

Record

Full year results

Attractive growth and dividend increased

Record had previously reported FY15 growth in assets under management equivalent (AUME) and client numbers. Full year results show that revenues and profits also grew slightly faster than we had forecast, and the 10% dividend increase was a positive surprise. Backed by a solid base of passive hedging mandates, Record appears well placed to grow its higher-margin dynamic hedging and currency for return products. Increasingly divergent global monetary policies have raised awareness of both FX risks and opportunities among existing and potential clients with continuing high levels of engagement. Although we have not included new inflows in our forecasts, Record is attractively rated compared with other asset managers, offers an attractive yield and is financially strong, with cash and marketable securities around 35% of its market capitalisation.

Year end	Revenue* (£m)	PBT* (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/14	20.3	6.9	2.47	1.50	15.5	3.9
03/15	20.9	7.5	2.65	1.65	14.5	4.3
03/16e	22.2	8.0	2.88	1.65	13.3	4.3
03/17e	22.8	8.2	2.96	1.65	12.9	4.3

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

Results beat with dividend increase

Revenues and profits were slightly ahead of our expectations on the back of a previously reported 7% increase in AUME (to \$55.4bn, including \$2.9bn of net new inflows). Product revenue margins were stable, but the mix was slightly negative (average fee margin 6bp versus 8bp in FY14). Dynamic hedging saw net outflows, while the broadened and maturing currency for return strategies doubled AUME to \$4.8bn. Group revenues (up 6%) were supplemented by modest performance fees on certain dynamic hedging mandates. Continued cost control saw pre-tax profits increase 18%, and the dividend was increased (by 10%), the first movement since 2011.

Currency volatility is a positive

It is impossible to predict how increased currency volatility and correspondingly high levels of engagement with existing and potential clients may translate into new business flows. While we share management's optimism that new business in risk management (hedging) and return seeking products is likely, our base case forecasts do not include this. In addition to this positive macro backdrop, the company provides an increasingly diversified product suite and has maintained its focus on client service and independence, with performance generally positive.

Valuation: Discount on earnings with yield premium

Record offers investors an attractive yield with a strong balance sheet and should benefit from currency turmoil – in contrast to traditional asset managers, whose net inflows tend to reduce when there is uncertainty. On an EV/EBITDA basis, it is trading around a 30% discount to other asset managers.

Financial services

2 July 2015

Price 38.3p

Market cap £85m

US\$1.55/£

Net cash and marketable securities (£m) at 31 March 2015 30.1

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

Q1 trading update 17 July 2015

Analysts

Peter Thorne +44 (0)20 3077 5765

Martyn King + 44(0)20 3077 5745

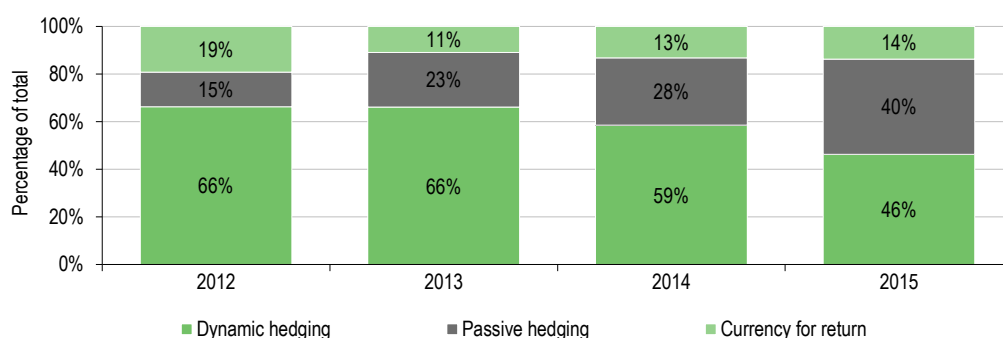
financials@edisongroup.com

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Client Update: Growth and diversification

Record has concentrated on developing a more diversified spread of clients and product suite so that it can service clients and earn profits, irrespective of the economic cycle or the clients' primary objectives. Recent years have seen low currency volatility and risk sentiment and in this period it has built a base of passive hedging clients to produce regular revenue and, at the same time, developed a suite of currency for return products to offer clients when volatility returns. Passive hedging mandates now amount to on average 74% of AUME compared with 61% in 2012 and, as we show in the following chart, they now account for 40% of management fees compared with just 15% in 2012. They represent a strong and stable revenue stream and are less sensitive to investor sentiment than the other strategies.

