

# Record

Trading update

## Net client inflows on their way

Record has reported that assets under management equivalent (AUME) in dollar terms were broadly flat in the quarter to December 2014, with net inflows amounting to just \$0.1bn. However, management has announced it expects \$2bn of net inflows in the current quarter. We estimate that these will produce a small uplift in profits despite a further shift from higher-margin dynamic mandates to lower-margin passive ones. We do not expect any impact from the Swiss franc currency turmoil as Record uses high-quality bank counterparties for its clients' business and not retail brokers. Unlike most other asset managers, Record should benefit from increased market (especially currency) volatility, which should increase demand for its hedging services and offer more scope for its currency for return strategies to perform. When allowance is made for the high element of cash in its balance sheet, the shares are modestly rated compared with other asset managers.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13	18.3	5.8	2.0	1.50	16.5	4.5
03/14	20.3	6.9	2.4	1.50	13.7	4.5
03/15e	19.8	6.5	2.3	1.50	14.3	4.5
03/16e	20.6	6.8	2.5	1.50	13.5	4.5

Note: \*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

## Q3 trading update

AUME at 31 December was \$52.7bn (30 September \$52.6bn), though there was a rise in sterling terms to £33.8bn (£32.4bn) as a result of the strength of the US dollar vs sterling. There were inflows across the product range, but profit taking in the dynamic hedging mandates resulted in net outflows in that area, which meant that net new client AUME amounted to \$0.1bn. During the quarter, average fee rates were broadly unchanged from the previous quarter across all product types.

## New client inflows for the next quarter

Record has been notified by its clients that in aggregate it will have an additional \$2bn of AUME to manage in the next quarter, though there will be a further shift from higher-margin dynamic hedging business to lower-margin passive activities. Even so, the inflows should be modestly accretive to revenues and earnings. This marks a welcome return to growth and Record hopes that recent currency turmoil will show the benefits of its hedging services.

## Valuation: Discount to peers if cash is included

Record is trading at a P/E ratio of 14.3x for its current financial year according to our forecasts, in line with the rating of 14.5x for US and UK asset managers, but there is a wide range of 10x to 18x. However, Record has a large amount of free cash resources in its balance sheet, which account for a third of its market capitalisation. On an EV/EBITDA basis, it is trading at a near 30% discount to other asset managers.

## Financial services

22 January 2015

**Price** 33.3p

**Market cap** £74m

US\$1.52/£

Net cash (£m) at 30 September 2014 27.7  
(including restricted cash and short-term money market instruments)

Shares in issue 221.4m

Free float 47%

Code REC

Primary exchange LSE

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs (3.6) 7.3 (7.6)

Rel (local) (6.2) 1.2 (6.4)

52-week high/low 43.8p 29.5p

## Business description

Record is a specialist currency manager, providing currency hedging and return-seeking mandates to institutional clients. Services include passive and dynamic hedging and return-seeking currency strategies via funds or segregated accounts.

## Next event

Q4 trading update 24 April 2015

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## Trading update

There was a modest \$0.1bn increase in AUME in Q315, in line with the previous two quarters, which had seen inflows of \$0.2bn in aggregate, as we show in the following exhibit.

**Exhibit 1: Record AUME Q315**

	30 September 2014		31 December 2014		New client AUME
	\$bn	%	\$bn	%	\$bn
Dynamic	10.6	20%	9.7	18%	(0.6)
Passive	39.1	74%	40.0	76%	0.5
Currency for return	2.6	5%	2.8	5%	0.3
Cash	0.3	1%	0.2	0%	(0.1)
	<b>52.6</b>	<b>100%</b>	<b>52.7</b>	<b>100%</b>	<b>0.1</b>

Source: Record

Net client AUME inflow of \$0.1bn was composed of outflows of \$0.6bn from its dynamic hedging mandates offset by inflows of \$0.5bn into passive hedging mandates and \$0.3bn into currency for return funds. The dynamic mandates have performed well and the strength of the US dollar has meant many US clients' hedging positions are in the money. Some clients have chosen to take these profits, hence the outflows. Fee rates for all products in the quarter were broadly unchanged from the previous quarter. The dynamic hedging average management fee rate remains around 14bp per year and currency for return rates are at 16bp with passive hedging just 3bp (cash nil), so the increase in the proportion of AUME accounted for by passive strategies will lower the overall average fee rate.

