Record

Dividend upside

FY16 results update

Financial services

Record, as an experienced, independent, well-capitalised provider, is in a good position to benefit should market volatility prompt a rise in demand for currency hedging and management services. Hedging now accounts for 85% of Record's fees, moderating the risks of volatility in its own income, while shareholders stand to benefit from a prospective total yield that could exceed 8% (6.5% from the indicated ordinary dividend).

Year end	Revenue* (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/15	20.9	7.5	2.66	1.65	9.3	6.6
03/16	21.2	7.0	2.55	1.65	9.7	6.6
03/17e	20.2	6.2	2.25	1.65	11.0	6.6
03/18e	20.6	6.4	2.31	1.65	10.7	6.6

Note: *Revenue, PBT and EPS exclude non-controlling interests relating to seed investments. Prospective DPS excludes any special dividends.

Recent trading

Record's Q1 update to end June, showed AUME in dollar terms down 1.3% to $53bn with a marginal net outflow and a negative exchange rate move of 2.8% relating to non-dollar mandates, partly offset by positive market movements. Exchange rate movements meant this translated into a 6.1% AUME increase in sterling terms. The multi-year positive trend in client numbers continued with an increase from 58 to 61. On a longer view, the AUME mix has shifted away from the higher-fee-margin currency for return strategy, but the stickier passive hedging strategy accounts for c 45% of fee income, which is equivalent to 85% of costs before group profit share. Our EPS estimate for 2017 is increased by 3%; it does not allow for any performance fees or additional net flows. (See page 4 for a discussion of FY16 results.)

Modified dividend policy

Record has previously indicated that it would follow a policy of paying dividends at least covered by earnings. With the full year results, the board reported that the balance sheet and capital buffer, with other operating capital of over £23m, is sufficiently strong that it can consider returning at least part of any excess of earnings over the ordinary dividend. Such payments may take the form of a special dividend and for the current year, based on our earnings estimate, could be equivalent to 0.45p per share, which, with the indicated maintained ordinary dividend, would give a total payout of 2.10p, a potential yield of 8.3%.

Valuation: Cautious by comparison

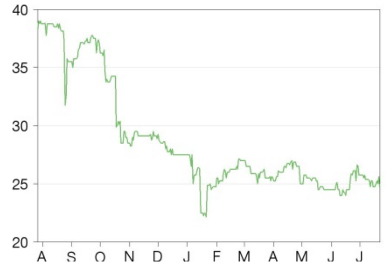
Record is differentiated from quoted UK asset managers by its focus on foreign exchange hedging and management and could therefore be seen as an uncorrelated play by investors. In another sense the business model is similar, arguably justifying a comparison of valuation multiples (page 6). The shares trade on significantly below average P/E and EV/EBITDA ratios. They also offer an attractive yield based on the ordinary dividend with the potential for a higher total payout, rewarding shareholders awaiting potential positive catalysts such as mandate wins or positive currency for return performance.

25 July 2016

Price	**24.75p**
Market cap	**£55m**

Net cash & money market instruments (£m) at end March 2016: excludes cash consolidated from seed funds	27.8
Shares in issue	221.4m
Free float	32%
Code	REC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(4.4)	(7.9)	(33.1)
Rel (local)	(9.8)	(12.7)	(33.2)
52-week high/low		39.0p	22.1p

Business description

Record is a specialist, independent currency manager providing a number of products and services, including passive and dynamic hedging, and a range of currency for return strategies, including funds and customised segregated accounts.

Next events

Q2 trading update	21 October 2016
AGM	28 July 2016

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Edison profile page

Record is a research client of Edison Investment Research Limited

Experienced, independent currency manager

Established in 1983 by Chairman Neil Record, the company's original and current main activity is the provision of currency hedging services to clients including public and private defined benefit pension schemes and other institutional investors. In the last financial year to end March, hedging services accounted for 85% of fee income. Passive hedging mandates require expertise in execution and operational efficiency and Record uses its experience to help tailor the systematic approach to meet each client's needs. The company's status as a well-capitalised independent operator is a positive factor when it tenders for such mandates. Dynamic hedging also targets a systematic reduction of currency risk but has a secondary aim of generating value by modifying the level of hedging dynamically to allow clients to benefit from weakness in their base currency.

