EDISON

Record

Update on H116 results

Possible beneficiary of US dollar strength

Financial services

Record's assets under management equivalent (AUME) fell as expected to $53.3bn at 30 September 2015 from $55.4bn at 31 March 2015, predominantly as a result of a previously announced reduction in size of a bespoke currency for return mandate. Record's core passive hedging mandates continued to experienced good inflows. Underlying profits in H116 increased by 9% y-o-y, partly boosted by revenues from the bespoke mandate. Record continues to experience a high level of client interest in its hedging strategies, and the likely imminent rise in US interest rates could transform this interest to new mandates.

Year end	Revenue* (£m)	PBT* (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/14	20.3	6.9	2.48	1.50	11.6	5.2
03/15	20.9	7.5	2.66	1.65	10.9	5.7
03/16e	20.4	6.5	2.40	1.65	12.0	5.7
03/17e	19.5	6.0	2.18	1.65	13.2	5.7

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

Passive mandates continue to expand

Record's passive mandates increased by $1.8bn in H116, annualised growth of almost 9%, as existing clients increased the size of their mandates with Record. Passive strategies are now the largest fee-earning element of Record's business (41% of revenue in H116). Passive mandates are considered to be a more stable source of revenue than Record's other strategies as they are less sensitive to investor sentiment. In H116 fees from passive mandates covered 64% of administrative expenses.

Client engagement remains high

Record continues its active dialogue with potential clients interested in its various hedging and currency for return strategies. This has been intensified by the increase in currency volatility over the last year, while the likely imminent rise in US interest rates could further intensify discussions. If the US rate rise causes further US dollar strength, Record believes it could encourage some of its US prospects in particular to award it hedging mandates.

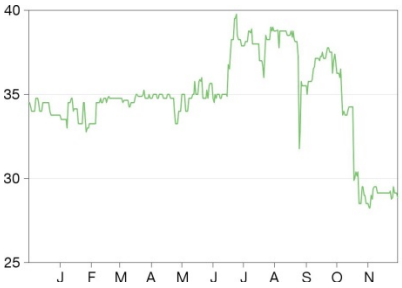
Valuation: High yield and cash on balance sheet

Record is trading at a discount on both P/E and EV/EBITDA multiples to US and UK asset managers and offers a near 6% dividend yield. Its dividend is covered by earnings and it has more than £30m of cash and equivalents on its balance sheet, equivalent to 52% of its current market capitalisation. Record's shares appear good value compared to other asset managers. We have not included the possible new business arising from a rise in US interest rates in our forecasts, but if it materialises it would further support Record's favourable valuation.

24 November 2015

Price	**28.9p**
Market cap	**£64m**
	US$1.51
Net cash and marketable securities (£m) at 30 September 2015	33.4
Shares in issue	221.4m
Free float	52%
Code	REC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.3	(18.7)	(15.1)
Rel (local)	1.1	(20.0)	(12.6)
52-week high/low		39.8p	28.3p

