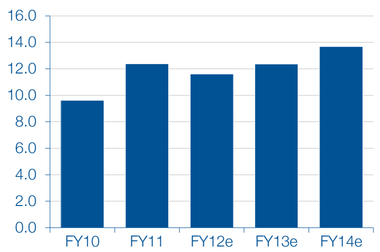
Revenue (£m)



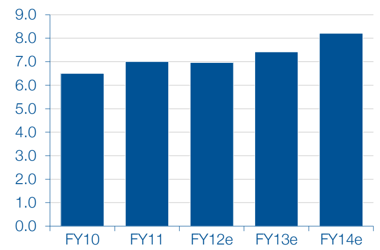
Adjusted EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Edison model

Henderson £m	2010	2011	2012e	2013e	2014e
Dec	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	**362**	**477**	**433**	**466**	**509**
Operating expenses	(250)	(301)	(273)	(289)	(315)
EBITDA (norm)	**112**	**176**	**160**	**178**	**194**
Depreciation & amortisation	(3)	(3)	(3)	(4)	(4)
Operating profit (norm)	**109**	**173**	**156**	**174**	**190**
Goodwill and amortisation of acquired intangibles	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	**109**	**173**	**156**	**174**	**190**
Net Interest	(8)	(14)	(5)	(6)	(4)
Other	0	0	0	0	0
Exceptionals	(24)	(146)	(59)	(58)	(58)
Profit Before Tax (norm)	**100**	**159**	**151**	**168**	**186**
Profit Before Tax (FRS 3)	**77**	**13**	**93**	**110**	**128**
Total tax	1	21	(6)	(10)	(14)
Profit After Tax (norm)	**82**	**125**	**126**	**134**	**149**
Profit After Tax (FRS 3)	**77**	**34**	**87**	**100**	**114**
Average Number of Shares Outstanding (m)	826.7	1,027.0	1,107.9	1,107.9	1,107.9
Diluted EPS - Company reported (total)	9.1	3.3	8.0	9.2	10.5
Diluted EPS - Company reported (clean)	9.4	12.4	9.0	10.1	11.4
Adjusted diluted EPS - Edison	9.6	12.4	11.6	12.4	13.7
Dividend per share (p)	6.5	7.0	7.0	7.4	8.2
Revenue Margin - AM (%)	48.2	53.3	54.6	54.7	54.8
EBITDA Margin norm. (%)	30.9	36.9	36.9	38.1	38.1
Operating Margin norm. (%)	30.0	36.3	36.1	37.3	37.3
BALANCE SHEET					
Fixed Assets	**574**	**1,096**	**977**	**926**	**875**
Intangible Assets	345	765	715	666	616
Tangible Assets	21	20	18	16	14
Investments	208	311	244	244	244
Current Assets	**421**	**594**	**532**	**626**	**732**
Debtors	142	168	168	168	168
Cash	177	274	212	305	411
Other	103	152	152	152	152
Long Term Liabilities	**(319)**	**(337)**	**(337)**	**(337)**	**(337)**
Long term borrowings	(179)	(148)	(148)	(148)	(148)
Other long term liabilities	(140)	(189)	(189)	(189)	(189)
Current Liabilities	**(321)**	**(566)**	**(422)**	**(422)**	**(422)**
Creditors	(222)	(303)	(303)	(303)	(303)
Short term borrowings	0	(143)	0	0	0
Other	(99)	(119)	(119)	(119)	(119)
Net Assets	**355**	**787**	**750**	**792**	**847**
CASH FLOW					
Operating cash flow	**134**	**91**	**160**	**175**	**191**
Capex	(1)	(1)	(2)	(2)	(2)
Cash flow from investing activities	(1)	227	(0)	(0)	(0)
Dividends	(49)	(70)	(77)	(79)	(83)
Other financing activities	(25)	(149)	(143)	0	0
Other	0	0	0	0	0
Net Cash Flow	**58**	**98**	**(62)**	**94**	**106**
Opening net debt/(cash)	63	2	17	(64)	(157)
Decrease / (increase) debt	0	(111)	(143)	0	0
Other	(2)	224	0	0	0
Closing net debt/(cash)	**2**	**17**	**(64)**	**(157)**	**(263)**
FUM					
Opening FUM	**58**	**62**	**64**	**66**	**71**
Net new money flows	(1)	(6)	(3)	1	2
Investment performance	5	(3)	5	3	4
Other	(0)	12	0	0	0
Closing FUM	**62**	**64**	**66**	**71**	**76**

Source: Bloomberg, company data, Edison Investment Research

Jupiter Fund Management

Edison investment research

A strong brand is key

Asset managers

Jupiter's track record of organic AUM growth is one of the strongest of all the managers in this report. Supported by some of the highest margins in its peer group, we forecast Jupiter to grow adjusted EBIT 25% over the last three years to FY12e. Jupiter looks well placed to continue to grow its market share in the UK retail space due to its strong brand name and consistent fund performance. But with 79% of its AUM sourced from retail clients, it remains exposed to a market that has historically been more volatile than institutional clients. We expect a changing product mix and rising variable costs to restrain both revenue and earnings growth this year. This leaves it trading on a FY13e EV/EBITDA ratio of 7.6x (peers: 7.5x) and generating a dividend yield of 3.4% (peers: 6.3%), which appears fairly valued relative to peers. Our sum-of-the-parts analysis generates a fair value of £2.78.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/10	231	88	12.5	4.7	20.9	1.8
12/11	249	109	16.9	7.8	15.4	3.0
12/12e	242	108	17.3	7.9	15.1	3.0
12/13e	265	121	19.4	9.4	13.5	3.6

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Strong organic growth

Jupiter's top-quartile AUM growth has been supported by its strong brand name in the UK retail market, consistent fund outperformance across the majority of its funds and positive UK retail fund flows over recent years. Jupiter's brand is well-regarded in the UK market and is likely to gain even more of a competitive advantage within retail mutual fund distribution, particularly in a post-RDR environment.

Concentrated revenues

By avoiding acquisitions it has reduced execution risk, but this organic growth has resulted in a concentrated client profile and product portfolio due to its targeted distribution network. Jupiter currently has 91% of clients based in the UK, 79% of AUM is in equities and 79% is in mutual funds. Management is conscious of this lack of diversification and has been actively increasing its fixed-income product range while expanding its presence in Europe and Asia; but this will cost money and its performance is unknown in these areas. Until this diversification is fully established, Jupiter remains vulnerable to any slowdown in UK retail flows, especially in equities.