The remaining 15% of fee income is generated by Record's currency for return strategies. The company employs its experience in and understanding of currency markets to identify stable inefficiencies that it can seek to exploit for clients to generate diversifying returns. While foreign exchange markets are highly liquid, they are also characterised by a majority of non-profit seeking participants, providing the opportunities Record targets with its strategies. The strategies include:

- **Forward rate bias**: a strategy based on the observation that, over time, higher yielding currencies outperform lower yielding currencies; Record sees this as reflecting a fundamental risk premium. The company launched an index with FTSE in 2010 based on this observation, the FTSE FRB10 Index, and also operates a fund based on the index.
- **Emerging market currency:** a strategy designed to allow investors to benefit from appreciation in emerging market currencies as their economies grow and mature, avoiding some of the costs and risks involved in direct bond or equity investment in these markets.
- **Momentum and value:** the first seeks to exploit inefficiencies exhibited by trends in currency movements, while the second takes the purchasing power parity approach to identify likely long-term movements in exchange rates.
- **Multi-strategy** provides clients with the opportunity to weight these approaches as preferred and allows them to achieve a diversified return with reduced correlation with other asset classes.

Record has noted that a challenging market environment requires a flexible approach and openness to innovation. Illustrating this has been the licensing agreement concluded with WisdomTree Investments Inc (sponsor of exchange traded products and asset manager). Record is to provide signals that will be used to hedge currency exposures dynamically for WisdomTree's rules-based indices. Given that Record provides signals rather than managing currency exposures for the related exchange-traded funds, these assets will not be included in the assets under management equivalents (AUME), which the company uses as a measure of the size of its mandates. Income will be included in the 'other' category.

In Exhibit 1 we have gathered the analysis of AUME, fees and clients that Record provides. Within this we would highlight a number of features.

The **analysis by strategy** makes clear the substantially lower level of fees that are applied to passive hedging mandates (3 basis points), which have accounted for a rising proportion of total AUME (now over 82%). Positively, these mandates have tended to be more sticky and are not subject to the same performance risk that applies to dynamic hedging and currency for return (as for any active fund manager). Passive hedging mandates also now account for the largest individual portion of fee income.

The **client analysis** highlights that, even against a background that has been more or less challenging, Record has succeeded in making net additions to clients in recent years. This has contributed to the rise in AUME from $30.9bn to $53.7bn between FY12 and FY16 (CAGR 15%), allowing fee income to make modest progress despite a significant mix change away from the higher fee margin categories over the period. As shown, corporate and public pension funds each make up over 40% of AUME, while concentration is quite high, with the top 10 clients accounting for approaching 80% of fee income.

Geographically, by client location, Switzerland accounts for two-thirds of AUME, with the Swiss franc a similar proportion of the underlying base currency of the funds for which currency is managed. The UK and sterling come second at just above 20%.

Exhibit 1: Record profile in numbers

Analysis by strategy

	AUME %	Fees %	Fees bps
Dynamic hedging	15	40	15
Passive hedging	82	45	3
Currency for return	3	15	15
Total	**100**	**100**	**6**
Value	$53.7bn	£20.9m	

Client analysis

Number (by financial year)		Type	% AUME	Concentration	% fees
2012	41	Corporate pension funds	44	Top 10	78
2013	44	Public pension funds	42	Next 10	15
2014	48	Foundations & trusts	8	Balance	7
2015	55	Investment /private funds	4		
2016	58	Insurance	2		
2017 Q1	61		**100**		**100**

Geographical/currency analysis

By country	AUME %	Base currency	AUME %
Switzerland	66	Swiss franc	64
UK	23	Sterling	21
US	7	US dollar	9
Other	4	Euro	6
	100		100

Underlying asset class exposure of hedging AUME (%)

	Dynamic	Passive	Est. % of fees
Equity	77	27	43
Fixed income	-	50	23
Other	23	23	19
	100	**100**	**85**

Source: Record, Edison Investment Research. Note: Year to end March 2016 unless shown.

The last section of the table shows the **underlying asset class exposures** within the hedging segments of AUME. If we assume that fee margins are broadly consistent within each hedging category then equity exposure would account for c 40% of total fees, but the more stable fixed income element is still significant at 23% and this falls within the passive hedging area, which, as noted, has tended to be more sticky.

The board

The board comprises 10 directors, with two of the non-executive directors, Cees Schrauwers and Andrew Sykes, set to retire in November this year, at which point they would have no longer been deemed independent, having joined just prior to the IPO in 2007. In anticipation of this, two appointments as independent non-executive directors have already been made. Jane Tufnell joined in September 2015, bringing experience in investment management (she was a co-founder of Ruffer, serving on its board until 2014), and Rosemary Hilary in June this year; she is a qualified accountant and has held senior positions in audit, risk and financial services regulation. The other members of the board are: Neil Record (chairman), James Wood-Collins (CEO), Leslie Hill (head of client team), Bob Noyen (chief investment officer), Steve Cullen (CFO) and David Morrison (non-executive).