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 events

Q316 trading update	January 2015

Analysts

Peter Thorne +44 (0)20 3077 5765

Martyn King +44 (0)20 3077 5745

financials@edisongroup.com

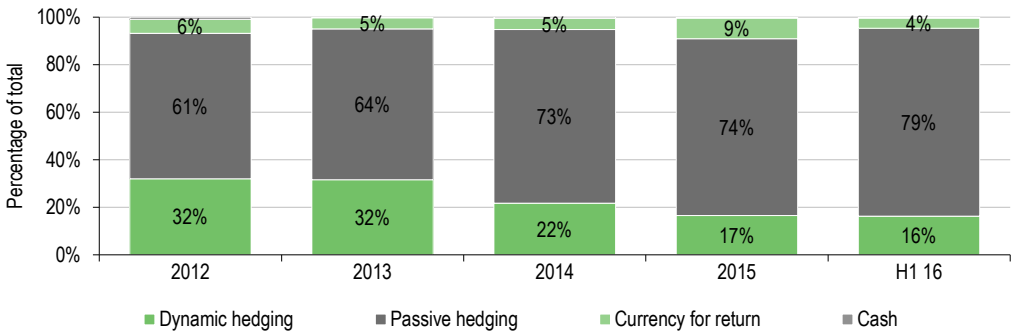
Edison profile page

Record is a research client of Edison Investment Research Limited

Client update: Strength in passive hedging continues

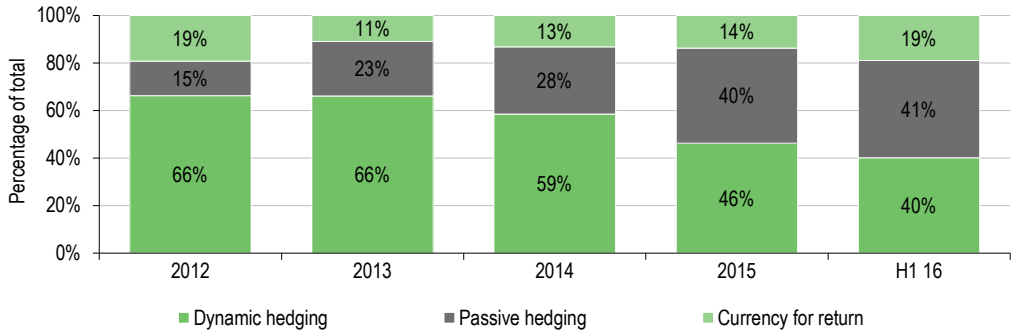
Record successfully expanded its passive hedging strategy mandates in H116 and these now account for 79% of its AUME and produce 41% of its management fees. This represents steady progress from the 61% of AUME and 15% of fees in 2012, as we show in the following exhibits. Passive mandates are considered to be a stable revenue stream, less sensitive to investor sentiment than other strategies and therefore useful in ensuring that Record continues to earn profits in a variety of economic environments and reduces profit volatility. Passive fees covered 22% of administrative expenses in 2012, but 64% in H116, showing the improvement in Record's quality of earnings in that period. As a currency manager, Record manages the impact of foreign exchange fluctuations and not the underlying assets, so its assets under management are notional rather than tangible. To distinguish them from the AUM of conventional asset managers, Record uses the concept of AUME.

Exhibit 1: Record AUME (end period)



Source: Record, Edison Investment Management

Exhibit 2: Record management fees by product strategy



Source: Record, Edison Investment Management

Currency hedging

Record offers clients two main types of hedging strategies: passive hedging and dynamic hedging. The former seeks to reduce the client's exposure to currency risk as its sole objective, while dynamic hedging mandates have this reduction as their principal objective, as well as a secondary one of generating value. Dynamic hedging seeks to allow clients to benefit from foreign currency strength while protecting them from weakness. Passive hedging is particularly popular in Continental Europe (especially Switzerland), Record's largest market by AUME with 68% of the total at 30 September 2015. Regulations require Swiss pension funds to hedge the currency exposure of their non-Swiss franc assets and Record has successfully won some of this business

away from the local Swiss banks. Record's passive hedging mandates performed in line with client expectations in H116.

Dynamic hedging tends to be more popular with Record's US clients. In H116 the US dollar generally weakened against developed market currencies, reflecting concerns about a delay to US interest rate increases, and Record's dynamic hedging strategies allowed its clients to benefit from the foreign currency strength.