Valuation: Fully valued

Jupiter is currently trading on a FY13e EV/EBITDA of 7.6x (peers: 7.5x) and P/E ratio of 13.5x (peers: 13.1x), which implies Jupiter is trading in line with peers. However, we believe this is justified due to its concentrated product and distribution profile, falling margins and the uncertainty surrounding RDR. As a result, we forecast medium-term EPS growth of 8% pa and a fair value of £2.78.

Price*	261p
Market cap	£1,194m

*Priced as at 13 November 2012

Shares in issue	457.7m
Free float	79%
Code	JUP
Primary exchange	LSE

Share price performance

Business description

Jupiter offers investment management services to retail and institutional clients, private clients, investment trusts and hedge funds.

Next events

Q4 trading update	16 January 2013
Annual results	28 February 2013

Analysts

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Investment summary

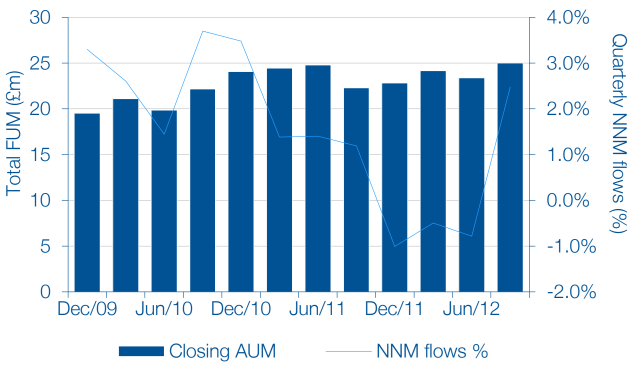
Company description: Stable, focused growth

Since returning to the market through an IPO in 2009, Jupiter has grown assets under management by £5bn to £25bn (September 2012). The manager focuses primarily on managing equity investments on behalf of UK retail investors and is the fifth-largest retail asset manager in the UK. Over 60% of its UK gross sales come directly from IFAs, with a further 20% sourced indirectly through life companies. Due to falling revenue margins and concerns surrounding the impact of RDR on NNM flows, we forecast Jupiter's adjusted EPS to grow 8% a year over the medium term.

Fund flows: Best of the bunch

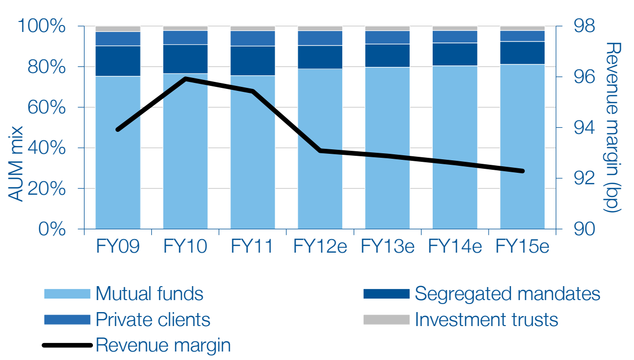
Over the last three years to FY12e, Jupiter has recorded one of the highest organic AUM growth rates (+31%) in its peer group to FY12e. The majority of this has come from positive net new money (NNM) flows, while consistent fund performance and its high equity exposure (FTSE All-Share TR: +31% three years to 31 August 2012) helped drive positive investment growth. However, Jupiter's NNM flows have been negative in three of the last four quarters due to sizeable outflows from its segregated mandates, as institutions adjust their strategic asset allocation. NNM flows recovered in Q312 to +2.5%, with the majority of assets being directed towards its mutual fund strategies. We have forecast total long-term NNM flows of 4% (5% for its mutual funds), which is above our average for the sector of 3%, as we believe its long-term fund outperformance and strong brand name will support further fund flows.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Fee pressure affecting margins



Source: Company data, Edison Investment Research

Operational efficiency: Room to fall

Jupiter has one of the strongest revenue margins in its peer group due to its focus on the higher-margin UK retail equity market. However, management expects its net management fee margins will decline 2-3% over the medium term as distributors take an increasing share of fees and the effects of the Retail Distribution Review take shape. We expect this will be compounded by a changing asset mix as Jupiter seeks to further diversify towards fixed income, where revenue margins are lower. Total variable costs are also expected to rise by c 3-5% over the medium term as the incentive schemes put in place as part of its IPO build to maturity. Fixed pay at Jupiter continues to be targeted at the market median and is also subject to a salary cap of £250,000 per annum, instead of paying out through the bonus scheme and equity participation. As a result of these factors, we forecast its adjusted EBIT margin to fall marginally from 49% in FY11 to 48% in FY14e.

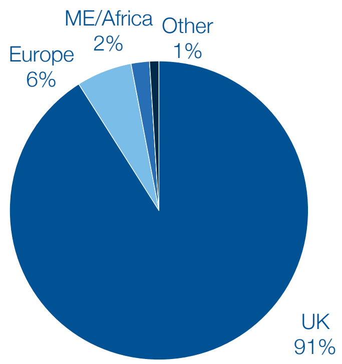
Fund performance: Consistently strong

One of Jupiter's key strengths has been its ability to consistently generate investment outperformance. Over the key three-year period, at the end of June 2012, 60% of its mutual funds (weighted by AUM) are in the first quartile of performance among peers, while a further 16% are in the second quartile (66% first and second quartile in 2010). Looking over a one-year period that has been fraught with high market instability, 84% of its mutual funds delivered first- and second-quartile investment performance (2010: 55%). Although there is no set in-house investment process, the funds have tended to be more defensively positioned, which has been beneficial recently.

Distribution and product portfolio: UK retail focused

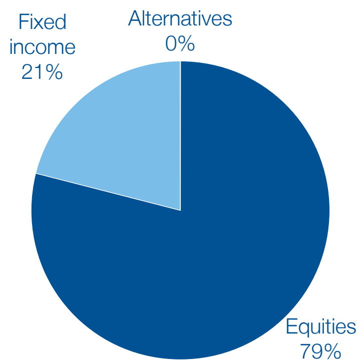
Exhibits 3 and 4 illustrate how Jupiter's portfolio is highly concentrated within UK retail investing in equities. While this has been beneficial over recent years as the UK has recorded positive net retail fund flows, it does expose Jupiter to a reversal of this trend. Jupiter is aware of this concentration and has been actively looking to diversify both its revenue streams and its fund range. Fixed income now represents 21% of its AUM, up from 16% in 2010 and through the addition of new managers and new funds we expect the share of its fixed-income portfolio to increase over time. Jupiter has also been actively looking to expand its geographic distribution capabilities by building out its sales presence in Germany and Switzerland and expanding its operations in Asia. Although it is continuing to invest, the current environment means it is proceeding cautiously for now.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix



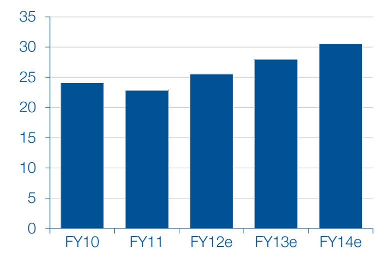
Source: Company data

Valuation

Jupiter has been steadily paying off its debt, a legacy of its pre-IPO private ownership, and is now in a net cash position (FY12e: £67m). This has enabled it to start paying a dividend in 2010, which we forecast will increase in line with its earnings due to its high cash-conversion rate. In addition to peer analysis, we have calculated a sum-of-the-parts valuation by applying EV/EBITDA multiples to its different revenue streams. As performance fees do not represent a significant proportion of revenues, we have applied a single multiple of 8.2x to total FY13e EBITDA. This multiple is 10% above the peer group average of 7.5x, which is justifiable given Jupiter's strong organic growth record and fund performance. This generates a FY13e fair value of £2.78, which reflects our conservatism with regard to its concentrated portfolio, falling margins and the uncertainty surrounding the impact RDR will have on NNM flows and margins.

Edison investment research

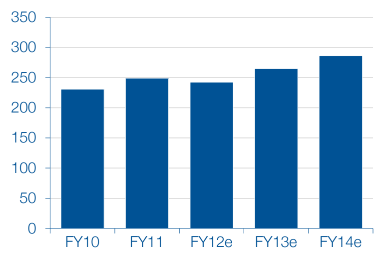
AUM (£m)



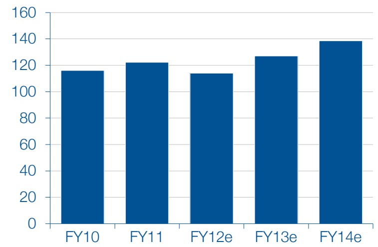
Valuation: Sum-of-the-parts

Valuation: Sum-of-the-parts	FY13e EBITDA	Multiple	
Management fees (£m)	137	8.2x	1,125
Performance fees (£m)			
Add net cash (£m)			149
Implied equity value (£m)			**1,273**
Number of shares (m)			458
FY13e fair value			**£2.78**

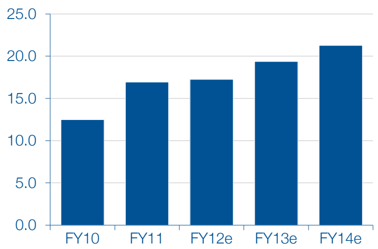
Revenue (£m)



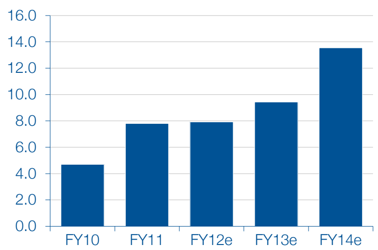
Adjusted EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Edison model

Jupiter	£m	2010	2011	2012e	2013e	2014e	2015e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		231	249	242	265	286	310
Operating expenses		(105)	(112)	(116)	(128)	(139)	(151)
EBITDA (norm)		126	136	126	137	147	159
Depreciation & amortisation		(10)	(11)	(10)	(8)	(7)	(5)
Operating profit (norm)		116	122	114	127	138	151
Goodwill and amortisation of acquired intangibles		(39)	(39)	(39)	(39)	(15)	(2)
Other	0	0	0	0	0	0	(0)
Operating Profit		77	84	75	88	124	149
Net Interest		(28)	(13)	(7)	(6)	(6)	(6)
Exceptionals		(7)	0	0	0	0	0
Other		0	0	0	0	0	0
Profit Before Tax (norm)		88	109	108	121	133	145
Profit Before Tax (FRS 3)		42	70	69	82	118	143
Tax		(10)	(19)	(17)	(20)	(28)	(34)
Profit After Tax (norm)		67	80	82	92	101	110
Profit After Tax (FRS 3)		33	51	52	62	89	109
Average Number of Shares Outstanding (m)		368.7	457.7	457.7	457.7	457.7	457.7
Basic EPS - Company reported		10.8	15.6	14.5	17.3	24.8	30.2
Diluted EPS - Company reported		7.6	15.0	13.9	16.5	23.7	28.9
Adjusted diluted EPS - Edison		12.5	16.9	17.3	19.4	21.3	23.3
Dividend per share - proposed (p)		4.7	7.8	7.9	9.4	13.5	16.5
Revenue Margin - AM (%)		95.9	95.4	93.1	92.9	92.6	92.3
EBITDA Margin norm. (%)		54.5	54.8	52.0	51.8	51.5	51.2
Operating Margin norm. (%)		50.3	49.2	47.1	48.0	48.4	48.8
BALANCE SHEET							
Fixed Assets		527	500	461	422	408	406
Intangible Assets		484	445	406	367	353	351
Tangible Assets		1	2	2	2	2	2
Investments		42	53	53	53	53	53
Current Assets		391	269	301	390	473	548
Debtors		111	79	77	84	90	98
Cash		220	151	175	257	333	401
Other		60	39	49	49	49	49
Long Term Liabilities		(338)	(195)	(162)	(162)	(162)	(162)
Long term borrowings		(282)	(141)	(109)	(109)	(109)	(109)
Other long term liabilities		(57)	(53)	(53)	(53)	(53)	(53)
Current Liabilities		(189)	(149)	(146)	(158)	(169)	(182)
Creditors		(171)	(132)	(129)	(141)	(152)	(165)
Short term borrowings		(282)	(141)	(109)	(109)	(109)	(109)
Other		263	125	92	92	92	92
Net Assets		391	425	454	493	549	610
CASH FLOW							
Operating cash flow		108	107	111	129	134	143
Capex		(1)	(1)	(1)	(1)	(1)	(1)
Cash flow from investing activities		11	5	(11)	(1)	(1)	(0)
Dividends		0	(32)	(36)	(38)	(49)	(66)
Other financing activities		(121)	(149)	(40)	(7)	(7)	(7)
Other		0	0	0	0	0	0
Net Cash Flow		(2)	(70)	24	82	76	67
Opening net debt/(cash)		404	68	(10)	(67)	(149)	(224)
Decrease / (increase) debt		(341)	(149)	(33)	0	0	0
Other		3	1	0	0	0	0
Closing net debt/(cash)		68	(10)	(67)	(149)	(224)	(292)
FUM							
Opening FUM		19,522	24,077	22,806	25,556	27,929	30,540
Net new money flows		2,320	746	546	1,143	1,260	1,388
Investment performance		2,235	(2,017)	2,204	1,229	1,352	1,487
Other		0	0	0	0	0	0
Closing FUM		24,077	22,806	25,556	27,929	30,540	33,416