Record has announced that its current and prospective clients have notified it that in the next quarter it can expect the following flows:

**Exhibit 2: New client AUME inflows**

	\$bn
<b>Dynamic hedging</b>	
Inflows	0.8
Outflows	(1.4)
	<b>(0.6)</b>
<b>Passive hedging</b>	
Net inflows	2.3
<b>Currency for return</b>	
New client	0.3
<b>Total</b>	<b>2.0</b>

Source: Record

It is a positive development that net inflows have resumed as in the first nine months of the current financial year new client inflows were just \$0.3bn. The new inflows are largely in low-margin passive hedging strategies, though there are some welcome inflows into higher-margin currency for return products. Dynamic hedging strategies will suffer further outflows in the current quarter, after similar ones in Q3, largely because of profit taking from US clients who have seen their hedging strategies produce good returns given the strength of the US dollar.

It is paradoxical that the expected trend of US dollar strength, which Record hopes will boost demand for its hedging services over the long term, is causing short-term outflows in its dynamic hedging business. In recent currency US dollar cycles, the US dollar has shown periods of strength and weakness lasting around seven years (see chart below), and Record hopes that profit taking by some of Record's US dynamic hedging clients may prove to be temporary until they are more comfortable with a rising US dollar.

**Exhibit 3: US\$ real trade-weighted index**


Source: Bloomberg

The new client inflows mainly consist of low-fee passive hedging products, which will put further pressure on the aggregate fee rate. We estimate that the net effect of these inflows on an annualised basis will be around \$0.2m to \$0.3m. However, a positive development is Record's new currency for return client, which should give the company around \$0.3bn to manage in the next quarter. The client is investing in its multi-strategy product, which comprises exposure to each of its currency for return strategies, the second client to do so. This is Record's flagship currency for return product, which should offer investors positive performance from currencies that are uncorrelated to other asset classes. An ungeared portfolio in this strategy produced a return of 1% in the quarter to 31 December 2014 and the annualised performance since inception has been 2.51% per year.

## Effect of the uncapping of the Swiss franc

On 15 January 2015 the Swiss National Bank announced that it will cease to cap the Swiss franc to 1.20 to the euro. Since then the Swiss franc has soared in value against the euro, in what was one of the largest one-day moves in a developed market currency ever. Record can report that it has weathered this currency storm in good shape, with its Swiss clients' hedging strategies proving effective and no exposure to insolvent retail FX brokers.

Record had significant Swiss franc passive hedging mandates, CHF28bn worth at 30 September 2014, as it is mandatory for Swiss pension funds to hedge currency exposure and Record has won a small share of this business. These hedges are in the money and have been profitable for its Swiss pension clients. On the other hand, Swiss franc hedges for non-Swiss franc clients have produced losses, but such business is considerably smaller than hedging for Swiss pension fund clients. Within Record's currency for return strategies, the sudden strength of the Swiss franc has resulted in some negative performances in the currency value strategy, which attempts to utilise the concept that developed market currencies typically trade around a long-term fair value, and in its forward rate bias, or 'carry' strategies, but its momentum strategy has benefited and the emerging markets strategy had no Swiss franc exposure.

There have been numerous press reports of currency traders, especially retail brokers, being made insolvent by the Swiss franc currency move. Record does not use such brokers for its clients' trading activities, nor does it take any principal positions in currencies itself, so it is unaffected by the collapse of these firms. Record's clients use major international highly rated banks for their currency trades and not the firms that have run into trouble. The recent Swiss franc currency turmoil has led to greater client engagement, which in the longer term may boost demand for its currency strategies.



Record believes that its current business is in much better shape than in the previous financial crisis in 2008, when its forward rate bias currency for return strategies underperformed and suffered significant outflows. Today, there is more diversification by product and client as passive and dynamic hedging strategies now produce significant amounts of revenue and the client base is more diversified. At the time of the last financial crisis, its client base was heavily exposed to one strategy, the Active Forward Rate Bias product, whose clients left en masse when their strategies were not producing the anticipated returns. Client numbers have also begun to expand again, to 51 at the end of December 2014, compared with 49 at the end of September 2014 and just 41 in March 2012.