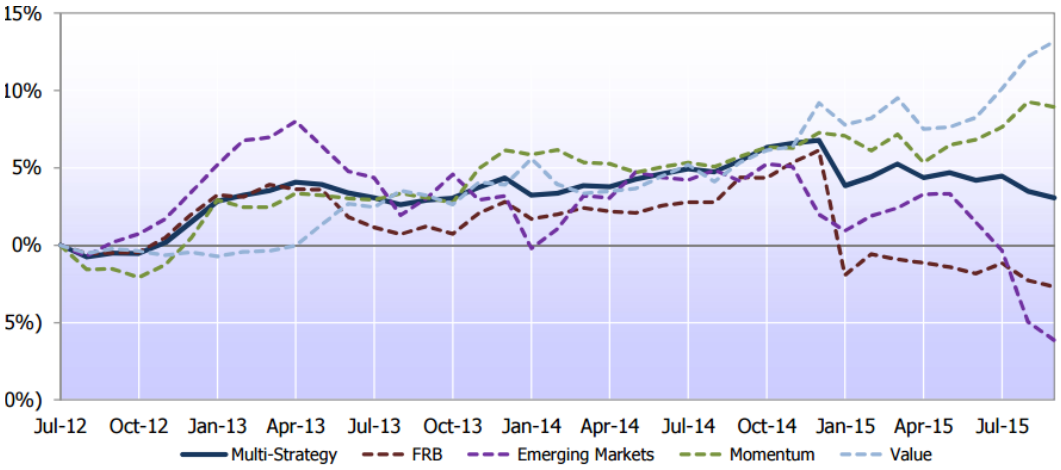
Currency for return

In addition to offering clients hedging services, Record offers currency for return products. It 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 the 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 currency for return strategies.

In H116 the momentum and value strategies performed positively over the period, but the FRB and emerging markets strategies underperformed, as shown in Exhibit 3 below.

Exhibit 3: Currency for return performance 31 July 2012 to 30 September 2015



Source: Record

The underperformance of the FRB strategy was attributable to long positions in New Zealand and Australian dollars, high-yielding currencies, which depreciated in the period as a result of concerns over falling commodity prices. The emerging markets strategy underperformed as a result of the decline in emerging market asset prices due to fears surrounding a rapid deceleration of Chinese growth. As a consequence of the underperformance of these two strategies, there was a slight dip in Record's multi-strategy performance in H116, although it has remained positive since inception. In H116 the multi-strategy product obtained the three-year track record that many consultants require before they recommend the product to their clients, so the slight downturn in performance is

unfortunate, but Record does not believe it is serious enough to permanently affect the attractiveness of the product to clients.

