

# Record

## Positive Q2 trading update

Record's Q217 trading update was encouraging as it showed an increase in assets under management equivalents (AUME), a maintained client count and an indication that investors are taking an interest in a range of the company's products following a period of heightened currency volatility. In this context, the prospective rating with an FY17e P/E of just over 10x and the yield of 6.2% (ex any special payment) seems very conservative.

Year end	Revenue* (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/15	20.9	7.5	2.66	1.65	10.2	6.1
03/16	21.2	7.0	2.55	1.65	10.6	6.1
03/17e	21.7	7.2	2.63	1.65	10.3	6.1
03/18e	23.1	8.1	2.93	1.65	9.3	6.1

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

## Q217 update

At end September Record's AUME stood at \$55.8bn, an increase of 5.2% compared with end June or +8.3% in sterling terms, reflecting weakness in the pound. Net fund flows and market movements were roughly equal contributors to the increase with exchange rate movements a minor negative. Other features of the update were positive performance figures for most of the currency for return strategies and management's indication that investors have become more sensitive to the risks and opportunities of currency volatility.

## Estimates increased

We have increased our forecasts to reflect both the increased AUME reported for the end of the second quarter and the further weakening of sterling since the end of September. Our US dollar AUME assumptions are increased modestly (by 3.5% and 1.9% for FY17 and FY19) on the basis that we have not included any further positive or negative net flows or market movements. In sterling terms this translates into an increase in revenue estimates of 7% and 12% and, with operational gearing, to earnings per share estimate increases of 17% and 26% for FY17 and FY18 respectively. We continue to look for maintained ordinary dividends but note the board's policy adopted this year under which it may consider returning earnings in excess of the dividend to shareholders. If this was in the form of a special dividend, on our estimates there could be a 0.9p payment giving a total dividend of 2.55p (and yield of over 9%).

## Valuation: Undemanding

On our estimate Record is trading on a current year P/E of 10.3x and ranks below UK asset managers (see page 4) both in terms of earnings and EV/EBITDA multiples. A limited free float and sensitivity to the US\$ exchange rate may explain this in part but the rating and yield both appear very conservative underlining the potential for a rerating. Further net inflows and positive currency for return performance would be potential catalysts.

## Q2 trading update

### Financial services

25 October 2016

**Price** 27.13p  
**Market cap** £60m

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 4.3 9.8 (6.6)

Rel (local) 1.9 4.6 (14.9)

52-week high/low 30.38p 22.13p

### 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

Interim results 18 November 2016

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## Q217 trading update is encouraging

Record's second quarter update for the period to end September signalled a positive move in AUME driven equally by net flows and market movements. Currency volatility remained a feature of the quarter, although this was at a lower level than in the previous quarter when the result of the Brexit vote affected markets. Importantly, management reports that investor awareness of the impact of currency volatility is generating increasing interest among investors in Record products.

- **End September AUME** was \$55.8bn compared with \$53.0bn at the end of June, up 5.2%.
- Positive client flows in passive hedging and currency for return, of \$1.5bn (+2.8%), market movements (+\$1.4bn) and a small negative exchange rate movement (-\$0.1bn) accounted for the change.
- Reflecting sterling weakness, there was a greater increase in AUME of 8.3% to £42.9bn and using a rate of \$1.22 (current at time of writing) would, all else being equal, give a figure of £45.7m: a further increase of over 6%.
- **Client numbers** were stable at 61 reflecting a new client win in passive hedging offset by a consolidation of legal entities that reduced the client count but left the related AUME and revenues unaffected. On a longer view, client numbers have shown good progress rising to the current level from 41 in 2012 and 48 in 2014, for example.
- **Performance** (see more below) was mainly positive. Dynamic hedging mandates performed as expected while within the currency for return segment the multi-strategy product delivered a positive performance (as in Q1) and the longest-running product now has an annualised performance of +1.56% since inception (2012).
- Average **fee rates** remain stable. We assume 15bp for currency for return and dynamic hedging and 3bp for passive mandates. No performance fees were earned in the period.
- Based on these fee rates we would estimate the net new flows in the quarter would add c £0.6m or 2.6% to **revenues** in a full year, a modest but useful increment.
- The **licencing agreement** with WisdomTree Investments was extended to include the provision of dynamic hedging signals to their new Canadian rules-based indices. For the moment we have not explicitly modelled revenue from the agreement, which falls within other income, but this has the potential to become a material contributor.

**Exhibit 1: Analysis of recent AUME changes (to end March, June and September 2016)**

\$bn	FY16	Q117	Q217
<b>Opening AUME</b>	<b>55.4</b>	<b>53.7</b>	<b>53.0</b>
Net flows			
Currency for return	(3.0)	0.2	0.2
Dynamic hedging	(1.0)	0.1	0.0
Passive hedging	1.8	(0.4)	1.3
<b>Total net flows</b>	<b>(2.2)</b>	<b>(0.1)</b>	<b>1.5</b>
Markets	0.4	0.9	1.5
FX effects	0.2	(1.5)	(0.1)
<b>Closing AUME</b>	<b>53.7</b>	<b>53.0</b>	<b>55.8</b>

Source: Record. Note: Rounding differences mean some totals do not reconcile.