Recent Q117 update and FY16 results

Results for FY16, announced in June, showed AUME modestly down in US dollar terms, client numbers up and pre-tax profit down 10% compared with the prior year. In the Q1 update to end June, AUME in dollar terms was reported as down 1.3% but up 6.1% in sterling terms. Key figures were as follows.

- **End March AUME** $53.7bn (down 3% on the year) or £37.4bn (up 0.3%). Currency for return saw the largest outflow, reflecting in particular the reduction in a bespoke tactical mandate that had been increased in the prior year but was recognised as being potentially volatile in size. In dynamic hedging the suspension of one mandate and switch of another to a passive strategy contributed to a net outflow of $1bn, but passive hedging continued to grow with a net addition of $1.8bn (see Exhibit 2).
- **End June AUME** $53.0m (-1.3% from March) with factors being flows (-0.2%), exchange rate movements (-2.8%) and market movements (+1.7%). Within flows, a new client mandate contributed to inflow to multi-strategy currency for return equivalent to 11% of end March AUME. Dynamic hedging also saw a small inflow, while the 0.9% outflow from passive hedging reflected modest changes in underlying allocations by clients rather than any loss of mandate.
- **Client numbers** increased by three to 58 in FY16 and a further three in Record's first quarter to 61.
- **FY16 Revenue** unchanged at £21.1m, helped in part by the contribution from the tactical currency for return mandate mentioned above. This included performance fees of £0.3m compared with £0.5m in FY15. No performance fees were earned in the first quarter.
- **By strategy,** passive and dynamic hedging accounted for 85% of total fees. Passive hedging alone accounted for 45% of fees, equivalent to 85% of costs before group profit share.
- **Operating margin** 32% versus 36% with the reduction largely reflecting a 10% increase in base salaries to maintain Record's competitive position in the financial services sector. Other costs only rose marginally.
- **Pre-tax profit** £6.9m versus £7.7m or, on an underlying basis (stripping out the impact of consolidated seed investments), £7.0m versus £7.5m. Resulting basic earnings per share were 2.55p (2.66p).
- **Dividend** – unchanged at 1.65p.

As a reminder, the definition of AUME, used as a measure of mandate size and shown in the chart below, includes the following: (1) for dynamic hedging, the total amount of clients' investment portfolios denominated in liquid foreign currencies that may be hedged under the mandate; (2) for passive hedging, the actual nominal amount of hedges outstanding; (3) for currency for return, the maximum nominal amount of outstanding forward contracts; and (4) for cash, the total set aside by clients and managed or employed in futures contracts.

Exhibit 2: AUME changes year to end March 2016 and quarter to end June 2016

$bn	FY16		Q116
AUME end FY15	55.4	AUME end FY16	53.7
Net flows		Net flows	
Currency for return	-3.0	Currency for return	0.2
Dynamic hedging	-1.0	Dynamic hedging	0.1
Passive hedging	1.8	Passive hedging	-0.4
Markets	0.4	Markets	0.9
FX effects	0.2	FX effects	-1.5
AUME end FY16	**53.7**	**AUME end Q116**	**53.0**

Source: Record plc. Note: FY16 figures do not sum due to rounding.

Reporting on FY16 performance in the currency for return strategies with the full year results, Record reported a difficult environment with an absence of persistent themes of individual currency strength or weakness and a narrowing of expectations of differentials in interest rates. Forward rate bias and emerging market strategies both suffered from a generally 'risk-off' market environment producing negative returns in the financial year, while the lack of trends led to the momentum strategy underperforming. By contrast, the value strategy performed strongly on the back of yen and euro strength. In the first quarter, forward rate bias performance remained negative, reflecting exposure to some of the more volatile currencies. Emerging markets turned positive contributing with momentum and value strategies to a positive outcome for multi-strategy. Over the period of the UK's EU referendum, with agreement from clients, Record took measures that succeeded in reducing the impact of heightened volatility on portfolios and contained cash trading costs.