Exhibit 1: Management fees by product strategy



Source: Record, Edison Investment Research

During the year client numbers at Record increased by 15% to 55, 34% higher than the low level of 31 March 2012, Exhibit 2. Record's marketing efforts continue to be concentrated on the US, UK and Europe, especially Switzerland.

Exhibit 2: Record client numbers

	2012	2014	2015
Dynamic hedging	9	12	11
Passive hedging	22	28	31
Currency for return	14	13	17
Clients with >1 product	-4	-5	-4
Total	41	48	55

Source: Record

Currency for return

Record managed \$4.8bn of currency for return as at end March 2015 and has expanded its product suite and strategies in recent years (see Exhibit 3).

Exhibit 3: Currency for return diversification

Strategy	First live programme
FRB Alpha	February 2003
FRB Beta	September 2009
Emerging markets	November 2009
Currency momentum	July 2012
Currency value	July 2012
Multi-strategy	July 2012

Source: Record

In its strategies Record does not attempt to predict currencies but seeks to exploit systematic features of currency markets to produce consistent returns for its clients. The strategies are:

- FRB Alpha strategy: this is the 'forward rate bias', the tendency of higher-yielding currencies to outperform lower-yielding ones and is often referred to as a carry trade. The 'beta' version was introduced in 2009 when a series of forward rate bias indices were developed in conjunction with FTSE;
- the emerging markets strategy, which attempts to capture the long-term appreciation potential of emerging market currencies;
- the currency momentum strategy, which attempts to exploit the observation that tomorrow's price movement is likely to be in the same direction as today's;
- the currency value concept, which attempts to utilise the concept that developed market currencies typically vary around a long-term fair value; and
- the multi-strategy product, which combines four of these currencies for return strategies.

The performance was mixed in the currency for return strategies with the FRB strategies producing negative returns largely because of the dramatic appreciation of the Swiss franc in January 2015. The following table summarises the performance of the multi-strategy mandate from 31 July 2012 to 31 March 2015.

Exhibit 4: Performance of multi-strategy currency for return mandate		
	Inception to date	
	Cumulative	Annualised
FRB	-0.9%	-0.3%
Emerging markets	2.4%	0.9%
Currency momentum	7.2%	2.6%
Value	9.5%	3.5%
Multi-strategy	5.2%	1.9%
Source: Record		

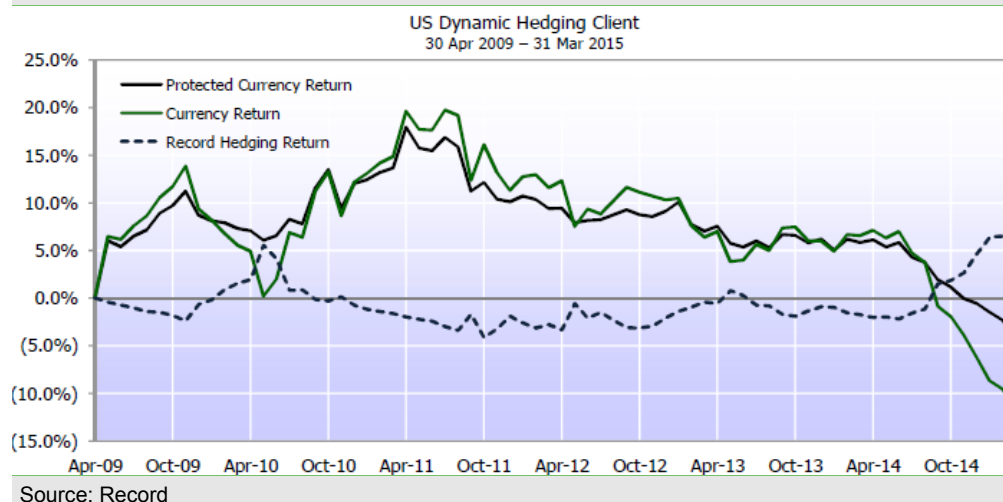
Annualised returns of around 2% are relatively modest by historical standards for asset returns, but are now comparable if not slightly higher than many developed market bond yields currently and offer investors diversification benefits. Furthermore, because currency mandates can be run on an "unfunded basis", they lend themselves well to gearing, with a consequent increase in returns (and risk).