Source: Bloomberg, company data, Edison Investment Research

Man Group

Edison investment research

Diminishing returns from a 'black box'

Asset managers

A disappointing performance from Man Group's (MAN) flagship fund and large outflows have led to a sharp decline in profitability over recent years. MAN's 'black-box' hedge fund AHL, which generated over two-thirds of MAN's management fee income in 2011, has underperformed both its peers and equity markets since the 2008 financial crisis, thus creating notable headwinds for its sales teams and limiting highly-profitable performance fees. In our base-case scenario, we envisage AHL's performance will stabilise but not enough to prevent net fund outflows continuing, most notably from its higher-margin products. We reiterate our fair value of 67p, believing MAN's share price will come under increasing pressure without an improvement in performance at AHL.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
03/11	1,655	599	26.6	22.0	4.8	17.3
12/11	1,254	262	10.3	16.5	12.3	13.0
12/12e	1,242	199	7.8	22.0	16.3	17.3
12/13e	1,259	230	9.4	8.3	13.5	6.5

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Fund underperformance driving NNM outflows

Despite additional cost-cutting initiatives and an enticing dividend, MAN's concentrated product portfolio means outflows from its higher-margin guaranteed products have a significant effect on revenue growth. MAN has experienced net outflows during 14 of the last 16 quarters, which has resulted in its funds under management (FUM) falling over 42% (adjusted for acquisitions) since June 2008. Furthermore, AHL remains on average 14% below its high water mark, which gives an indication of the scale of the recovery required before it can begin to generate sizeable performance fees again.

Margin pressures rising

A decline in the FUM of these higher-margin products has been one of the major factors behind the fall in its adjusted operating margin from 59% in FY08 to 19% in FY12e (excluding performance fees: 35% to 16%). MAN is attempting to counter this downtrend by cutting $195m from operating expenses over the next 18 months. While this will alleviate some of the pressure in the near term, a continuation of the trend away from guaranteed products and subdued flows into its open-ended AHL funds would more than offset any long-term benefits. Hence, cost cutting alone cannot arrest the decline in operating margins.

Valuation: Downside risks

The longer the disappointing performance continues, the greater the damage to its brand. Although its performance could recover, we believe it is unlikely to return to previous levels. We maintain our fair value of 67p, which assumes long-term AUM growth of c 6% and a 5-10bp annual reduction in revenue margins, as we believe MAN's shares will come under increasing pressure unless it rectifies the performance in its funds.

Price*	80p
Market cap	£1,418m

*Priced as at 13 November 2012

Shares in issue	1821
Free float	91%
Code	EMG
Primary exchange	LSE

Share price performance

Business description

Man Group is primarily a manager of hedge funds. It has three businesses: AHL, a trend-following fund; Man Multi-Manager, which has fund-of-hedge-fund products; and GLG, which is a fundamental investor that also runs long-only funds.

Next events

Q4 trading update	January 2013
Annual results	February 2013 (estimate)

Analysts

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Investment summary

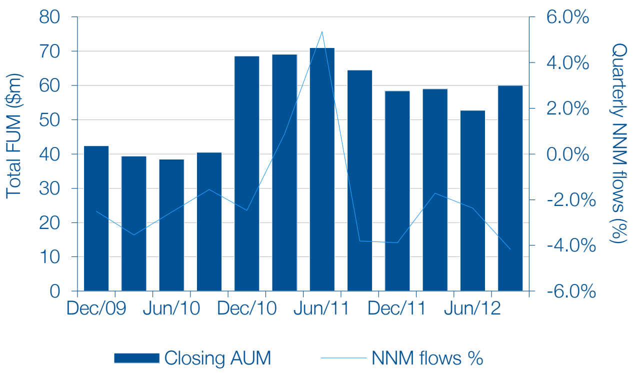
Company description: 'Black box' investing

MAN is the largest UK-listed hedge fund group. While its flagship product AHL ($19.5bn FUM as at 31 March 2012) has a strong track record since its inception in 1987, its performance after the financial crisis has been disappointing. Despite recent acquisitions of GLG in 2010 (£28bn) and FRM in 2012 ($8.3bn), MAN remains highly dependent on its AHL product range, which generated over two-thirds of its revenues in 2011. This underperformance, coupled with negative net new money flows, has led to a 50% drop in revenues from $3.2bn in FY08 to $1.2bn FY12e and a c 80% drop in adjusted EBIT.

Fund flows: Outflows influenced by fund performance

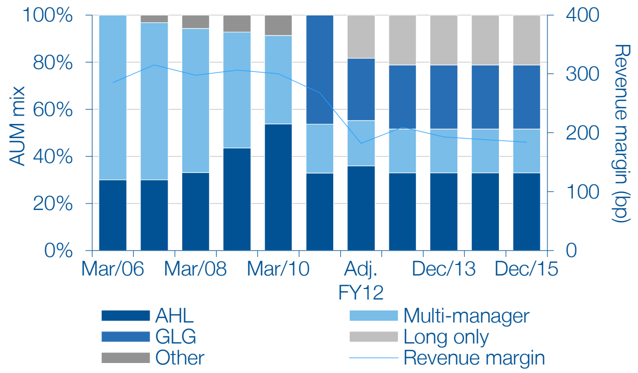
MAN has experienced net outflows during 14 of the last 16 quarters, which has resulted in its FUM falling over 42% (adjusted for acquisitions) since June 2008. Management has expressed concerns that the outlook remains poor for guaranteed products due to low interest rates and has forecast that current outflows of c $400m a quarter will continue for the foreseeable future. In an attempt to diversify its fund range and reduce its reliance on AHL, MAN acquired the hedge fund manager GLG in October 2010 for £1.1bn. This was followed by the acquisition of fund-of-fund manager FRM in May 2012 for a maximum consideration of $83m. While these have extended its product range and made better utilisation of its extensive sales channels, they have been largely ineffective at stemming the net outflows across its funds due to a combination of weak performance, strong peer performance and investor risk aversion. Having paid a 50% premium to buy GLG, it highlights that acquisition-led growth is not always the most effective way to boost AUM.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Asset mix drives margin progression



Source: Company data, Edison Investment Research

Operational efficiency: Margins under pressure

Investors in AHL products typically pay a 3% management fee and 20% performance fee, although the management fee for guaranteed products can be as high as c 4.5%. Investors in its GLG products generally pay a much lower management fee of around 1-2%, falling to a c 1% for its fund-of-fund products. Whereas GLG's fees are in line with peers, AHL's remain conspicuously above the industry norm of 2% management fee and 20% performance fee. A decline in the FUM of these higher-margin products is one of the major factors behind the fall in its revenue margins from 315bp in FY07 to 193bp in FY13e. MAN is attempting to counter this downtrend by cutting $195m from operating expenses over the next 18 months. While this will alleviate some of the pressure in the near term, a continuation of the trend away from guaranteed products and subdued flows into its open-ended AHL funds would more than offset any long-term benefits. Hence, cost-cutting alone cannot arrest the decline in operating margins and will ultimately have an impact on profitability.