On the dividend, the company has indicated that, subject to business conditions, it expects to maintain the dividend at 1.65p in the current year to end March 2017. The board will continue to set a level that is at least covered by earnings and allows for sustainable growth in line with profitability. Additionally, however, the board now regards the balance sheet and capital buffer as being sufficiently strong to support the return of at least part of any surplus of earnings over ordinary dividends, potentially through special dividends. The policy would be that the total payout would still have to be covered by earnings. Based on our current year estimated earnings per share there could be an additional payout of 0.45p. Adding this to the indicated ordinary dividend would give a yield of 8.3%, versus 6.5% excluding.

As far as capital is concerned, the group had year-end operating capital (net current assets of the parent company and the main trading subsidiaries) of £31.7m, of which £8.5m was allocated as regulatory capital, with the £23.2m balance being significantly greater than required for day to day operations in the view of the directors.

Outlook and financials

Exhibit 3 summarises the modest changes in our estimates compared with our last published forecasts. The 3% forecast increase for FY17 reflects the changes in AUME and exchange rates noted above, partly offset by an increased lease cost for the Windsor HQ. New forecasts for FY18 are also introduced. The numbers are shown on an underlying or normalised basis, excluding the contribution of seed investments in funds that are consolidated.

Exhibit 3: Estimate revisions

	Revenue* (£m)			PBT* (£m)			EPS* (p)			DPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
03/16	20.4	21.2	4%	6.5	7.0	8%	2.40	2.55	6%	1.65	1.65	0%
03/17e	19.5	20.2	3%	6.0	6.2	3%	2.18	2.25	3%	1.65	1.65	0%
03/18e	N/A	20.6		N/A	6.4		N/A	2.31		N/A	1.65	

Source: Record, Edison Investment Research. Note: *Excludes non-controlling interests relating to seed investments.

The macro background is one of accentuated uncertainty in the wake of the UK referendum result with the risks of slower global growth highlighted by a range of forecasters. This could continue to suppress the divergence of monetary policy that had been expected last year. However, expectations could change again and, together with other events such as the presidential election in the US, could give rise to further exchange rate volatility. Record has reported a divergence of responses among its clients in the policies they wish to adopt and with its range of strategies it appears well placed to offer appropriately tailored services.

As previously, when preparing our estimates we have not allowed for any net new money inflows or outflows, with only small assumed performance-based increments in the AUME that forms the basis for our revenue estimates; by inference there is therefore no significant expected change in the fee mix within our estimates, another important driver/sensitivity. (See Exhibit 5, Financial summary, for additional P&L, balance sheet and cash flow information.)

Valuation

As a specialist foreign exchange manager with a current emphasis on hedging strategies, Record is differentiated from other quoted asset managers. However, while the drivers of AUM and AUME are markedly different, there is some commonality in the business model with asset managers, so, for reference, we show a comparison of valuation measures with UK-quoted asset managers. Within this list (Exhibit 4), Record features among the lowest rated on both prospective P/E ratio and EV/EBITDA and is significantly below average, particularly in terms of EV/EBITDA.

Exhibit 4: Earnings and EBITDA multiple comparisons for UK fund managers

	Price p	Market cap £m	P/E ratio calendar 2016e	EV/EBITDA calendar 2016e
Aberdeen Asset Management	320.7	4,205	16.7	12.0
Ashmore	338.0	2,356	21.6	12.8
Charlemagne Capital	9.0	26	N/A	3.9
City of London Inv Group	328.3	88	10.8	7.2
Henderson	224.7	2,496	14.9	10.5
Impax Asset Management	51.5	66	17.7	11.6
Jupiter	399.0	1,811	14.2	9.2
Liontrust	295.0	134	10.2	7.1
Man Group	123.5	2,052	8.9	5.2
Polar Capital	311.8	285	12.6	8.9
Schroders	2,578.0	6,974	15.5	8.3
Average			**14.3**	**8.8**
Record	**25.6**	**56**	**9.9**	**3.4**

Source: Bloomberg, Edison Investment Research. Note: Prices as at 21July 2016.

The presence of nearly £28m of cash and money market instruments (excluding cash consolidated from seed funds) on the balance sheet is a positive feature when considering the valuation of Record. Having said this, it is difficult to judge what portion of this could be regarded as truly surplus to requirements. As noted earlier, when considering the capital position, approximately £23m of capital is classified as other operating capital. The business could presumably operate with lower levels of capital/cash but, without experimenting, it is not possible to say where the tipping point from a client perspective would lie. For the moment we would follow the line adopted by the board that aims to retain the current capital/liquidity buffer rather than build it further or reduce it. Conceivably if there were ever to be a change of ownership then this buffer could be a source of additional value that is, arguably, not fully reflected in the share price.

