

# Record

FY14 strong volumes at lower fee margin

Record's FY14 results contained few surprises. As had previously been announced, AUME saw rapid growth driven by lower fee margin but stickier passive hedging products. Customer numbers were up in all product areas including increased cross-sales. Looking forward, already announced mandate losses and fee reductions in dynamic hedging explain the lower starting point for our forecasts. These estimates do not incorporate significant mandate wins (or losses) but with renewed interest in return-seeking strategies and greater variance in global monetary policy there are grounds for optimism here.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/13	18.3	5.8	2.0	1.5	17.8	4.2
03/14	20.3	6.9	2.4	1.5	14.8	4.2
03/15e	18.4	5.4	1.9	1.6	18.8	4.5
03/16e	18.7	5.4	1.9	1.6	18.8	4.5

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

## FY14 highlights

Record continued to grow its franchise with total customer numbers up from 44 (FY13) to 48 and growth in AUME in all of its products areas (passive hedging up \$15.8bn, dynamic hedging \$0.3bn and currency for return products \$0.8bn). The competitive environment has continued to tighten and Record responded by reducing dynamic hedging fees during the year; the run rate is now c 14bp versus an average of 16bp in FY14. The mix effect of a higher proportion of AUME in passive funding (average fee margin 3bp) also affected group margins. The group has continued to control costs resulting in overall growth in PBT (up 7%).

## Outlook

The current year will see the full-year effect of fee reductions taken in FY14 while Record also announced on 1 April 2014 that a dynamic hedging client would terminate its mandate, reducing expected revenues by £0.7m and PBT profit by £0.5m. However, the prospect of greater divergence in monetary policy globally and unexpected policy adjustments could create an increasingly healthy appetite for both the hedging and currency for return products. Specifically, a period of renewed dollar appreciation could act as a catalyst in the US market where Record is maintaining its marketing programme. While the passive mandate wins have diluted average fee margins, Record notes that these clients tend to be stickier and there is also potential to cross-sell higher margin services.

## Valuation: Upside from new business wins

Record trades at c 18.6x calendar 2015 earnings. While this represents a substantial premium to other smaller UK asset managers (12.2x), allowance needs to be made for the strong balance sheet (cash is circa one third of market cap) and the potentially geared impact of further new business wins on estimates.

FY results to March 2014

Financial services

24 June 2014

**Price** **35.63p**

**Market cap** **£79m**

US\$1.64/£

Net cash (£m) as at 31 March 2014 27.0  
(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	(4.5)	(19.5)	3.8
Rel (local)	(5.1)	(21.9)	7.0
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

Quarterly update	18 July 2014
AGM	24 July 2014
Quarterly update	17 October 2014
Interim results	14 November 2014

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## FY14 summary

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### Financial headlines

- AUME of \$51.9bn at 31 March 2014 was up 49% (or £31.1bn, up 36%). 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 tangible. To distinguish this from the AUM of conventional asset managers, Record uses the concept of assets under management equivalent ("AUME"). These numbers had already been disclosed in the IMS.
- Revenue of £19.9m (up 7%). The growth in revenue was as expected, below that in AUME because of the mix of assets. In particular, there has been strong growth in lower margin passive hedging strategy accounts, which saw an increase of \$15.8bn, while dynamic hedging grew \$0.3bn and there was an increase of \$0.8bn in currency for return products.
- The average fee margin was 8bp compared with 9bp in the prior year. Passive hedging was stable at 3bp but dynamic hedging was lower at 16bp versus 18bp, reflecting the partial impact of fee reductions. Currency for return was also down, at 17bp from 22bp, but this was purely on mix change as one mandate was reallocated from the dynamic hedging category.
- Reported PBT was £6.5m (up 7%) with good control of costs (half the cost increase arose because of the employee group profit sharing scheme).
- Operating profit margin (excluding the impact of the prior consolidation of seed funds) increased from 31% to 33%.
- The financial position remains strong with cash and money market instruments of £27m at 31 March 2014 (2013: £29m).
- Basic EPS of 2.48p per share (2013: 1.98p)
- Proposed final dividend for the year to 31 March 2014 is 0.75p per share, giving a total dividend of 1.50p per share (FY13: 1.50p). The board also indicates its intention, subject to business conditions, to maintain this level of dividend for the current year. An increase would be considered once there is a sustainable increase in profit.