In Exhibit 1 we summarise the changes in AUME for Record's first and second quarters together with FY16. This highlights the more positive recent trend in flows, which can be lumpy according to the incidence of mandates or additions/withdrawals. Unsurprisingly there are noticeable variations in the impact of market and foreign exchange movements on the level of AUME reflecting mandates linked to stock or other markets and the translation of non-dollar mandates.

Exhibit 2 summarises key points from the performance data given for the currency for return products in the update. Performance is given for the FTSE Currency FRB10 index and the related fund continued to track the index closely with 1.8x gearing. All forward rate bias mandates now follow the FTSE Currency FRB10 index strategy rather than an active forward rate bias approach that overlaid this with a momentum-driven drawdown control process. The accumulation of a positive return over longer periods, as is evident for both emerging market and multi-strategy products, seems likely to help encourage interest.

**Exhibit 2: Currency for return products – performance data**

	Q2	Q1	Annualised S.I.	Inception
FTSE FRB10 Currency Index (basis for forward rate bias products)	+1.37	+0.78		
Emerging market product (ungeared)	+2.51	+0.63	+1.38	30/11/2009
Multi-strategy product (ungeared)	+1.03	+1.48	+1.56	31/12/2012

Source: Record. Note: S.I. = since inception.

Of potential importance for the future is management's indication of heightened investor awareness of the risks and opportunities of currency fluctuations, which is generating interest across the range of Record products from a spread of investors both geographically and by type. The institutional nature of Record's client base and the process involved in deciding to adopt a hedging or currency for return strategy means this is unlikely to generate an immediate change in the level of new mandates but is certainly an encouraging indicator on a medium-term view, if sustained.

## Changes in estimates

As noted above, since the end of September a further significant weakening in sterling has taken place that will, if maintained, result in an increase in AUME in sterling terms and hence revenue and profits.

Our estimates have not allowed for further net newflows into AUME nor assumed any market performance. Factoring in the increase in AUME reported for the first half of FY17 we have increased our dollar AUME by 4% and 2% for FY17 and FY18, respectively. Because of the weakness in sterling, assuming the US dollar/sterling rate is maintained our revenue assumptions are increased by 7% and 12% for FY17 and FY18, which flows through to earnings per share estimate increases of 17% and 26% respectively (see Exhibit 3). Following the recent sharp decline in sterling (currently trading 17% below the end of March rate versus the US dollar), it should be noted that a recovery could in large part reverse the increase in estimates.

**Exhibit 3: Estimate revisions**

	Revenue* (£m)			PBT* (£m)			EPS* (p)			DPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
03/17e	20.2	21.7	7%	6.2	7.2	17%	2.25	2.63	17%	1.65	1.65	0%
03/18e	20.6	23.1	12%	6.4	8.1	26%	2.31	2.93	26%	1.65	1.65	0%

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

We have left our ordinary dividend forecasts unchanged but note that this year the board adjusted its policy as it felt the capital buffer was sufficiently strong. It will now consider returning any excess of earnings above the ordinary dividend payment. Based on our earnings estimate shown for FY17 and rounding down, this could mean a special payment of 0.90p giving a total dividend of 2.55p.

## Valuation

Record is differentiated from other quoted asset managers by its role as a specialist foreign exchange manager with an emphasis on hedging strategies. The drivers of AUM and AUME are also different but the Record business model does have some features in common with asset managers, so, as in previous notes, we show a comparison of valuation measures with UK-quoted asset managers. Within this list (Exhibit 4), Record is the lowest rated on both prospective P/E ratio and EV/EBITDA and is significantly below average, particularly in terms of EV/EBITDA.

<b>Exhibit 4: Earnings and EBITDA multiple comparisons for UK fund managers</b>				
	<b>Price p</b>	<b>Market cap £m</b>	<b>P/E ratio calendar 2016e</b>	<b>EV/EBITDA calendar 2016e</b>
Aberdeen Asset Management	321.5	4,237	16.2	11.9
Ashmore	359.5	2,543	19.3	12.0
City of London Inv Group	375.0	100	13.5	8.3
Henderson	247.7	2,804	16.7	12.0
Impax Asset Management	47.9	61	16.1	10.6
Jupiter	448.1	2,051	15.0	10.4
Liontrust	310.0	141	13.3	7.1
Man Group	122.8	2,091	12.2	6.1
Polar Capital	291.5	266	14.3	7.9
Schroders	2,806.0	7,517	16.4	12.3
<b>Average</b>			<b>15.3</b>	<b>9.9</b>
<b>Record</b>	<b>28.1</b>	<b>62</b>	<b>10.2</b>	<b>3.1</b>

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

At the year-end Record had nearly £28m of cash and money market instruments (excluding cash consolidated from seed funds) on the balance sheet while the capital position was also strong with approximately £23m of capital classified as other operating capital. It is not clear what level of capital would be sufficient to give clients comfort and it would seem prudent from a valuation perspective to take a lead from the line adopted by the board, which aims to retain the current capital/liquidity buffer rather than build it further or reduce it. Nevertheless, any eventual change of ownership could potentially crystallise additional value from this buffer.