In any case the strong balance sheet, below average prospective P/E and EBITDA multiples, a yield based on the ordinary dividend of over 6% and the potential for a usefully higher total payout all suggest the current valuation is cautious. Positive signals in terms of mandate wins or improved performance in the currency for return strategies could be particularly well received.

Exhibit 5: Financial summary

Year to March (£'000s)	2014	2015	2016	2017e	2018e
PROFIT & LOSS					
Revenue	19,922	21,057	21,134	20,183	20,644
Operating expenses	(13,498)	(13,521)	(14,344)	(14,125)	(14,418)
Operating profit	6,424	7,536	6,790	6,058	6,226
Finance income	113	146	143	142	146
Profit before tax	6,537	7,682	6,933	6,199	6,372
Taxation	(1,494)	(1,708)	(1,523)	(1,302)	(1,338)
Minority interests	364	(192)	131	0	0
Attributable profit	5,407	5,782	5,541	4,897	5,034
Normalised revenue (underlying)	20,266	20,865	21,246	20,183	20,644
Operating expenses (excl. dep'n and amortisation)	(13,190)	(13,206)	(14,023)	(13,804)	(14,097)
Normalised EBITDA	7,076	7,659	7,223	6,379	6,547
Depreciation and amortisation	(308)	(315)	(321)	(321)	(321)
Normalised Operating profits	6,768	7,344	6,902	6,058	6,226
Finance income	113	146	143	142	146
Normalised profit before tax	6,881	7,490	7,045	6,199	6,372
Normalised revenue/AuME (excl. perf fees) bps	8.0	6.0	5.6	5.1	5.1
Normalied Operating Margin norm. (%)	33.4	35.2	32.5	30.0	30.2
Average Diluted Shares Outstanding (m)	218.7	218.4	217.9	218.3	218.5
Basic EPS (p)	2.48	2.66	2.55	2.25	2.31
Diluted EPS (p)	2.47	2.65	2.54	2.24	2.30
Dividend per share - proposed (p)	1.50	1.65	1.65	1.65	1.65
BALANCE SHEET					
Fixed Assets	3,732	3,273	423	282	141
Intangible Assets	734	504	299	105	(89)
Tangible Assets	86	129	81	134	187
Investments	2,754	2,567	0	0	0
Deferred tax assets	158	73	43	43	43
Current Assets	32,835	37,053	40,541	41,893	43,531
Debtors	5,646	6,324	5,695	5,410	5,534
Cash	11,503	12,010	21,720	23,357	24,872
Money market instruments	15,488	18,100	13,020	13,020	13,020
Other	198	619	106	106	106
Current Liabilities	(3,660)	(4,522)	(3,256)	(3,153)	(3,205)
Creditors	(2,706)	(2,949)	(2,372)	(2,253)	(2,305)
Other	(954)	(1,573)	(884)	(900)	(900)
Net Assets	32,907	35,804	37,708	39,022	40,467
Minority interests	3,667	3,876	4,019	4,019	4,019
Net assets attributable to ordinary shareholders	29,240	31,928	33,689	35,003	36,448
No of shares at year end	217.5	217.5	217.2	217.5	217.5
NAV per share p	13.4	14.7	15.5	16.1	16.8
CASH FLOW					
Operating cash flow	5,167	6,472	5,791	5,259	5,137
Capex	(25)	(128)	(29)	(130)	(130)
Cash flow from investing activities	0	0	(39)	(50)	(50)
Dividends	(4,898)	(3,266)	(3,750)	(3,583)	(3,589)
Other financing activities	(17,766)	(2,571)	7,737	142	146
Other	0	0	0	0	0
Net Cash Flow	(17,522)	507	9,710	1,637	1,514
Opening cash/(net debt)	29,025	11,503	12,010	21,720	23,357
Other	0	0	0	0	0
Closing cash/(net debt)	11,503	12,010	21,720	23,357	24,872
Closing net debt/(cash) inc money market instruments	26,991	30,110	34,740	36,377	37,892
AUME					
Opening ($'bn)	34.8	51.9	55.4	53.7	53.9
Net new money flows	14.1	2.9	(1.4)	0.0	0.0
Performance	3.0	0.6	(0.3)	0.2	0.9
Closing ($'bn)	51.9	55.4	53.7	53.9	54.8

Source: Edison Investment Research

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