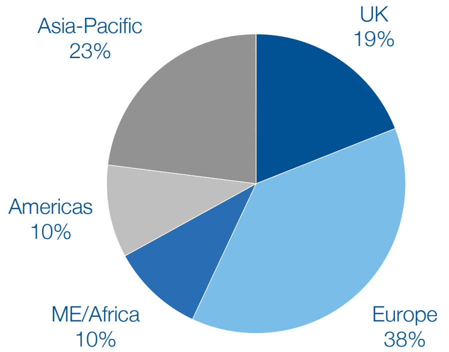
Fund performance: Missing expectations

AHL's performance peaked in 1999, when it generated an average net return of 30% per year from 1997-99, but has steadily fallen since to an average 3% per year as at September 2012. Recent performance has continued to disappoint (-7.3% one-year to 28 September 2012 vs MSCI World: 16.3%) as it has underperformed peers (Winton: -3.4%, Aspect: -6.9%, BlueTrend: 1.3%) and global markets (MSCI World: 16.3%). As a trend-following strategy, AHL is expected to perform best when markets exhibit a clear trend in either direction. However it has struggled during recent periods of high market volatility, as its fast trading systems have meant AHL is whipsawed at each turn of the market and is unable to identify any clear trends. This negative performance also leads AHL to deleverage, exacerbating AUM erosion. As at 30 September 2012, AHL was on average 14% below its peak on a weighted-average basis, while c 20% of GLG's performance fee eligible AUM was more than 5% below its high water mark. In addition, the recently acquired FRM business is also on average c 10% below its high water mark. Until fund performance overcomes these hurdles, MAN's profitability will remain subdued, as it will not be able to earn lucrative performance fees.

Distribution and product portfolio: Concentration limiting fund flows

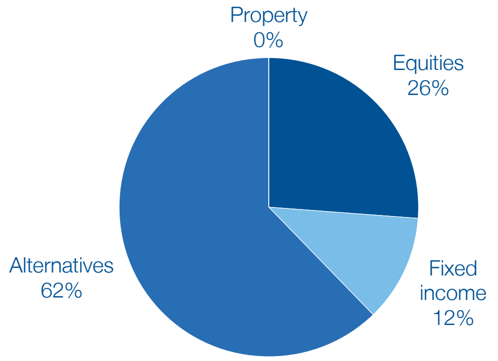
Having been one of the primary drivers of MAN's historical growth, its guaranteed products are now having a disproportionally large impact on FUM levels. Appetite for these products, which offer a guaranteed base return, has remained subdued since the collapse of Lehman Brothers and has led to notable net outflows as investors favoured more liquid investments. This concentrated product portfolio leaves MAN in a vulnerable position due to its reliance on AHL, which to date has struggled to live up to expectations over recent years.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix



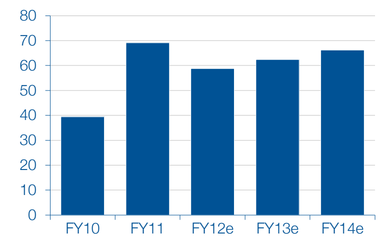
Source: Company data

Valuation

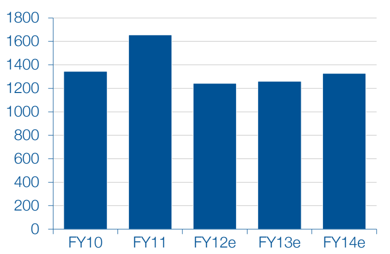
There is no doubt that the long-term track records of MAN's funds have been excellent and it retains strong distribution capabilities. However, we believe its recent fund underperformance, concentrated product portfolio and falling margins will continue to restrict both revenue and profit growth. In our sum-of-the-parts analysis, we use a FY13e EV/EBITDA of 6.0x for management fee income (1.0x for performance fees) which is a 20% discount to its peers due to its large outflows and falling revenue margins. Based on these assumptions, it generates an FY13 fair value of £0.67.

Edison investment research

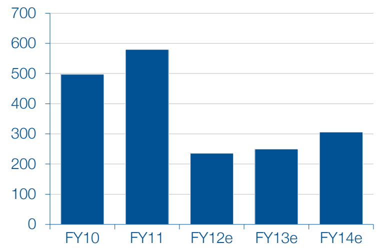
AUM (£m)



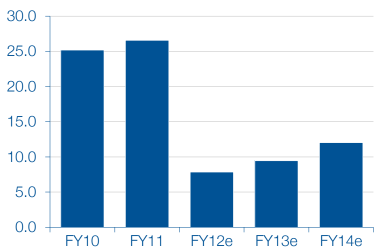
Revenue (£m)



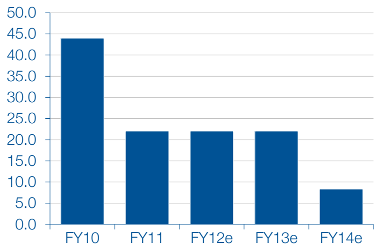
EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Valuation: Sum-of-the-parts	FY13e EBITDA	Multiple	
Management fees ($m)	$232	6.0x	1,388
Performance fees ($m)	$55	1.0x	55
Add net cash ($m)			430
Implied equity value ($m)			**1,873**
Number of shares (m)			1,767
FY13 Fair value (US$)			**$1.06**
US$/£ exchange rate			1.5884
FY13 Fair value £			**£0.67**