Record believes that when the market appetite for currency for return products improves, its multi-strategy product, which combines these different strategies, could be particularly attractive to clients.

Currency hedging

Record manages \$41.2bn in passive hedging programmes and \$9.2bn in dynamic hedging (as at end March 2015). Passive hedging mandates have the reduction of exposure to currency risk as their sole objective, while dynamic hedging mandates have this reduction as their principal objective and generating value as a secondary objective. Dynamic hedging seeks to allow clients to benefit from foreign currency strength while protecting them from weakness.

Record's passive and dynamic hedging strategies performed as management led clients to expect in 2015. The following exhibit shows the good performance of a US dynamic hedging client over the last six months. While this performance did result in some outflows from profit taking, in the longer term it could be supportive of further inflows if clients expect the US currency to continue to strengthen.

Exhibit 5: Performance of a Record US dynamic hedging client


Financials: Full year 2015 results

As can be seen in Exhibit 6, there was a 27% increase in the US\$ value of average assets under management equivalent (AUME), largely thanks to the full year impact of the large inflows into passive hedging strategies received in the second half of FY14. As a currency manager, Record manages the impact of foreign exchange and not the underlying assets so its assets under management are notional rather than tangible. To distinguish this from the AUM of conventional asset managers, Record uses the concept of AUME. In FY15 net new money inflows, at \$2.9bn, amounted to annualised growth of just over 5% and were well below the previous year's net inflows of \$14.1bn. The year started with the loss of a large dynamic hedging client of around \$0.6bn and there were also some reductions in dynamic hedging mandates from clients taking profits. As a result, the company performed well in achieving net growth for the year. Inflows in FY15 included \$1.75bn for a bespoke mandate, classified as a currency for return product which, being a tactical bespoke mandate, may prove temporary. Of the \$2.9bn of net new money in FY15, \$2.6bn was received in the final quarter and so, while revenue from the money had little impact on the 2015 results, a full year impact should be felt in FY16.

The average fee margin declined from 8.0bp in 2014 to 6.1bp in 2015, a 23% reduction. We estimate that around 1.5bp of this 2bp fall was the result of a change in the mix of funds towards lower-margin passive funds and the remainder due to lower fees in the dynamic hedging and currency for return strategies. The former reflects an across-the-board lowering of fees in dynamic hedging in 2014 and the latter the influence of larger mandates that pay lower fees.

The result of a 27% increase in average AUME in US dollar terms was broadly offset by the 23% fall in the average fee margin and currency moves, so that management fees were unchanged year-on-year. However, Record earned £0.5m of performance fees in 2015, its first for five years, which resulted in underlying group revenue rising by 3%. The performance fees were earned in the dynamic hedging mandates. Other income, principally earned from gains on forward exchange mandates by Record's seed funds added another £0.1m; underlying revenue rose 3% in the year.

The revenue from non-controlling interests in Record's seed funds switched from a loss in 2014 to a positive figure in 2015 so that reported revenues grew 6% in 2015. Record kept administrative expenses flat during the year such that operating profits increased by 17%. After adjusting for profits from non-controlling interests in seed funds, attributable net profit rose 7% in 2015 and diluted EPS by a similar amount. The company announced a 10% increase in the dividend for the year, to 1.65p per share. Record remains financially strong with cash and money market

instruments at the end of the year amounting to £30.1m, up from £27m at the end of the previous year.