Financials: Half-year 2016 results and forecasts

Exhibit 4: Results breakdown and forecasts

	H115	H215	2015	H116	H216e	2016e	2017e	% change			
								H116e/		2016e/	2017e/
								H115	H215	2015	2016e
NNM $bn											
Dynamic hedging	(0.7)	(1.6)	(2.3)	0.0	(0.8)	(0.8)	0.0				
Passive hedging	0.7	2.2	2.9	1.8	1.0	2.8	0.0				
Currency for return	0.1	2.2	2.3	(2.4)	0.0	(2.4)	0.0				
Cash	0.1	(0.1)	0.0	0.0	0.0	0.0	0.0				
Total	**0.2**	**2.7**	**2.9**	**(0.6)**	**0.3**	**(0.3)**	**0.0**				
Av. AUME $bn											
Dynamic hedging	11.0	9.4	10.2	9.1	8.4	8.8	8.3	(17)	(3)	(14)	(5)
Passive hedging	39.3	40.1	39.7	41.9	42.9	42.4	44.2	7	4	7	4
Currency for return	2.5	3.3	2.9	4.2	2.3	3.3	2.3	68	27	12	(28)
Cash	0.3	0.3	0.3	0.2	0.2	0.2	0.2	(33)	(33)	(33)	0
Total	**53.1**	**53.1**	**53.1**	**55.4**	**53.8**	**54.6**	**55.1**	**4**	**4**	**3**	**1**
Av. Mgmt. fee bps											
Dynamic hedging	14.0	16.0	15.0	15.0	15.0	15.0	15.0	7	(6)	0	0
Passive hedging	3.0	3.0	3.0	3.0	3.0	3.0	3.0	0	0	0	0
Currency for return	16.0	16.0	16.0	15.0	16.0	16.0	16.0	(6)	(6)	0	0
Cash	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0	0	0	0
Average	**6.0**	**6.1**	**6.0**	**5.9**	**5.4**	**5.7**	**5.4**	**(2)**	**(4)**	**(6)**	**(6)**
Average £1=$*	1.61	1.53	1.57	1.48	1.51	1.50	1.51	(8)	(3)	(5)	1
	£000	£000	£000	£000	£000	£000	£000				
Dynamic hedging	4,722	4,654	9,376	4,397	4,180	8,577	8,252	(7)	(6)	(9)	(4)
Passive hedging	3,825	4,280	8,105	4,493	4,260	8,753	8,787	17	5	8	0
Currency for return	1,160	1,614	2,774	2,066	1,225	3,291	2,486	78	28	19	(24)
Management fees	**9,707**	**10,548**	**20,255**	**10,956**	**9,665**	**20,621**	**19,525**	**13**	**4**	**2**	**(5)**
Performance fees	0	480	480	0	0	0	0	0	0	0	0
Other income	186	(56)	130	(199)	0	(199)	0				
Underlying revenue	**9,893**	**10,972**	**20,865**	**10,757**	**9,665**	**20,422**	**19,525**	9	(2)	(2)	(4)
Revenue from NCI	165	27	192	(373)	0	(373)	0				
Total revenue	**10,058**	**10,999**	**21,057**	**10,384**	**9,665**	**20,049**	**19,525**	3	(6)	(5)	(3)
Cost of sales	(64)	(84)	(148)	(98)	(95)	(193)	(190)				
Gross profit	**9,994**	**10,915**	**20,909**	**10,286**	**9,570**	**19,856**	**19,335**	3	(6)	(5)	(3)
Expenses	(6,497)	(6,876)	(13,373)	(7,071)	(6,800)	(13,871)	(13,472)	9	3	4	(3)
Operating profit	**3,497**	**4,039**	**7,536**	**3,215**	**2,770**	**5,985**	**5,863**	(8)	(20)	(21)	(2)
Finance income	70	76	146	76	76	152	150				
Profit before tax	**3,567**	**4,115**	**7,682**	**3,291**	**2,846**	**6,137**	**6,013**	(8)	(20)	(20)	(2)
Taxation	(717)	(991)	(1,708)	(706)	(598)	(1,304)	(1,263)	(2)	(29)	(24)	(3)
Profit after tax	**2,850**	**3,124**	**5,974**	**2,585**	**2,248**	**4,833**	**4,750**	(9)	(17)	(19)	(2)
Minority interests	(158)	(34)	(192)	381	0	381	0				
Attributable profit	**2,692**	**3,090**	**5,782**	**2,966**	**2,248**	**5,214**	**4,750**	10	(4)	(10)	(9)
Tax rate	20%	24%	22%	21%	21%	21%	21%				
Underlying											
Profit before tax	3,402	4,088	7,490	3,664	2,846	6,510	6,013	8	(10)	(13)	(8)
Operating margin	33.7%	36.6%	35.2%	33.4%	28.7%	31.1%	30.0%				

Source: Record, Edison Investment Research. Note: *Assuming rate of £1=$1.51 for H216 and FY17.

NNM (net new money) was -$0.6bn in H116 largely as a result of the reduction in the size of currency for return strategies, which fell by $2.4bn; there were net inflows into passive hedging strategies of $1.8bn. The fall in the currency for return strategies was largely the result of the decline in a bespoke mandate to manage a client's currency position. When the mandate increased in March 2015 Record warned that its size could be volatile, and this proved to the case. In August 2015 Record informed the market that the client had withdrawn $2.8bn from the mandate, so there