Edison model

MAN Group	US$'m	2010	2011	Adj. 2011	2012e	2013e	2014e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		1,345	1,655	1,254	1,242	1,259	1,328
Operating expenses		(803)	(1,024)	(897)	(973)	(972)	(982)
EBITDA (norm)		542	631	357	270	287	346
Depreciation & amortisation		(45)	(51)	(42)	(35)	(37)	(40)
Operating profit (norm)		497	580	315	235	250	306
Goodwill and amortisation of acquired intangibles		0	(28)	(47)	(49)	(49)	(49)
Exceptionals		(53)	(107)	(22)	(20)	0	0
Other		0	0	0	0	(0)	(0)
Operating Profit		444	445	246	167	201	258
Net Interest		(7)	(46)	(56)	(41)	(24)	(25)
Exceptionals		34	(140)	0	(233)	0	0
Other		70	65	3	4	4	4
Profit Before Tax (norm)		560	599	262	199	230	285
Profit Before Tax (FRS 3)		541	324	193	(103)	182	236
Total tax		(96)	(51)	(34)	19	(33)	(43)
Profit After Tax (norm)		461	505	216	163	189	234
Profit After Tax (FRS 3)		461	505	216	163	189	234
Average Number of Shares Outstanding (m)		1,712.3	1,881.5	1,820.8	1,767.5	1,767.5	1,767.5
Diluted EPS - Company reported (total)		24.2	13.5	7.2	(6.2)	7.1	9.7
Diluted EPS - Company reported (clean)		25.2	26.6	10.3	7.8	9.4	12.0
Adjusted diluted EPS - Edison		25.2	26.6	10.3	7.8	9.4	12.0
Dividend per share - proposed (c)		44.0	22.0	16.5	22.0	8.3	10.1
Revenue Margin - AM (%)		300.0	267.6	182.0	209.3	192.8	188.4
EBITDA Margin norm. (%)		40.3	38.1	28.5	21.7	22.8	26.1
Operating Margin norm. (%)		37.0	35.0	25.1	18.9	19.9	23.1
BALANCE SHEET							
Fixed Assets		2,414	3,846	3,855	3,531	3,441	3,350
Intangible Assets		1,135	2,712	2,665	2,341	2,251	2,160
Tangible Assets		72	138	173	173	173	173
Investments		1,207	996	1,017	1,017	1,017	1,017
Current Assets		3,549	2,950	2,158	1,864	1,799	1,900
Debtors		320	522	428	428	428	428
Cash		3,229	2,359	1,639	1,345	1,280	1,381
Other		0	69	91	91	91	91
Long Term Liabilities		(1,486)	(1,474)	(1,061)	(844)	(843)	(842)
Long term borrowings		(1,489)	(1,478)	(1,066)	(850)	(850)	(850)
Other long term liabilities		3	4	5	6	7	8
Current Liabilities		(553)	(900)	(882)	(881)	(880)	(879)
Creditors		(376)	(647)	(675)	(675)	(675)	(675)
Short term borrowings		3	4	5	6	7	8
Other		(180)	(257)	(212)	(212)	(212)	(212)
Net Assets		3,924	4,422	4,070	3,671	3,517	3,530
CASH FLOW							
Operating cash flow		754	527	677	239	242	290
Capex		(242)	(652)	(490)	(35)	(37)	(40)
Cash flow from investing activities		327	621	57	34	34	34
Dividends		(778)	(646)	(419)	(317)	(305)	(183)
Other financing activities		753	(665)	(545)	(216)	0	0
Other		0	0	0	0	0	0
Net Cash Flow		814	(815)	(720)	(294)	(65)	101
Opening net debt/(cash)		(1,718)	(1,740)	(881)	(573)	(495)	(430)
Decrease / (increase) debt		796	(583)	(349)	(216)	0	0
Other		(4)	627	(63)	0	0	0
Closing net debt/(cash)		(1,740)	(881)	(573)	(495)	(430)	(531)
FUM - USD							
Opening FUM		47	39	69	58	59	62
Net new money flows		(5)	(2)	(2)	(6)	1	1
Investment performance		(2)	5	(7)	1	3	3
Other		(1)	27	(2)	5	0	0
Closing FUM		39	69	58	59	62	66

Source: Bloomberg, company data, Edison Investment Research

Conservatism supports stability

Asset managers

Strong brand recognition, good long-term fund outperformance and a global distribution network have helped Schroders grow AUM by 39% over the last three years to FY12e. We forecast this growth, combined with tight cost controls, has helped Schroders increase adjusted EBIT 164% during this time. Schroders' large surplus capital dilutes operational gearing and profitability, but supports the conservative nature of the brand and could be used for opportunistic, value-enhancing acquisitions. We favour Schroders' diverse product portfolio and strong distribution networks and forecast annual long-term growth in AUM of 9%. Adjusting for FY13e investment capital of £1122m, Schroders trades at a small premium to the sector, which reflects its stable organic NNM flows. Our sum-of-the-parts analysis generates a fair value of £16.72.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/10	1,156	453	120.7	37.0	13.0	2.3
12/11	1,153	424	116.5	39.0	13.5	2.5
12/12e	1,135	370	102.4	39.9	15.3	2.5
12/13e	1,217	412	114.0	45.0	13.8	2.9

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Strong organic fund flows

Schroders' sector-leading organic net new money (NNM) inflows have helped it grow forecast AUM by 39% over the last three years to FY12e. Unlike most of its peers, this growth has largely been achieved without having to resort to acquisitions. During H112, the majority of this growth was from its institutional clients in Europe, Asia and the Americas, while its retail business has also attracted net inflows despite the uncertain economic and market outlook. We forecast NNM inflows of c 4% pa due to its strong brand name, solid performance record and broad distribution capabilities.

Stabilising margins

An increase in the share of institutional funds under management to 58% in FY12e (FY08: 54%) and the continued diversification of the product offering have resulted in a reduction in its forecast revenue margins to 54bp (2008: 61bp). Schroders has been able to counter this by improving its operating margin from 18% in 2009 to c 31% in FY12e through tight cost controls. Revenue margins are expected to continue to decline due to the changing asset mix, but this should be more than compensated for by overall growth in AUM.

Valuation: Conservative value

We forecast adjusted EBIT to fall 14% in FY12e due to lower performance fees and reduced operating margins, but to then grow c 10% pa as revenue growth more than offsets rising operating expenses. Schroders currently trades at a slight premium to peers (FY13e EV/EBITDA: 8.2x vs peers: 7.5x), which we believe is justified given strong NNM inflows but allows for a reduction in margins. Our sum-of-the-parts analysis generates a fair value of £16.72.

Price*	1,569p
Market cap	£4,433m

*Priced as at 13 November 2012

Shares in issue	226m
Free float	68%
Code	SDR
Primary exchange	LSE

Share price performance

Business description

Schroders is a diversified asset manager and private bank. It has funds across all the main asset classes with a broad global distribution network.

