

# Record

Q4 IMS

## Modest Q4 progress; FY14 estimates reaffirmed

Record has issued a trading update for the fourth quarter of its fiscal year that ended 31 March 2014. Full-year results will be published on 17 June. Modest fund inflows and relatively stable fee margins in Q4 lead us to confirm our FY14 estimates. A changing mix of AUME at year-end, as well as the previously announced dynamic hedging mandate loss, feed through into a lower FY15 forecast (c 13% lower PBT). Our forward estimates continue to include no new business wins, an assumption that could easily be conservative given increased levels of interest in currency management strategies among potential clients and their consultants.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13	18.3	5.8	2.0	1.5	17.0	4.4
03/14e	20.1	6.9	2.4	1.5	14.2	4.4
03/15e	19.6	6.3	2.2	1.6	15.4	4.7
03/16e	20.1	6.5	2.2	1.6	15.4	4.7

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

## Modest Q3 AUME growth completes strong year

Assets under management equivalent (AUME) reached \$51.9bn at 31 March 2014, slightly ahead of both the \$51.5bn that we had forecast, and the \$51.1bn total at 31 December 2013. Q4 passive hedging net inflows of \$1.3bn were partially off-set by \$0.9bn of dynamic hedging outflows. FX translation effects and market movements were positive. Net inflows of \$0.3bn took the full year inflow to \$14.1bn. Fee rates across all products remained broadly unchanged in the quarter.

## Hedging interest remains strong

The absence of a sustained or pronounced US dollar appreciation, despite on-set of tapering of quantitative easing, has seen some cooling of interest in currency hedging strategies from US investors since last summer. However, that interest could quickly return. Meanwhile, currency management strategies continue to be of interest to more potential clients and consultants than has historically been the case. Management remains optimistic that further opportunities in both return seeking mandates and hedging strategies will present themselves.

## Valuation: Upside from new business wins

Our 2014 estimates are unchanged but the AUME mix changes and the recently lost mandate reduce our updated FY15 and FY16 PBT estimates by c 13%. We continue to assume no new business wins in our forward-looking estimates. On a calendar year basis, Record trades at c 15x 2014 and 2015 earnings. The c 20% premium to other smaller UK asset managers for 2015 is supported by a strong balance sheet (free cash resources equivalent to around one-third of market cap) but may act as drag until the company is able to announce further new business wins; with a scalable platform, Record's earnings would respond positively.

### Financial services

24 April 2014

**Price** **34.0p**
**Market cap** **£75m**

US\$/£1.64

Net cash (£m) as at 30 Sept 2013 (inc restricted cash and short-term money market instruments) 27.7

Shares in issue 221.4m

Free float 47%

Code REC

Primary exchange LSE

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (21.4) (9.9) 8.8

Rel (local) (22.4) (8.8) 2.6

52-week high/low 43.75p 28.25p

### 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

FY14 full-year results 17 June 2014

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## Modest Q4 progress; FY14 estimates reaffirmed

Record has issued a trading update for fourth quarter of its fiscal year that ended 31 March 2014. Full-year results will be published on 17 June 2014, and a trading update for the first quarter of FY15 will be issued on 18 July. Modest fund inflows and relatively stable fee margins lead us to confirm our FY14 estimates. A changing mix of AUME at year-end, as well as the previously announced dynamic hedging mandate loss, feed through into a lower FY15 forecast (c 13% lower PBT). Our forward estimates continue to include no new business wins, an assumption that could easily be conservative.

## Modest growth in AUME

AUME<sup>1</sup> reached \$51.9bn at 31 March 2014, slightly ahead of both the \$51.5bn that we had forecast, and the \$51.1bn total at 31 December 2013.

**Exhibit 1: AUME development (\$bn)**

	Q3 FY14A	Q4 FY14A	Q4 FY14E
Dynamic hedging	12.1	11.3	12.2
Passive hedging	36.1	37.9	36.4
Currency for return	2.5	2.4	2.5
Cash & futures	0.4	0.3	0.4
Total AUME	51.1	51.9	51.5

Source: Company data, Edison Investment Research

Net client flows during Q4 were \$0.3bn. Passive hedging net inflows were \$1.3bn (c 3.6% of the total at the quarter opening), while dynamic hedging net outflows were \$0.9bn (c 7.4%), and cash and futures showed a small \$0.1bn decrease. Exchange rate movements (affecting the conversion into US dollars) and market movements (primarily in the value of the underlying assets being managed for clients) were a positive \$0.5bn.