was $0.4bn net of other inflows into the currency for return strategies. As a consequence of the net outflows and the performance of the assets, average AUME in dollar terms in H116 was 4% higher than in H215 and H115. Fee rates by strategy in H116 were unchanged for the hedging strategies, but fell by 1bp for the currency for return strategy, reflecting a slightly lower fee level for the bespoke mandate. The increasing importance of passive hedging in the mix resulted in a decline in the total management fee rates of 4% compared with H215 and a 2% fall compared with H115. The rise in average AUME in dollar terms, together with favourable currency movements, offset the slight reduction in average fee rates and led to H116 management fees rising 13% y-o-y and 4% h-o-h. Record did not earn performance fees in H116, unlike H215 when it earned performance fees in its dynamic hedging mandates, and there were £0.2m of losses recorded in other income from Record's investment in its seed funds, which declined in value during the period. The outturn was a 9% rise in underlying revenues y-o-y and 2% fall h-o-h. In addition, Record consolidates the results of seed funds in which, along with those connected to it, it has a controlling interest according to accounting rules. The non-controlling element of these seed funds incurred a loss of £0.4m in the period, resulting in reported revenue of £10.4m in H116, a rise of 3% on H115 but a 6% fall on H215.

Expenses in H116 increased 9% y-o-y, and 3% h-o-h, mainly driven by a previously announced 10% salary increase across the board from May 2015 to attract and retain top-quality staff. The underlying operating margin in H116 was 33.4%, in line with H115. After deducting profits from non-controlling seed funds, attributable profits increased 10% y-o-y in H116, but fell 4% h-o-h.

The interim dividend was increased to 0.825p from 0.75p last year, and Record has indicated that it will also pay a final dividend of 0.825p, making 1.65p for the full year, the same as the previous year.

Record had cash and marketable securities of £33.4m at 30 September 2015, up from £30.1m at end March 2015 and we estimate its Tier 1 capital is around £33m. This compared to a published Pillar 1 capital requirement of £2.6m and a Pillar 2 capital requirement of £8.5m, so the company remains well capitalised.

Estimates update

We have made minor changes to our revenue and profits forecasts and summarise these in Exhibit 5 below. Record has said that since end September 2015 it has started a new dynamic hedging mandate of around $600m and converted a £900m dynamic hedging mandate to a passive one of reduced size. We have incorporated these announcements into our forecasts for H216 and 2016 but, as usual, have not included any NNM inflow for Record's considerable efforts to win additional mandates.

Exhibit 5: Earnings revisions

	Revenue* (£m)			PBT* (£m)			EPS (p)			DPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
03/16e	20.5	20.4	0%	6.7	6.5	-3%	2.42	2.40	-1%	1.65	1.65	0%
03/17e	19.9	19.5	-2%	6.2	6.0	-3%	2.23	2.18	-2%	1.65	1.65	0%

Source: Record, Edison Investment Research. Note: *Normalised

We maintain our dividend forecasts at 1.65p for 2016 and 2017. Management has said that it wishes dividends to be at least covered by earnings, which will be the case in FY16 and FY17 if our forecasts are realised.

Outlook

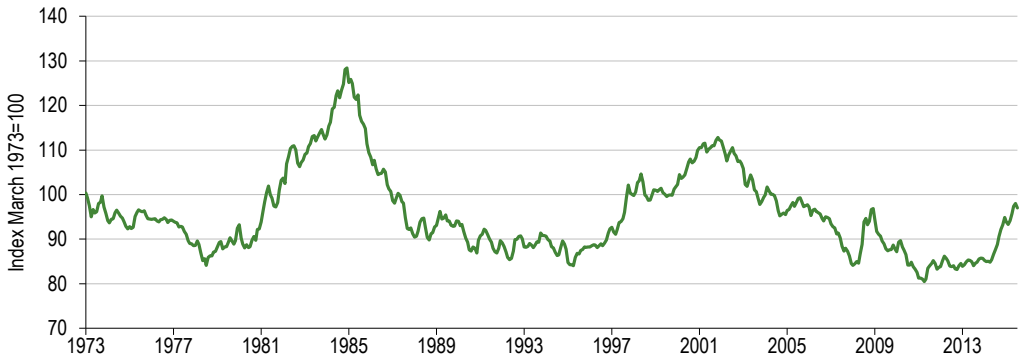
The near-term outlook for Record's business depends on two market developments:

- currency volatility remaining high; and
- the prospect of increased monetary divergence arising from a rise in US interest rates, which could lead to further US dollar strength.