Exhibit 6: Results breakdown and forecasts

	2014	2015	2016e	2017e	% change		
Average AUME (\$bn)					2015/14	2016/15	2017/16
Dynamic hedging	11.8	10.4	9.3	9.7	(12)	(10)	4
Passive hedging	27.8	39.8	41.8	43.0	43	5	3
Currency for return	2.5	3.1	4.8	4.8	24	55	1
Cash	0.2	0.3	0.2	0.2	38	(27)	
Total	42.3	53.6	56.2	57.7	27	5	3
Net new money (\$bn)							
Dynamic hedging	0.2	(2.3)					
Passive hedging	13.8	2.9					
Currency for return	(0.1)	2.3					
Cash	0.2						
Total	14.1	2.9					
Average Management fee (bp)							
Dynamic hedging	16.0	15.0	15.0	15.0	(6)		
Passive hedging	3.0	3.0	3.0	3.0			
Currency for return	17.0	16.0	16.0	16.0	(6)		
Cash							
Total	8.0	6.1	6.1	6.1	(23)	0	0
Average £1=\$	1.53	1.60	1.55	1.55	5	(3)	
Profit and loss (£000)							
Dynamic hedging	11,872	9,376	9,038	9,370	(21)	(4)	4
Passive hedging	5,728	8,105	8,095	8,323	41	0	3
Currency for return	2,671	2,774	4,955	5,004	4	79	1
Management fees	20,271	20,255	22,088	22,697	0	9	3
Performance fees		480					
Other income	-5	130	100	100			
Underlying revenue	20,266	20,865	22,188	22,797	3	6	3
Revenue from NCI	(344)	192					
Total revenue	19,922	21,057	22,188	22,797	6	5	3

Source: Record, Edison Investment Research

Estimates update and outlook

We have made only minor changes to our forecasts, as summarised in Exhibit 7. The main change relates to the increase in DPS forecasts for 2016 and 2017 following the announcement of an increase in 2015 after three years of unchanged dividends of 1.5p per share.

Exhibit 7: Earnings revisions

	Revenue* (£m)			PBT* (£m)			EPS (p)			DPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
03/15	20.5	20.9	1.9	7.3	7.5	2	2.63	2.65	1	1.50	1.65	10
03/16e	22.1	22.2	0.5	8.0	8.0	0.0	2.90	2.88	(1)	1.50	1.65	10
03/17e	N/A	22.8		N/A	8.2		N/A	2.96		N/A	1.65	

Source: Company data, Edison Investment Research. Note: *Revenue and PBT are normalised. Old forecasts as per Edison Insight, May edition.

As is our normal practice, we have included neither net new money nor performance fees in our forecasts as the timing of these is always uncertain and we prefer to take a conservative approach. However, we do allow for performance of the underlying assets at around 3% per year which, together with the timing of the inflows in 2015, will result in average AUME growth of 5% in 2016 and 3% in 2017. The details of our forecasts are given in Exhibit 6. We anticipate that fee levels will remain in line with those achieved in 2015, so that in sterling terms fees rise 9% in 2016 and 3% in 2017.

Record has indicated that it increased salary levels by 10% across the board in May 2015, in addition to the normal performance and bonus arrangements, which we estimate will add around

£0.6m to expenses in 2016. Record believes that to continue to attract and retain top-quality professionals it needs to adjust its remuneration policy, especially increasing the basic pay level, to be more in line with those in the investment banking and asset management industries. We anticipate that the underlying operating margin, after allowing for revenue from non-controlling interests, will remain around 35% (35.2% in FY15).

Our forecasts anticipate a 9% rise in attributable profit in 2016 and a 3% rise in 2017, with a similar increase in diluted EPS. Management has a progressive dividend policy and seeks to increase dividends in line with sustainable profit growth. However we do not anticipate further dividend growth in the next couple of years.

Record had cash and marketable securities of £30.1m at the end of March 2015 and regulatory capital resources of £31.4m, which compares with a Pillar 1 requirement of £2.6m (31 March 2014 Pillar 3 disclosure July 2014), and which the company believes is more than adequate.