**Exhibit 2: Quarterly AUME movement (\$bn)**

	Q3 FY14A	Q4 FY14A	Q4 FY14E
Dynamic hedging	(0.3)	(0.9)	0.0
Passive hedging	12.2	1.3	0.0
Currency for return	0.0	0.0	0.0
Cash & futures	0.1	(0.1)	0.0
Net flows	12.0	0.3	0.0
FX and market movements	1.4	0.5	0.4
Total	13.4	0.8	0.4

Source: Company data, Edison Investment Research

The change in dynamic hedging AUME during the quarter includes \$600m of inflow from the new mandate that was announced on 14 January 2014; in our forecasts we had assumed that this would fund during early FY15. The termination of the dynamic hedging mandate announced on 1 April 2014 does not reflect in the Q4 flows above, but is allowed for in our FY15 estimates for the first time. Management has guided that the loss of this mandate will reduce revenues by c £0.7m and PBT by c £0.5m in the year to 31 March 2015. Record attributes the net out-flow of dynamic hedging AUME in Q4 to reductions in the size of some of its existing mandates.

There were small but encouraging inflows (\$20m) into the Record FTSE FRB10 Index Fund (currency for return) during the period.

<sup>1</sup> As a currency manager Record manages only the impact of foreign exchange and not the underlying assets, therefore its "assets under management" are notional rather than real. To distinguish this from the AUM of conventional asset managers, Record uses the concept of assets under management equivalents "AUME" and by convention this is quoted in US dollars

## Range-bound trading markets limit opportunities in quarter

Record's dynamic hedging strategies performed as expected during the period. For US clients, weakness in the US dollar generated negative performance, although the systematic lowering of hedge ratios helped to limit losses on yen and Australian dollar hedges; conversely, range trading in the euro versus the US dollar generated risk management costs. For UK-based clients, range bound trading during much of the period similarly impeded returns, producing modest underperformance.

The Active Forward Rate Bias (FRB) product produced a negative ungeared performance of -0.66% in the quarter (Q3 positive 1.41%), while the FTSE Currency FRB10 index produced a positive return of 1.31%; the FTSE FRB10 Fund more closely tracks the index, on a 1.8x geared basis.

Emerging Market performance was positive in the quarter (0.35% on an ungeared basis compared with 0.60% in Q3), with performance since inception (30 November 2009) increasing to 1.85% pa.

Record's multi-strategy product produced a negative ungeared return of 0.36% (Q3 positive 1.28%).

## Estimate update and outlook

The trading statement, including comment that fee rates for all products have remained broadly unchanged in the quarter, appears consistent with our estimates for FY14 and we have made no changes. The changing mix of AUME in Q4 (inflows of lower revenue margin passive hedging largely offset by outflows from higher revenue margin dynamic hedging) as well as the need to adjust for the recently announced mandate loss are the reasons for a c 13% reduction in FY15 PBT and EPS estimates, with the lower base feeding through to our FY16 estimates. It is important to note that our estimates include no assumption of new business wins (or losses).

**Exhibit 3: Earnings revisions**

	Revenue (£m)		% chge.	PBT*		% chge.	EPS*		% chge.	DPS		% chge.
	Old	New		Old	New		Old	New		Old	New	
03/14e	20.1	20.1	0.0%	6.9	6.9	0.0%	2.38	2.38	-0.1%	1.5	1.5	0.0%
03/15e	21.0	19.6	-6.3%	7.2	6.3	-12.5%	2.49	2.18	-12.6%	1.57	1.57	0.0%
03/16e	21.6	20.1	-6.7%	7.5	6.5	-13.4%	2.57	2.22	-13.6%	1.62	1.62	0.0%

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

Management has recently commented that the absence of a sustained or pronounced US dollar appreciation, despite on-set of tapering of quantitative easing, has seen some cooling of interest in currency hedging strategies from US investors since last summer. That interest could quickly return. Meanwhile, currency management strategies continue to be of interest to more potential clients and consultants than has historically been the case. Management remains optimistic that further opportunities in both return seeking mandates and hedging strategies will present themselves.