## Financials

### Estimate update and outlook

We have revised our forecasts after Record's trading update and have increased our FY15 and FY16 EPS forecasts by 6% and 11% respectively, largely as a result of the strengthening US dollar (\$1.52/£ from \$1.62/£ used previously) and higher than previously expected product margins in 2015 (6.1bp from 5.9bp previously). We have included the new client flows that Record expects in Q415 given the fact that Record has been notified by clients about them. For future periods, we have not included new wins or losses, consistent with our past practice. Given that the current quarter is only a few weeks old, it is possible that there will be additional client flows in the quarter, either in or out, but we have not included them in our forecasts.

**Exhibit 4: Earnings revisions**

	Revenue (£m)		% chg.	PBT* (£m)		% chg.	EPS* (p)		% chg.	DPS (p)		% chg.
	Old	New		Old	New		Old	New		Old	New	
03/14	20.3	20.3	N/A	6.9	6.9	N/A	2.43	2.43	N/A	1.50	1.50	N/A
03/15e	19.1	19.8	4%	6.0	6.5	8%	2.19	2.32	6%	1.50	1.50	N/A
03/16e	19.6	20.6	5%	6.1	6.8	11%	2.22	2.47	11%	1.50	1.50	N/A

Source: Company data, Edison Investment Research. Note: \*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

## Valuation

Record is trading at a P/E ratio of 14.3x for its current financial year according to our forecasts, in line with US and UK asset managers' rating of 14.5x according to Bloomberg, but there is a wide range of 10x to 18x. However, Record has a large amount of free cash resources in its balance sheet, which account for a third of its market capitalisation. On an EV/EBITDA basis, it is trading at a near 30% discount to other asset managers.

**Exhibit 5: Record rating vs UK and US asset managers**

	Price	Market cap	P/E ratio		EV/EBITDA	
	Local currency	£m	Current year	Next year	Current year	Next year
MAN Group (p)	161.5	2,968	9.9	9.7	9.2	8.9
Aberdeen Asset Management (p)	412.2	5,549	12.1	11.1	9.1	8.3
Schroders (p)	2,678.0	7,234	17.5	15.6	7.2	6.5
Henderson (p)	219.0	2,523	14.8	13.9	12.7	11.1
Jupiter (p)	350.5	1,628	13.6	13.0	9.3	9.1
Ashmore (p)	260.4	1,840	12.2	11.8	7.1	6.8
Blackrock (US\$)	346.6	38,351	17.1	14.9	12.0	10.7
Franklin Resources (US\$)	51.6	21,226	13.7	12.8	7.9	7.3
Invesco(US\$)	36.0	10,249	14.3	13.1	10.4	9.7
Legg Mason(US\$)	53.2	4,014	16.1	13.0	11.9	9.9
T Rowe Price(US\$)	81.4	13,954	18.1	16.6	9.7	9.0
<b>Average</b>			<b>14.5</b>	<b>13.2</b>	<b>9.7</b>	<b>8.8</b>
Record plc	33.3	74	14.3	13.5	6.8	6.5

Source: Edison Investment Research and Bloomberg. Note: Prices at close 20 January 2015.