Next events

Q4 trading update	January 2013 (estimate)
Annual results	February 2013 (estimate)

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Investment summary

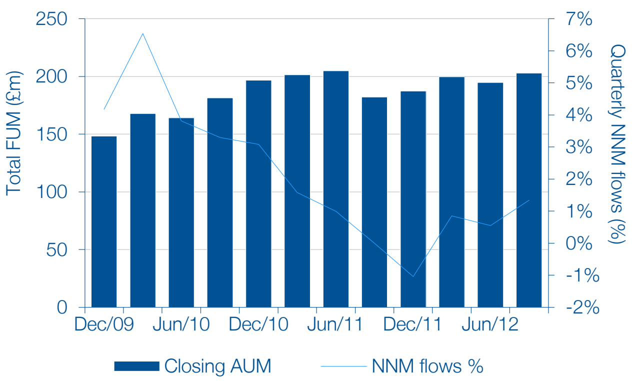
Company description: Long-established history

Schroders is a diversified global asset manager with £202bn (September 2012) in funds under management, 62% of which are sourced from outside the UK. Unlike other asset managers, Schroders also has a private banking business with £16bn in funds under management, which generated 9% of total FY11 revenues. Consistent fund flows, coupled with tight cost controls, have meant Schroders has been able to grow adjusted EBIT by 164% over the three years to FY12e.

Fund flows: Strong organic growth

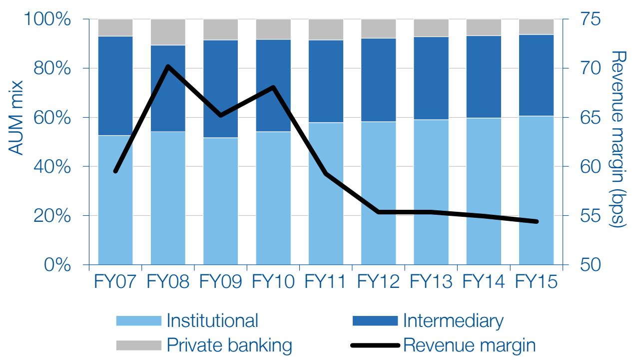
Schroders' organic fund inflows have been among the strongest of all the managers in our sample group. Over the last three years to FY12e, AUM has increased 39%, with 25% coming from NNM flows and the other 14% from investment performance. Net retail flows have recovered in 2012 (+£1.8bn ytd) due to strong interest in its multi-asset and, to a lesser extent, its fixed-income products. Institutional fund flows remain robust (+£3.8bn ytd), driven by high levels of net new business notably from its Asia-Pacific clients, but management expects these to slow in the fourth quarter. Although a small part of the overall business, the private bank has seen negative flows in 2012 (-£300m ytd). We forecast total NNM inflows of c 4% to continue over the long term due to its strong brand name, global distribution capabilities and solid long-term investment performance.

Exhibit 1: AUM growth and NNM flows



Source: Company data, Edison Investment Research

Exhibit 2: Asset mix drives margin progression



Source: Company data, Edison Investment Research

Operational efficiency: Asset mix lowering revenue margins

NNM inflows have increased the proportion of institutional funds under management to 58% (2008: 54%), which has resulted in a reduction in its FY12e revenue fee margins to 54bp (2008: 61bp). Management expects this trend to continue with a further 1-2%-point decrease in margins over the near term as it looks to target continued growth in multi-asset and fixed income. This margin decline has been at a much slower rate than the growth in AUM, allowing significant revenue improvement over this period. Schroders has also maintained good cost controls, while growing and investing in the business, with operating margins improving from 16% in FY08 to 35% in FY11. But we forecast this to fall to 31% in FY12e due to lower performance fees and an increase in operating expenses. The latter is largely due to a major upgrade of its IT systems and taking advantage of the dislocation in markets to make strategic hires. While these investments lower margins in the near term, management is confident they will position the firm well for the long term.

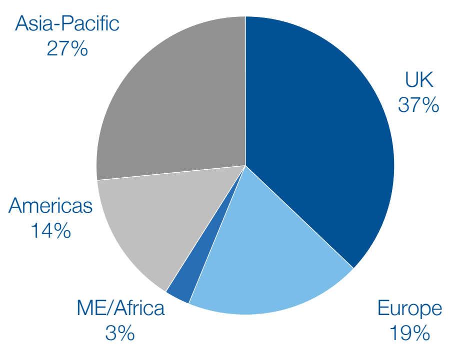
Fund performance: Stable long-term returns

Fund performance remains strong with 63% and 68% of funds outperforming their benchmark or peer group over the last one and three years to September 2012. However, in some important areas where market fund flows have been strong, performance has not been as good. In particular, its corporate bond funds (c €10bn in FUM) have underperformed over the important one-, three- and five-year periods. According to the Investment Management Association (IMA), corporate bonds have been among the bestselling retail funds over recent years.

Distribution and product portfolio: Diversification provides stability

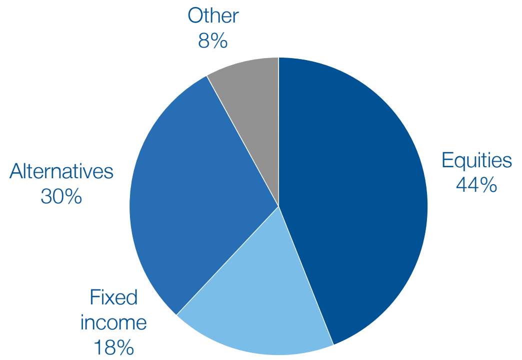
Although the majority of Schroders' clients are located in the UK and Europe (59%) and invest in equities (44%), a large proportion of its clients are located within Asia-Pacific (27%) and the Americas (14%). This regional diversification of clients means 67% of its nine-month revenues were earned from outside the UK. Schroders also has a large presence in emerging markets with c £30bn of equities and c £6bn of fixed income invested in emerging markets. This diversified product portfolio and extensive distribution network puts the company in a very strong position to maintain growth in existing markets, capitalise on the growing wealth in emerging markets, while mitigating a slowdown in NNM flows from any one market.

Exhibit 3: Client base



Source: Company data

Exhibit 4: AUM mix

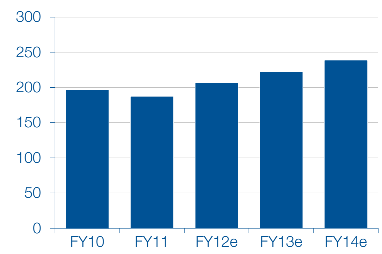


Source: Company data

Valuation

In addition to peer analysis, we have calculated a sum-of-the-parts valuation by applying EV/EBITDA multiples to its different FY13e revenue streams. Schroders has had significant surplus capital for more than a decade. Despite external pressure to use it or return it to shareholders, the company has retained the bulk and only made a few relatively small acquisitions in this period. We forecast FY13e net assets of £2.8bn, which, assuming a regulatory capital requirement of c £0.5bn plus a £0.5bn buffer, generates surplus capital of £1.4bn (£1.1bn investment capital and £0.3bn operational capital). We believe its FY13e enterprise value should be adjusted for the total investment capital of £1.1bn. We have applied an FY13e EV/EBITDA multiple of 9.0x to its asset management business (20% premium) and the average of the private wealth sector (7.4x) to its private bank. Based on this approach, we estimate a fair value for Schroders of £16.72, which reiterates its slight premium to peers.