**Exhibit 4: Financial summary**

Record	£'000s	2012	2013	2014e	2015e	2016e
March		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue (norm)		20,542	18,258	20,146	19,637	20,108
Revenue		20,535	18,552	20,146	19,637	20,108
Operating expenses		(13,875)	(12,349)	(13,244)	(13,310)	(13,684)
EBITDA (norm)		6,667	5,909	6,902	6,327	6,425
Depreciation & amortisation		(106)	(283)	(220)	(185)	(157)
Operating profit (norm)		6,561	5,626	6,683	6,142	6,268
Goodwill and amortisation of acquired intangibles		0	0	0	0	0
Exceptionals		(7)	294	0	0	0
Other		0	0	0	0	0
Operating Profit		6,554	5,920	6,683	6,142	6,268
Net Interest		155	158	180	193	205
Profit Before Tax (norm)		6,716	5,784	6,862	6,334	6,473
Profit Before Tax (FRS 3)		6,709	6,078	6,862	6,334	6,473
Tax		(1,803)	(1,450)	(1,637)	(1,511)	(1,544)
Profit After Tax (norm)		4,911	4,404	5,225	4,823	4,929
Profit After Tax (FRS 3)		4,906	4,628	5,225	4,823	4,929
Average Diluted Shares Outstanding (m)		220.3	219.1	219.8	221.7	221.7
Basic EPS - Company reported		2.2	2.0	2.4	2.2	2.2
Diluted EPS - Company reported		2.2	2.0	2.4	2.2	2.2
Adjusted diluted EPS - Edison		2.2	2.0	2.4	2.2	2.2
Dividend per share - proposed (p)		1.5	1.5	1.5	1.6	1.6
Revenue Margin - AM (%)		11.3	8.5	7.5	6.2	6.2
EBITDA Margin norm. (%)		32.5	32.4	34.3	32.2	32.0
Operating Margin norm. (%)		31.9	30.8	33.2	31.3	31.2
<b>BALANCE SHEET</b>						
Fixed Assets		2,398	1,108	937	792	670
Intangible Assets		1,140	963	813	687	580
Tangible Assets		183	140	118	100	84
Investments		1,075	5	5	5	5
Current Assets		29,675	34,637	36,969	38,543	40,186
Debtors		5,070	5,569	6,048	5,895	6,036
Cash		24,572	29,025	30,878	32,606	34,107
Other		33	43	43	43	43
Long Term Liabilities		(15)	0	0	0	0
Long term borrowings		0	0	0	0	0
Other long term liabilities		(15)	0	0	0	0
Current Liabilities		(3,442)	(3,457)	(3,685)	(3,612)	(3,679)
Creditors		(2,494)	(2,672)	(2,900)	(2,827)	(2,894)
Short term borrowings		0	0	0	0	0
Other		(948)	(785)	(785)	(785)	(785)
Net Assets		28,616	32,288	34,221	35,723	37,177
<b>CASH FLOW</b>						
Operating cash flow		2,393	5,609	5,194	5,089	5,011
Capex		(52)	(63)	(48)	(41)	(34)
Cash flow from investing activities		93	149	0	0	0
Dividends		(7,371)	(1,645)	(3,292)	(3,321)	(3,476)
Other financing activities		784	403	0	0	0
Other		0	0	0	0	0
Net Cash Flow		(4,153)	4,453	1,853	1,727	1,501
Opening unrestricted net debt/(cash)		(23,728)	(22,372)	(25,425)	(27,278)	(29,006)
Decrease / (increase) debt		0	0	0	0	0
Other		(2,797)	1,400	0	0	0
Closing unrestricted net debt/(cash)		(22,372)	(25,425)	(27,278)	(29,006)	(30,507)

Source: Company data, Edison Investment Research

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