The low relative valuation on P/E and EV/EBITDA multiples and an 'ordinary' yield of over 6% before any special dividend all suggest that any capital surplus is not being factored into market thinking. The same metrics also suggest that a continuation of AUME growth and positive performance from the currency for return strategies could prompt a significant re-rating in due course.

## Record profile

In addition to the analysis by product type, Record provides useful disclosure of AUME including splits by geography, client type and currency. For ease of reference we have duplicated a table summarising this and other data presented in our last note in [July](#).

### Exhibit 5: Record profile in numbers

Analysis by strategy					
	Q2 AUME %		Fees %	Fees bp	
Dynamic hedging	13		40	15	
Passive hedging	82		45	3	
Currency for return	4		15	15	
Total	100		100	6	
Value	\$55.8bn		£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 Q2	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.

**Exhibit 6: Financial summary**

Year to March	£'000s	2015	2016	2017e	2018e
<b>PROFIT &amp; LOSS</b>					
Revenue		21,057	21,134	21,656	23,054
Operating expenses		(13,521)	(14,344)	(14,567)	(15,141)
Operating Profit (before amort. and except.)		7,536	6,790	7,089	7,913
Finance income		146	143	142	146
Profit Before Tax		7,682	6,933	7,230	8,059
Taxation		(1,708)	(1,523)	(1,518)	(1,692)
Minority interests		(192)	131	0	0
Attributable profit		5,782	5,541	5,712	6,367
Normalised revenue (underlying)		20,865	21,246	21,656	23,054
Operating expenses (excl. dep'n and amortisation)		(13,206)	(14,023)	(14,246)	(14,820)
EBITDA		7,659	7,223	7,410	8,234
Depreciation and amortisation		(315)	(321)	(321)	(321)
Normalised Operating profits		7,344	6,902	7,089	7,913
Finance income		146	143	142	146
Profit Before Tax (norm)		7,490	7,045	7,230	8,059
Normalised revenue/AuME (excl. perf fees) bps		6.0	5.6	5.1	5.1
Normalised Operating Margin norm. (%)		35.2	32.5	32.7	34.3
Average Diluted Shares Outstanding (m)		218.4	217.9	218.3	218.5
Basic EPS (p)		2.66	2.55	2.63	2.93
EPS - normalised fully diluted (p)		2.65	2.54	2.62	2.91
Dividend per share - proposed (p)		1.65	1.65	1.65	1.65
<b>BALANCE SHEET</b>					
Fixed Assets		3,273	423	282	141
Intangible Assets		504	299	105	(89)
Tangible Assets		129	81	134	187
Investments		2,567	0	0	0
Deferred tax assets		73	43	43	43
Current Assets		37,053	40,541	42,872	45,947
Debtors		6,324	5,695	5,805	6,180
Cash		12,010	21,720	23,941	26,642
Money market instruments		18,100	13,020	13,020	13,020
Other		619	106	106	106
Current Liabilities		(4,522)	(3,256)	(3,318)	(3,474)
Creditors		(2,949)	(2,372)	(2,418)	(2,574)
Other		(1,573)	(884)	(900)	(900)
Net Assets		35,804	37,708	39,837	42,615
Minority interests		3,876	4,019	4,019	4,019
Net assets attributable to ordinary shareholders		31,928	33,689	35,818	38,596
No of shares at year end		217.5	217.2	217.5	217.5
NAV per share p		14.7	15.5	16.5	17.7
<b>CASH FLOW</b>					
Operating Cash Flow		6,472	5,791	5,843	6,323
Capex		(128)	(29)	(130)	(130)
Cash flow from investing activities		0	(39)	(50)	(50)
Dividends		(3,266)	(3,750)	(3,583)	(3,589)
Other financing activities		(2,571)	7,737	142	146
Other		0	0	0	0
Net Cash Flow		507	9,710	2,221	2,700
Opening cash/(net debt)		11,503	12,010	21,720	23,941
Other		0	0	0	0
Closing net (debt)/cash		12,010	21,720	23,941	26,642
Closing net debt/(cash) inc money market instruments		30,110	34,740	36,961	39,662
<b>AUME</b>					
Opening (\$'bn)		51.9	55.4	53.7	55.8
Net new money flows		2.9	(1.4)	1.4	0.0
Performance		0.6	(0.3)	0.7	0.0
Closing (\$'bn)		55.4	53.7	55.8	55.8

Source: Edison Investment Research

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