Outlook

Record believes that the near-term outlook for its business will benefit from the return of two important features:

- the continued expectation of monetary policy divergence; and
- the return of volatility to currency markets.

The US monetary authorities are set to begin raising interest rates in the near future according to most economic forecasters, which could be expected to strengthen the US dollar so that US owners of assets denominated in foreign currencies suffer US\$ losses unless they hedge their exposure. This should increase the demand for hedging products from US clients.

The return of volatility in the currency market, caused by the divergent monetary policy, could be expected to increase the opportunities available in currency for return strategies. Record has received increased engagement with existing and potential clients and investment consultants over the last year and this may lead to new business in the future. Its multi-strategy currency for return product now has a three-year track record (July 2015), which is the time period many consultants consider necessary for recommending products to their clients.

Valuation

Record is trading at a P/E of 13.6x CY15 according to our forecasts, 7% lower than the average rating for US and UK asset managers of 14.6x according to Bloomberg, with a wide range of 8-17x. However, Record has a large amount of free cash resources in its balance sheet, which account for 35% of its market capitalisation. On an EV/EBITDA basis, it is trading at around a 30% discount to other asset managers and its multiples do not appear challenging. Record also offers a high dividend yield of more than 4%, has a strong balance sheet and, unlike traditional asset managers, should benefit from currency volatility.

Exhibit 8: Record rating vs UK and US asset managers

	Price	Market cap*	P/E (x)		EV/EBITDA (x)	
	Local currency	(m)	Current year	Next year	Current year	Next year
MAN Group (p)	164.9	2,720	7.9	7.0	7.1	6.4
Aberdeen Asset Management (p)	417.8	5,465	12.7	11.9	9.2	8.7
Schroders (p)	3,308.0	8,723	18.3	16.7		
Henderson (p)	275.4	3,006	17.0	14.6	12.8	11.0
Jupiter (p)	463.6	2,070	16.4	14.9	10.8	9.9
Ashmore (p)	305.7	2,157	14.3	14.9	8.1	8.9
Blackrock (US\$)	354.5	37,661	17.4	15.3	12.6	11.1
Franklin Resources (US\$)	50.5	19,895	13.7	13.1	7.6	7.1
Invesco (US\$)	38.6	10,582	14.5	12.4	10.8	9.6
Legg Mason (US\$)	51.9	3,664	11.7	9.7	9.6	8.5
T Rowe Price (US\$)	79.4	13,183	16.3	14.9	8.7	8.0
Average			14.6	13.2	9.7	8.9
Record plc	38.25	85	13.3	12.9	7.0	6.8

Source: Edison Investment Research and Bloomberg. Note: *Translated where relevant at £1=\$1.57. Priced at close on 25 June 2015.