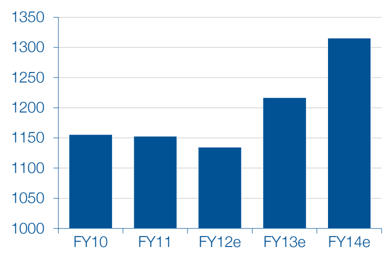
AUM (£m)



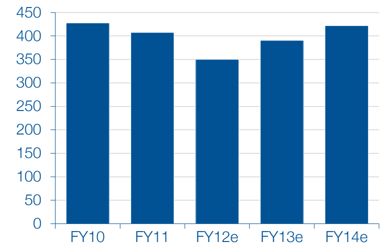
Valuation: Sum-of-the-parts

Valuation: Sum-of-the-parts	FY13e EBITDA	Multiple	
Asset management (£m)	399	9.0x	3,571
Private bank (£m)	21	7.4x	157
Group/other (£m)	(14)	9.0x	(125)
Add investment capital (£m)			1,122
Implied equity value (£m)			**4,725**
Number of shares (m)			283
FY13e fair value			**£16.72**

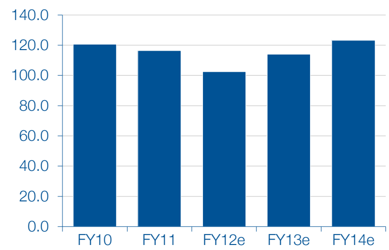
Revenue (£m)



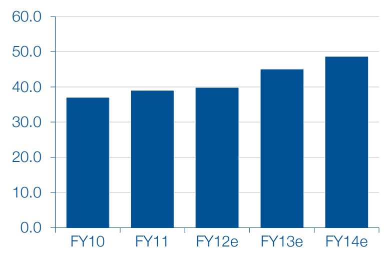
Adjusted EBIT (£m)



Adjusted diluted EPS (p)



DPS (p)



Edison model

Schroders	£m	2010	2011	2012e	2013e	2014e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		**1,156**	**1,153**	**1,135**	**1,217**	**1,315**
Operating expenses		(672)	(720)	(765)	(811)	(877)
EBITDA (norm)		**483**	**433**	**370**	**406**	**438**
Depreciation & amortisation		(19)	(14)	(15)	(15)	(16)
Operating profit (norm)		**428**	**407**	**350**	**391**	**422**
Goodwill and amortisation of acquired intangibles		(10)	(5)	(5)	(5)	(5)
Exceptionals		(36)	(11)	(5)	0	0
Other		0	0	(0)	(0)	(0)
Operating Profit		**382**	**391**	**340**	**385**	**417**
Net Interest		10	15	11	11	11
Other		16	2	9	10	12
Profit Before Tax (norm)		**453**	**424**	**370**	**412**	**445**
Profit Before Tax (FRS 3)		**407**	**407**	**360**	**407**	**440**
Tax		(96)	(92)	(83)	(94)	(101)
Profit After Tax (norm)		**346**	**329**	**285**	**317**	**342**
Profit After Tax (FRS 3)		**311**	**316**	**277**	**313**	**338**
Average Number of Shares Outstanding (m)		290.4	282.5	282.5	282.5	282.5
Basic EPS - Company reported		111.8	115.9	102.6	115.9	125.3
Dilluted EPS - Company reported		108.3	111.9	99.6	112.6	121.7
Adjusted diluted EPS - Edison		120.7	116.5	102.4	114.0	123.1
Dividend per share (p)		37.0	39.0	39.9	45.0	48.7
Revenue Margin - AM (%)		58.8	57.1	53.9	53.8	53.4
EBITDA Margin norm. (%)		41.8	37.5	32.6	33.4	33.3
Operating Margin norm. (%)		37.0	35.3	30.8	32.1	32.1
BALANCE SHEET						
Fixed Assets		**971**	**918**	**910**	**901**	**892**
Intangible Assets		143	144	139	134	129
Tangible Assets		19	16	13	9	5
Investments		809	758	758	758	758
Current Assets		**4,130**	**4,321**	**4,749**	**5,273**	**5,848**
Debtors		374	411	405	434	469
Cash		2,004	2,339	2,772	3,267	3,807
Other		1,752	1,572	1,572	1,572	1,572
Long Term Liabilities		**(554)**	**(440)**	**(440)**	**(440)**	**(440)**
Long term borrowings		0	0	0	0	0
Other long term liabilities		(554)	(440)	(440)	(440)	(440)
Current Liabilities		**(2,747)**	**(2,898)**	**(2,889)**	**(2,931)**	**(2,980)**
Creditors		(496)	(581)	(572)	(613)	(663)
Short term borrowings		0	0	0	0	0
Other		(2,251)	(2,317)	(2,317)	(2,317)	(2,317)
Assets backing unit-linked liabilities		**8,273**	**8,645**	**9,077**	**9,531**	**10,008**
Unit-linked liabilities		**(8,273)**	**(8,645)**	**(9,077)**	**(9,531)**	**(10,008)**
Net Assets		**1,800**	**1,902**	**2,329**	**2,804**	**3,320**
CASH FLOW						
Operating cash flow		**1,066**	**427**	**364**	**401**	**434**
Capex		(10)	(13)	(6)	(7)	(7)
Cash flow from investing activities		(5)	139	22	23	25
Dividends		(88)	(105)	108	116	129
Other financing activities		(122)	(146)	(2)	(2)	(2)
Other		0	0	0	0	0
Net Cash Flow		**841**	**302**	**487**	**531**	**578**
Opening net debt/(cash)		(1,769)	(2,712)	(3,012)	(3,499)	(4,030)
Decrease / (increase) debt		0	0	0	0	0
Other		(102)	1	0	0	0
Closing net debt/(cash)		**(2,712)**	**(3,012)**	**(3,499)**	**(4,030)**	**(4,608)**
FUM						
Opening FUM		**148**	**197**	**187**	**207**	**225**
Net new money flows		27	3	7	8	9
Investment performance		21	(13)	13	10	11
Other		0	0	0	0	0
Closing FUM		**197**	**187**	**207**	**225**	**245**

Source: Bloomberg, company data, Edison Investment Research

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