**Exhibit 6: Financial summary**

	£000s	2011	2012	2013	2014	2015e	2016e
Year end March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>							
Revenue (norm)		28,169	20,542	18,258	20,286	19,774	20,593
Revenue		28,196	20,535	18,552	19,922	19,782	20,593
Operating expenses		(15,652)	(13,875)	(12,349)	(13,190)	(13,206)	(13,789)
EBITDA (norm)		12,517	6,667	5,909	7,096	6,568	6,804
Depreciation & amortisation		(191)	(106)	(283)	(308)	(312)	(163)
Operating profit (norm)		12,326	6,561	5,626	6,788	6,345	6,641
Normalised operating margin %		43.8%	31.9%	30.8%	33.5%	32.1%	32.2%
Goodwill and amortisation of acquired intangibles		0	0	0	0	0	0
Seed fund consolidation adjustment		27	(7)	294	(364)	8	0
Operating Profit		12,353	6,554	5,920	6,424	6,353	6,641
Net Interest		184	155	158	113	140	140
Profit Before Tax (norm)		12,510	6,716	5,784	6,901	6,485	6,781
Profit Before Tax (FRS 3)		12,537	6,709	6,078	6,537	6,493	6,781
Tax		(3,603)	(1,803)	(1,450)	(1,494)	(1,384)	(1,356)
Profit After Tax (norm)		8,915	4,911	4,404	5,324	5,103	5,425
Profit After Tax (FRS 3)		8,934	4,906	4,628	5,043	5,109	5,425
Average Diluted Shares Outstanding (m)		221.3	220.3	219.1	218.7	219.5	219.5
Basic EPS - Company reported (p)		4.0	2.2	2.0	2.5	2.3	2.5
Diluted EPS - Company reported (p)		4.0	2.2	2.0	2.5	2.3	2.5
Adjusted diluted EPS - Edison (p)		4.0	2.2	2.0	2.4	2.3	2.5
Dividend per share - proposed (p)		4.6	1.50	1.50	1.50	1.50	1.50
Revenue Margin - AM (%)		14.0	11.2	8.8	7.6	6.1	5.6
EBITDA Margin norm. (%)		44.4	32.5	32.4	35.0	33.2	33.0
Operating Margin norm. (%)		43.8	31.9	30.8	33.5	32.1	32.2
<b>BALANCE SHEET</b>							
Fixed Assets		4,404	2,398	1,108	3,732	3,524	3,371
Intangible Assets		1,085	1,140	963	734	559	426
Tangible Assets		227	183	140	86	53	32
Investments		3,092	1,075	5	2,912	2,912	2,912
Current Assets		31,632	29,675	34,637	32,835	34,857	37,258
Debtors		6,904	5,070	5,569	5,646	5,606	5,836
Cash		24,728	24,572	29,025	11,503	13,565	15,736
Money market instruments		0	0	0	15,488	15,488	15,488
Other		0	33	43	198	198	198
Long Term Liabilities		0	(15)	0	0	0	0
Long term borrowings		0	0	0	0	0	0
Other long term liabilities		0	(15)	0	0	0	0
Current Liabilities		(5,938)	(3,442)	(3,457)	(3,660)	(3,643)	(3,743)
Creditors		(4,089)	(2,494)	(2,672)	(2,706)	(2,689)	(2,789)
Short term borrowings		0	0	0	0	0	0
Other		(1,849)	(948)	(785)	(954)	(954)	(954)
Net Assets		30,098	28,616	32,288	32,907	34,739	36,886
<b>CASH FLOW</b>							
Operating cash flow		8,241	2,393	5,609	5,167	5,214	5,318
Capex		(85)	(52)	(63)	(25)	(15)	(9)
Cash flow from investing activities		(491)	93	149	(18,376)	140	140
Dividends		(5,723)	(7,371)	(1,645)	(4,898)	(3,278)	(3,278)
Other financing activities		925	784	403	610	0	0
Other		0	0	0	0	0	0
Net Cash Flow		2,867	(4,153)	4,453	(17,522)	2,062	2,172
Opening unrestricted net debt/(cash)		(21,861)	(23,728)	(22,372)	(25,425)	(11,503)	(13,565)
Decrease / (increase) debt		0	0	0	0	0	0
Other		1,000	(2,797)	1,400	(3,600)	0	0
Closing unrestricted net debt/(cash)		(23,728)	(22,372)	(25,425)	(11,503)	(13,565)	(15,736)
Closing unrestricted net debt/(cash) inc money market instruments		(23,728)	(22,372)	(25,425)	(26,991)	(29,053)	(31,224)
<b>AUME</b>							
Opening (\$bn)		34.0	31.4	30.9	34.8	51.9	55.1
Net new money flows		(3.6)	0.3	2.0	14.1	2.3	0.0
Investment performance		1.0	(0.8)	1.9	3.0	0.9	1.6
Other		0.0	0.0	0.0	0.0	0.0	0.0
Closing (\$bn)		31.4	30.9	34.8	51.9	55.1	56.6

Source: Company accounts, Edison investment Research

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