Record believes that these two factors could increase the demand for its hedging services and increase the opportunities for its currency for return strategies to produce positive returns and be attractive to clients who award Record increased currency for return mandates. The increase in currency volatility over the last year can be seen in the large currency moves in the Swiss franc when the SNB ceased to cap its value to the euro in January 2015; other examples include the moves in many emerging markets currencies as a result of the slowdown in the Chinese economy and the collapse in commodity prices.

The likely rise in US interest rates has been a long time coming, but expectations that it will happen soon are high, with a Bloomberg survey reporting a 74% probability for a December 2015 hike, 77% for one in January 2016 and 88% for March 2016. The US dollar has been strong for some time, which suggests that the currency may already have discounted some of the increase in US rates, but may still continue to strengthen after the rate rise has occurred. In the past the US currency has exhibited long cycles of performance and underperformance against other currencies, as shown in Exhibit 6 below, and if these are repeated the recent strength of the US$ could be just the start of a long period of outperformance. Record believes that US interest rate rises, together with a strengthening currency, could be the tipping point for many of its prospective US clients to engage its services. It continues to see a high level of currency engagement, for both its hedging and currency for return strategies.

Exhibit 6: US$ real trade-weighted index



Source: Bloomberg

Valuation

Record's P/E ratio for FY16e is 12x, 18% lower than the average multiple for US and UK asset managers, according to Bloomberg data, although the range is wide – from 7.4x to18.5x – indicating that P/E ratios are only a rough guide to valuations of asset managers. Record has a large amount of cash and cash-equivalent resources in its balance sheet, equivalent to 52% of its current market capitalisation. On an EV/EBITDA basis, it is trading at around a 50% discount to other asset managers for FY15 and its multiples do not appear challenging. Record has a prospective dividend yield of almost 6%, a strong balance sheet and, unlike traditional asset managers, should benefit from currency volatility.

Exhibit 7: Record rating vs UK and US asset managers

	Market cap (m)	Enterprise value m	P/E (x)		EV/EBITDA (x)	
	Local currency	Local currency	Current year	Next year	Current year	Next year
MAN Group	2,803	3,301	7.4	8.0	6.8	6.9
Aberdeen Asset Management	4,140	1,821	13.3	12.1	4.4	4.1
Schroders	8,068	0	17.2	16.1		
Henderson	3,517	3,396	18.4	16.5	14.9	13.4
Jupiter	2,148	1,892	16.5	16.0	11.4	11.1
Ashmore	1,799	1,229	16.1	14.7	8.9	8.3
Blackrock	60,424	60,046	18.5	17.4	12.1	11.3
Franklin Resources	25,214	19,716	13.7	12.9	6.7	6.4
Invesco	14,280	20,988	13.7	12.4	13.1	12.3
Legg Mason	4,781	5,300	10.7	9.2	9.1	8.2
T Rowe Price	19,121	17,957	16.8	16.0	8.8	8.6
Average			**14.7**	**13.7**	**9.6**	**9.1**
Record	65	31	12.0	13.2	4.6	4.9

Source: Edison Investment Research and Bloomberg. Note: Prices at 30 November 2015.