Exhibit 9: Financial summary

	£'000s	2011	2012	2013	2014	2015	2016e	2017e
March		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue		28,196	20,535	18,552	19,922	21,057	22,188	22,797
Operating expenses		(15,843)	(13,981)	(12,632)	(13,498)	(13,521)	(14,364)	(14,740)
Operating profit		12,353	6,554	5,920	6,424	7,536	7,824	8,057
Finance income		184	155	158	113	146	140	140
Profit before tax		12,537	6,709	6,078	6,537	7,682	7,964	8,197
Taxation		(3,603)	(1,803)	(1,450)	(1,494)	(1,708)	(1,672)	(1,721)
Minority interests		(27)	7	(294)	364	(192)	0	0
Attributable profit		8,907	4,913	4,334	5,407	5,782	6,292	6,476
Normalised revenue		28,169	20,542	18,098	20,266	20,865	22,188	22,797
Operating expenses (excl. dep'n and amortisation)		(15,652)	(13,875)	(12,349)	(13,190)	(13,206)	(14,049)	(14,425)
Normalised EBITDA		12,517	6,667	5,749	7,076	7,659	8,139	8,372
Depreciation and amortisation		(191)	(106)	(283)	(308)	(315)	(315)	(315)
Normalised Operating profits		12,326	6,561	5,466	6,768	7,344	7,824	8,057
Finance income		184	155	158	113	146	140	140
Normalised Profit Before Tax		12,510	6,716	5,624	6,881	7,490	7,964	8,197
Normalised revenue/AuME (excl. perf fees) bps		14.0	11.2	8.8	8.0	6.1	6.1	6.1
Normalised Operating MARGIN norm. (%)		43.8	31.9	30.2	33.4	35.2	35.3	35.3
Average Diluted Shares Outstanding (m)		221.0	220.3	219.1	218.7	218.4	218.5	218.5
Basic EPS - Company reported (p)		4.03	2.23	1.98	2.48	2.66	2.89	2.98
Diluted EPS - Company reported (p)		4.03	2.23	1.98	2.47	2.65	2.88	2.96
Dividend per share - proposed (p)		4.59	1.50	1.50	1.50	1.65	1.65	1.65
BALANCE SHEET								
Fixed Assets		1,382	1,323	1,108	3,732	3,273	3,079	2,852
Intangible Assets		1,085	1,140	963	734	504	274	44
Tangible Assets		227	183	140	86	129	132	135
Investments		0	0	0	2,754	2,567	2,600	2,600
Deferred tax assets		70	0	5	158	73	73	73
Current Assets		34,654	30,750	34,637	32,835	37,053	40,127	43,441
Debtors		6,904	5,070	5,569	5,646	6,324	6,500	6,650
Cash		24,728	24,572	29,025	11,503	12,010	14,527	16,691
Money market instruments			0	0	15,488	18,100	18,500	19,500
Other		3,022	1,108	43	198	619	600	600
Current Liabilities		(5,938)	(3,457)	(3,457)	(3,660)	(4,522)	(4,700)	(4,900)
Creditors		(4,089)	(2,494)	(2,672)	(2,706)	(2,949)	(3,100)	(3,300)
Other		(1,849)	(963)	(785)	(954)	(1,573)	(1,600)	(1,600)
Net Assets		30,098	28,616	32,288	32,907	35,804	38,506	41,393
Minority interests		952	2,263	3,646	3,667	3,876	3,876	3,876
Net assets attributable to ordinary shareholders		29,146	26,353	28,642	29,240	31,928	34,630	37,517
No of shares at year end		221.3	220.3	219.1	217.5	217.5	217.5	217.5
NAV per share (p)		13.2	12.0	13.1	13.4	14.7	15.9	17.2
CASH FLOW								
Operating cash flow		8,241	2,393	5,609	5,167	6,472	6,488	6,701
Capex		(85)	(52)	(63)	(25)	(128)	(88)	(88)
Cash flow from investing activities		(679)	(65)	0	0	0	0	0
Dividends		(5,723)	(7,371)	(1,645)	(4,898)	(3,266)	(3,589)	(3,589)
Other financing activities		1,113	942	552	(17,766)	(2,571)	(293)	(860)
Other		0	3,997	0	0	0	0	0
Net Cash Flow		2,867	(156)	4,453	(17,522)	507	2,517	2,164
Opening cash/(net debt)		21,861	24,728	24,572	29,025	11,503	12,010	14,527
Other		0	0	0	0	0	0	0
Closing cash/(net debt)		24,728	24,572	29,025	11,503	12,010	14,527	16,691
Closing net debt/(cash) inc money market instruments		24,728	24,572	29,025	26,991	30,110	33,027	36,191
AUME								
Opening (\$'bn)		34.0	31.4	30.9	34.8	51.9	55.4	56.9
Net new money flows		(3.6)	0.2	1.9	14.1	2.9	0.0	0.0
Performance		1.0	(0.7)	2.0	3.0	0.6	1.5	1.6
Closing (\$'bn)		31.4	30.9	34.8	51.9	55.4	56.9	58.5
NNM %		(10.6)	0.6	6.1	40.5	5.6	0.0	0.0
Performance %		2.9	(2.2)	6.5	8.6	1.2	2.8	2.8

Source: Company accounts, Edison Investment Research

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