### Franchise update

- Client numbers increased to 48 at 31 March 2014 (2013: 44). There has been an increase in customer numbers for each product: Passive hedging (28 vs 26), dynamic hedging (12 vs 8) and currency for return (13 vs 12). With increasing cross-selling, the number of multiple product customers has increased.
- AUME exceeds \$50.0bn for the first time in six years. Of the \$17.1bn increase in AUME during FY14, \$14.1bn was due to customer inflows, \$0.4bn from market movements and \$2.6bn from FX effects.
- Growing interest in currency for return strategies underlined by the first significant external investment into FTSE FRB10 Index Fund during the year.
- The mix of clients remains relatively broad with government and public bodies accounting for 45% of AUME (FY13: 67%), corporates 44% (FY13: 21%) and foundations and investment funds 11% (FY13: 12%). UK customers account for 21% of AUME, European 68% and US 11%.
- The business remains relatively concentrated with the top 10 clients accounting for 81% of management fees.

## Operating environment

Management reports greater US interest in currency management driven by growth in international asset allocations, combined with an expectation of US dollar appreciation. The impetus for this has weakened recently along with modest dollar weakness since early February. However, the longer-term uptrend in the dollar (trade-weighted index 102.7 versus a low of 94.0 in July 2011) and the prospect of more divergent monetary policies globally are positive factors. This backdrop has also contributed to early signs of renewed interest in currency for return strategies, in particular the forward rate bias strategy. The multi-strategy offering within this product suite will reach its third anniversary in July next year, potentially providing the basis for a wider take-up.

The higher level of new business opportunities, in particular from the US, has led to increased competitive activity and pressure on fee margins, notably in the dynamic hedging area. Further growth in mandates and AUME will be required to offset fully the impact of fee reductions undertaken in the financial year and the loss of a client announced since the year end. While large financial groups can offer a currency management service at low fee rates, Record believes its tailored service and independence are key differentiating points.

## Key performance indicators

The group uses a number of KPIs, which are detailed below. This highlights additions to AUME flowing through to a higher underlying operating margin, although the mix change noted earlier means the overall average fee margin has moved lower again. The second increase in client numbers since 2012 is encouraging.

<b>Exhibit 1: Record Group KPIs</b>					
<b>Year ended March</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
AUME (\$bn)	34.0	31.4	30.9	34.8	51.9
Client numbers	93	46	41	44	48
Average management fee rates (bp)	15	14	11	9	8
Underlying operating profit margin (%)	49	44	32	31	33
Source: Record, Edison Investment Research					

## Valuation

As noted on the front page, comparing Record's prospective P/E (18.6x calendar 2015 earnings on our estimates) with peers shows a substantial premium to peers based on Bloomberg-collected consensus (c 12.2x for 2015). However, this apparently demanding valuation needs to be considered in light of the strong balance sheet with £27m of cash, the fact that our estimates allow for very limited AUME accumulation over the period and the geared impact mandate wins could have on earnings.

## Financials

### Estimate update and outlook

Our forecast numbers are reduced (see Exhibit 2) primarily to reflect slightly reduced ongoing fee rate assumptions (-1bp) in dynamic hedging and currency for return and a small negative exchange rate adjustment. Our estimates may prove conservative as we have not included any benefit for future mandate wins in an environment that seems set to become more favourable for Record's products.

**Exhibit 2: Earnings revisions**

	Revenue (£m)		% chg.	PBT* (£m)		% chg.	EPS* (p)		% chg.	DPS (p)		% chg.
	Old	New		Old	New		Old	New		Old	New	
03/14	20.1	20.3	1	6.9	6.9	0	2.38	2.43	2	1.50	1.50	0
03/15e	19.6	18.4	(6)	6.3	5.4	(14)	2.18	1.90	(13)	1.57	1.57	0
03/16e	20.1	18.7	(7)	6.5	5.4	(17)	2.22	1.92	(14)	1.62	1.62	0

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

**Exhibit 3: Financial summary**

	£000s	2012	2013	2014	2015e	2016e
Year end March		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue (norm)		20,542	18,258	20,286	18,403	18,670
Revenue		20,535	18,552	19,922	18,403	18,670
Operating expenses		(13,875)	(12,349)	(13,190)	(12,909)	(13,185)
EBITDA (norm)		6,667	5,909	7,096	5,494	5,485
Depreciation & amortisation		(106)	(283)	(308)	(223)	(163)
Operating profit (norm)		6,561	5,626	6,788	5,271	5,322
Normalised operating margin %		31.9%	30.8%	33.5%	28.6%	28.5%
Goodwill and amortisation of acquired intangibles		0	0	0	0	0
Seed fund consolidation adjustment		(7)	294	(364)	0	0
Other		0	0	0	0	0
Operating Profit		6,554	5,920	6,424	5,271	5,322
Net Interest		155	158	113	120	126
Other						
Profit Before Tax (norm)		6,716	5,784	6,901	5,391	5,448
Profit Before Tax (FRS 3)		6,709	6,078	6,537	5,391	5,448
Tax		(1,803)	(1,450)	(1,494)	(1,232)	(1,245)
Profit After Tax (norm)		4,911	4,404	5,324	4,159	4,203
Profit After Tax (FRS 3)		4,906	4,628	5,043	4,159	4,203
Average Diluted Shares Outstanding (m)		220.3	219.1	218.7	218.4	218.4
Basic EPS - Company reported (p)		2.2	2.0	2.5	1.9	1.9
Diluted EPS - Company reported (p)		2.2	2.0	2.5	1.9	1.9
Adjusted diluted EPS - Edison (p)		2.23	2.01	2.43	1.90	1.92
Dividend per share - proposed (p)		1.5	1.5	1.5	1.6	1.6
Revenue Margin - AM (%)		11.2	8.8	7.6	5.9	5.9
EBITDA Margin norm. (%)		32.5	32.4	35.0	29.9	29.4
Operating Margin norm. (%)		31.9	30.8	33.5	28.6	28.5
<b>BALANCE SHEET</b>						
Fixed Assets		2,398	1,108	3,732	3,524	3,371
Intangible Assets		1,140	963	734	559	426
Tangible Assets		183	140	86	53	32
Investments		1,075	5	2,912	2,912	2,912
Current Assets		29,675	34,637	32,835	33,750	34,725
Debtors		5,070	5,569	5,646	5,215	5,291
Cash		24,572	29,025	11,503	12,849	13,748
Money market instruments		0	0	15,488	15,488	15,488
Other		33	43	198	198	198
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)	(3,660)	(3,471)	(3,505)
Creditors		(2,494)	(2,672)	(2,706)	(2,517)	(2,551)
Short term borrowings		0	0	0	0	0
Other		(948)	(785)	(954)	(954)	(954)
Net Assets		28,616	32,288	32,907	33,803	34,591
<b>CASH FLOW</b>						
Operating cash flow		2,393	5,609	5,167	4,504	4,197
Capex		(52)	(63)	(25)	(15)	(9)
Cash flow from investing activities		93	149	(18,376)	120	126
Dividends		(7,371)	(1,645)	(4,898)	(3,263)	(3,415)
Other financing activities		784	403	610	0	0
Other		0	0	0	0	0
Net Cash Flow		(4,153)	4,453	(17,522)	1,346	899
Opening unrestricted net debt/(cash)		(23,728)	(22,372)	(25,425)	(11,503)	(12,849)
Decrease / (increase) debt		0	0	0	0	0
Other		(2,797)	1,400	(3,600)	0	0
Closing unrestricted net debt/(cash)		(22,372)	(25,425)	(11,503)	(12,849)	(13,748)
Closing unrestricted net debt/(cash) inc money market instruments		(22,372)	(25,425)	(26,991)	(28,337)	(29,236)
<b>FUM</b>						
Opening FUM (\$bn)		31	31	35	52	53
Net new money flows		0	2	14	(1)	0
Investment performance		(1)	2	3	1	2
Other		0	0	0	0	0
Closing FUM (\$bn)		31	35	52	53	54

Source: Record accounts, Edison Investment Research

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