Exhibit 8: 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	20,049	19,525
Operating expenses	(15,843)	(13,981)	(12,632)	(13,498)	(13,521)	(14,064)	(13,662)
Operating profit	12,353	6,554	5,920	6,424	7,536	5,985	5,863
Finance income	184	155	158	113	146	152	150
Profit before tax	12,537	6,709	6,078	6,537	7,682	6,137	6,013
Taxation	(3,603)	(1,803)	(1,450)	(1,494)	(1,708)	(1,304)	(1,263)
Minority interests	(27)	7	(294)	364	(192)	381	0
Attributable profit	8,907	4,913	4,334	5,407	5,782	5,214	4,750
Normalised revenue (underlying)	28,169	20,542	18,098	20,266	20,865	20,422	19,525
Operating expenses (excl. dep'n and amortisation)	(15,652)	(13,875)	(12,349)	(13,190)	(13,206)	(13,732)	(13,332)
Normalised EBITDA	12,517	6,667	5,749	7,076	7,659	6,690	6,193
Depreciation and amortisation	(191)	(106)	(283)	(308)	(315)	(332)	(330)
Normalised Operating profits	12,326	6,561	5,466	6,768	7,344	6,358	5,863
Finance income	184	155	158	113	146	152	150
Normalised profit before tax	12,510	6,716	5,624	6,881	7,490	6,510	6,013
Normalised revenue/AUME (excl. perf fees) bps	14.0	11.2	8.8	8.0	6.0	5.7	5.4
Normalied Operating Margin norm. (%)	43.8	31.9	30.2	33.4	35.2	31.1	30.0
Average Diluted Shares Outstanding (m)	221.0	220.3	219.1	218.7	218.4	218.5	218.5
Basic EPS (p)	4.03	2.23	1.98	2.48	2.66	2.40	2.18
Diluted EPS (p)	4.03	2.23	1.98	2.47	2.65	2.39	2.17
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	530	330
Intangible Assets	1,085	1,140	963	734	504	274	44
Tangible Assets	227	183	140	86	129	153	183
Investments	0	0	0	2,754	2,567	0	0
Deferred tax assets	70	0	5	158	73	103	103
Current Assets	34,654	30,750	34,637	32,835	37,053	39,890	41,323
Debtors	6,904	5,070	5,569	5,646	6,324	5,913	6,000
Cash	24,728	24,572	29,025	11,503	12,010	19,773	21,100
Money market instruments		0	0	15,488	18,100	14,181	14,200
Other	3,022	1,108	43	198	619	23	23
Current Liabilities	(5,938)	(3,457)	(3,457)	(3,660)	(4,522)	(3,328)	(3,400)
Creditors	(4,089)	(2,494)	(2,672)	(2,706)	(2,949)	(2,460)	(2,500)
Other	(1,849)	(963)	(785)	(954)	(1,573)	(868)	(900)
Net Assets	30,098	28,616	32,288	32,907	35,804	37,092	38,253
Minority interests	952	2,263	3,646	3,667	3,876	3,328	3,328
Net assets attributable to ordinary shareholders	29,146	26,353	28,642	29,240	31,928	33,764	34,925
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	15.5	16.1
CASH FLOW							
Operating cash flow	8,241	2,393	5,609	5,167	6,472	4,803	4,915
Capex	(85)	(52)	(63)	(25)	(128)	(126)	(130)
Cash flow from investing activities	(679)	(65)	0	0	0	0	0
Dividends	(5,723)	(7,371)	(1,645)	(4,898)	(3,266)	(3,756)	(3,589)
Other financing activities	1,113	942	552	(17,766)	(2,571)	6,842	131
Other	0	3,997	0	0	0	0	0
Net Cash Flow	2,867	(156)	4,453	(17,522)	507	7,763	1,327
Opening cash/(net debt)	21,861	24,728	24,572	29,025	11,503	12,010	19,773
Other	0	0	0	0	0	0	0
Closing cash/(net debt)	24,728	24,572	29,025	11,503	12,010	19,773	21,100
Closing net debt/(cash) inc money market instruments	24,728	24,572	29,025	26,991	30,110	33,954	35,300
AUME							
Opening ($'bn)	34.0	31.4	30.9	34.8	51.9	55.4	54.3
Net new money flows	(3.6)	0.2	1.9	14.1	2.9	(0.3)	0.0
Performance	1.0	(0.7)	2.0	3.0	0.6	(0.7)	1.5
Closing ($'bn)	31.4	30.9	34.8	51.9	55.4	54.3	55.8
NNM %	(10.6)	0.6	6.1	40.5	5.6	(0.6)	0.0
Performance %	2.9	(2.2)	6.5	8.6	1.2	(1.3)	2.8

Source: Company accounts, Edison Investment Research

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand