EDISON

Record

FY17 results

Generating and returning cash

Financial services

Record's FY17 results were close to our expectations so the main new news was the level of ordinary dividend increase (+21%), the announcement of a revised capital policy and the accompanying return of capital by way of a c £10m tender offer. These underline the balance sheet strength and cash-generative nature of the business. Despite re-rating in the last year the shares still trade below average multiples for UK asset managers and the yield, including the special dividend, is over 7%.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS** (p)	P/E (x)	Yield** (%)
03/16	21.2	7.0	2.54	1.65	18.4	3.5
03/17	23.1	7.9	2.90	2.00	16.1	4.3
03/18e	25.1	8.8	3.39	2.10	13.8	4.5
03/19e	25.6	9.0	3.59	2.20	13.0	4.7

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

FY17 results

As reported previously, AUME was $58.2bn, up 10% (or 26% in sterling terms). Underlying revenue, excluding income from seed funds, increased by 9%, helped by sterling weakness against the base currencies of Record's main client exposures in Switzerland and the US. Pre-tax profit on the same basis was 13% ahead of FY16. Reflecting the dividend policy adopted last year, there was both a 21% increase in the ordinary dividend and a special dividend payment, giving a total dividend of 2.91p, in line with basic earnings per share.

New capital policy and tender offer

Reflecting the growth and increased diversity of revenues and the 50%+ contribution from passive hedging, the board has reviewed its capital policy. It has set a new target to maintain capital at a level equivalent to the regulatory requirement plus one rather than two years overhead (excluding variable compensation). The board will also take into consideration prospective working capital and investment requirements although, given the nature of the business, we do not expect these to be substantial. Reflecting the change, the board has proposed a capital return of up to c £10m by way of a tender offer and this is the main contributor to the 8% increase in our estimate for FY18 earnings per share (we assume full take-up). We have included an FY19 estimate for the first time. Even after the cash return there will still be a substantial capital cushion, so customer confidence seems unlikely to be affected and the loss of interest income will have a minor impact on earnings.

Valuation

Although the share price has gained more than 80% over the last 12 months, the P/E remains below the average for a group of UK asset managers, while there are clear income attractions based either on ordinary or total dividend payouts (yield above 4% and 7% respectively).

26 June 2017

Price	**46.75p**
Market cap	**£104m**

Net cash and money market instruments (£m) at 31 March 2017, excluding cash consolidated from seed funds.	29.2
Shares in issue	221.4m
Free float	32%
Code	REC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	14.4	5.4	81.6
Rel (local)	15.4	3.6	55.6
52-week high/low		47.25p	24.50p

Business description

Record is a specialist independent currency manager that provides 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

Q118 trading update	21 July 2017
AGM	27 July 2017

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Edison profile page

Record is a research client of Edison Investment Research Limited

Dedicated, independent currency manager

Founded in 1983 by chairman Neil Record, the company's 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 as a whole accounted for 78% of fee income and passive hedging 53%. Passive hedging mandates tend to be sticky and revenues from these clients cover Record's operating expenditure before variable remuneration.

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, differentiating itself from more standardised services. The company's status as a well-capitalised independent operator is a positive factor when it tenders for these 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 22% of fee income is generated by Record's currency for return and multi-product categories. In its return-seeking 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.

The multi-product mandates combine hedging and return-seeking objectives on a bespoke basis.

Record is always looking to innovate to enhance existing services and develop new products. An example of this is the licensing agreement established in 2016 with WisdomTree Investments Inc (sponsor of exchange traded products and asset manager). Record provides signals used to hedge currency exposures dynamically for WisdomTree's rules-based indices. Although a small contributor to revenue currently, this agreement could become more significant as dynamically hedged exchange-traded funds (ETFs) gain traction.

Exhibit 1 summarises the AUME and fee analysis that Record provides and we pick out a number of features from this below.

The **analysis by strategy** shows the relatively low level of fees applied to passive hedging mandates (4 basis points) that 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, against a mixed market background, Record has succeeded in making net additions to clients in recent years. This has contributed to the rise in AUME from $30.9bn to $58.2bn between FY12 and FY17 (CAGR 13%), allowing fee income to make modest progress despite a significant mix change away from the higher fee margin categories over the period. Corporate and public pension funds each make up over 40% of AUME, while concentration is quite high, with the top 10 clients accounting for over 70% of fee income.

Geographically, by client location, continental Europe (mainly Switzerland) accounts for two-thirds of AUME. Swiss clients account for just over half of fee income (the preponderance of passive hedging mandates accounts for the lower proportion versus AUME). The US and UK are the other main markets.

Exhibit 1: Record profile in numbers

Analysis by strategy			
	AUME %	Management fees %	Fees bp
Dynamic hedging	10.8	24	12
Passive hedging	82.8	53	4
Currency for return	1.7	5	15
Multi-product	4.3	18	20
Cash	0.3	N/A	N/A
Total	**100.0**	**100**	**6**
Value	$58.2bn	£22.7m	

Client analysis					
Number (by financial year)		Type	% AUME	Concentration	% fees
2012	41	Corporate pension funds	44	Top 10	74
2013	44	Public pension funds	41	Next 10	17
2014	48	Foundations & trusts	7	Balance	9
2015	55	Investment /private funds	5		
2016	58	Insurance	3		
2017	59		**100**		**100**

Geographical analysis			
By region	AUME %	Country	% fees
Continental Europe	67	Switzerland	51
UK	22	US	22
US	10	UK	17
Other	1	Other	10
	100		**100**

Underlying asset class exposure of hedging AUME (%)			
	Dynamic	Passive	Est. % of hedging fees
Equity	98	29	51
Fixed income	-	42	29
Other	2	29	21
	100	**100**	**100**

Source: Record, Edison Investment Research. Note: Year to end March 2017.

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 in each hedging category, then equity exposure would account for c 50% of hedging fees, but the more stable fixed income element is still significant at nearly 30% and this falls within the passive hedging area which, as noted, has tended to be more sticky.

FY17 results, revised capital policy and tender offer

FY17 results

The main surprises in Record's full year results were the accompanying announcements of larger than expected ordinary and special dividends, together with a revised capital policy and planned £10m return of capital. The year-end update had already confirmed AUME progress of 10% and the revenue, profit and earnings per share figures were in line with or slightly ahead of our expectation. Key points from the FY17 results are summarised below.

- **AUME** was at a record level of $58.2bn, an increase of 10% from the March 2016 year end (in sterling terms +26%). A client has notified the termination of a $1.2bn passive hedging mandate, which is expected to take place in the current quarter (Q118). During the year there was a net inflow of $3.2bn ($9.2bn gross inflow and $6.0bn outflow), positive net market movements totalling $5.4bn and negative FX effects of $3.3bn.
- There was no significant change in **fee terms** in FY17, although the measured fee rate for the currency for return category fell from 20bp to 15bp. This reflected a number of mandates where Record is effectively allotted a risk budget. This means that when volatility is lower, as has been the case recently, the exposure and hence AUME is increased to maintain target volatility.
- **Revenue** increased by 13% to £23.9m or, on an underlying basis that strips out the effect of consolidated seed investments, by 9%. The weakness of sterling against the base currencies of clients was a key contributor here (the Swiss franc and US dollar being the largest exposures). The underlying **operating margin** increased from 33% to 34%. **Pre-tax profit** on an underlying basis increased by 13% to £7.9m (by 26% to £8.7m on a reported basis). Basic **earnings per share** were 2.91p (+14%).
- The proposed final ordinary **dividend** is 1.175p, giving a total of 2.00p, an increase of 21% on the prior year. In addition a special dividend of 0.91p (FY16 nil) was declared, taking the total dividend to 2.91p, exactly in line with earnings per share and consistent with the dividend policy adopted at the time of the FY16 results, under which the board would consider returning any earnings in excess of the ordinary dividend.
- The number of **clients** at the end of the year was 59. While this was only one up from the beginning of the year this was after the departure of the six linked clients (Record counts separate legal entities) and compares with 44 in FY13.
- Looking at FY17 **performance,** the US dynamic hedging programmes performed as intended, while the UK programmes were affected by volatility and the resulting cash costs associated with changing hedging levels. Performance in the currency for return strategies is shown in Exhibit 2. All strands within the multi-strategy product provided a positive return during the year although, on a longer view, Record would expect greater variation with the diversity of the product moderating volatility. No performance fees were earned in FY17.

Exhibit 2: Currency for return performance metrics

%	Year to end March 17	Return since inception (% pa)	Volatility since inception (% pa)	Inception	Base currency
Funds					
FTSE FRB10 Index fund (1.8x gearing)	8.09	2.1	7.32	Dec-10	GBP
Emerging Market Currency Fund (1x gearing)	10.37	1.58	6.53	Dec-10	GBP
Index/composite returns					
FTSE Currency FRB10	4.45	2.04	4.62	Dec-87	GBP
Currency Value	1.37	2.93	3.13	Jul-12	CAD
Currency Momentum	2.06	1.82	3.78	Jul-12	CAD
Record Multi-Strategy composite (excess returns before fees)	6.82	2.48	2.45	Jul-12	USD

Source: Record

Revised capital and dividend policy

In the period following the financial crisis the group has focused on building and maintaining a strong capital and cash position, ensuring a substantial buffer from a regulatory perspective and providing reassurance to clients. The broad yardstick used to achieve this has been to hold excess capital equivalent to two years' overhead (ex-variable remuneration). The year-end position for FY17 matched this guidance with capital in excess of the regulatory requirement (after deducting proposed ordinary and special dividends) standing at £23.1m and overheads of £11.7m.

The board has reviewed the capital policy and decided to reduce the target level of excess capital from two to one year's overhead taking into account requirements for working capital and capital investment in new opportunities. Given limited requirement for working capital or investment (new products offerings do not consume significant capital), this leaves available £10m of capital for return to shareholders.

On dividends the board indicates that it intends to follow a progressive ordinary dividend policy and to pay equal dividends at the interim and final stages. The dividend is to be set at a level that is expected to be at least covered by earnings and allows for sustainable growth with earnings in future. The board will also continue to consider the return of earnings in excess of the ordinary dividend after allowing for increased capital requirements. The total dividend for any year is to be at least covered by earnings.

Tender offer

Record has announced that, subject to a general meeting, it will use a tender offer to return up to approximately £10m to shareholders. The offer will be for c 22.3m shares, equivalent to just over 10% of the shares outstanding. Each shareholder is entitled to tender 10.0851% of their holding and can make an additional, excess tender. Excess tenders will be satisfied to the extent that other shareholders tender less than their pro rata basic entitlement. The price set is 44.79p, equivalent to the closing price on 20 June, adjusted for the final and special dividends. The offer closes at 1.00pm 12 July.

The company indicates that the non-executive chairman, Neil Record, is to use the tender as an opportunity to reduce his shareholding, tendering additional shares above his basic entitlement. If fully accepted, his holding would fall from 32.06% to 27.06%. Mr Record intends to remain as chairman and play an active role in the company for the foreseeable future, with no change in his involvement following the tender.

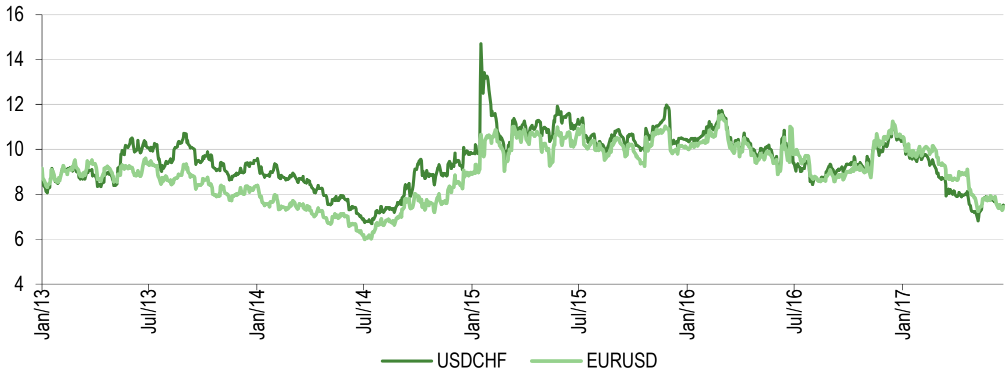
Outlook, estimate changes and financial position

Outlook

Globally, the political and economic background remains uncertain, with developments such as the UK vote for Brexit and US presidential and UK general elections highlighting the potential for surprises and significant currency volatility. In practice, currency volatility has generally fallen in the current calendar year as exemplified by the implied volatility of at-the-money options on the Swiss franc and euro versus the US dollar (Exhibit 3). Record notes that while volatility measured in this way has declined, the perception of heightened tail risk is contributing to continuing and diversified interest in its services.

More specifically, the company highlights several themes emerging. The macro background mentioned and a period of $ strength has increased the importance of currency hedging as a consideration among US institutions, while the UK is more challenging following a period of sterling weakness with hedging programmes giving rise to cash outflows. In the Swiss market, where passive hedging is a large part of the business, there is an increased focus on efficiency and a customised service helps to achieve this. To increase its local presence and facilitate servicing clients in this way, Record has established a small Zurich office.

Exhibit 3: Implied volatility for one year at the money options CHF and EUR versus USD



Source: Bloomberg. Note: CHF = Swiss franc, EUR = euro, USD = US$.

In the currency for return area, the lengthening positive track record is helpful and the multi-strategy product, which is seen as a flagship product, will reach its fifth anniversary in July, a supportive milestone for marketing purposes.

Estimate changes

We have updated our estimates with the change in FY18e earnings mainly attributable to the effect of the tender offer (we have assumed full take-up). We had already adjusted our estimates at the time of the FY17 year-end update to allow for the increase in AUME during Q417 and the termination of the $1.2bn passive hedging contract in Q118. Our estimates also allow for slightly higher costs in FY18 to reflect costs associated with managing the effect of regulatory requirements in different territories for clients and an increased lease cost at the Windsor head office, the move of the US office from Atlanta to New York and, to a limited extent, the new Zurich office. We have introduced an FY19 estimate for the first time. Note that we have assumed market appreciation of 2% pa in the hedging mandates to allow for market exposure. Clearly significant variation is possible compared with this assumption. Apart from the $1.2bn hedging contract mentioned above, we do not allow for any mandate gains or losses. Our dividend expectations are adjusted in line with the dividend policy set out earlier.

Exhibit 4: Estimate changes

	Revenue* (£m)		% chg.	PBT* (£m)		% chg.	EPS* (p)		% chg.	DPS** (p)		% chg.
	Old	New		Old	New		Old	New		Old	New	
03/17	22.6	23.1	2%	7.9	7.9	0%	2.84	2.90	2%	1.65	2.00	21%
03/18e	24.1	25.1	4%	8.5	8.8	3%	3.03	3.39	12%	1.65	2.10	27%
03/19e	N/A	25.6		N/A	9.0		N/A	3.59		N/A	2.20	

Source: Edison Investment Research. Note: *Normalised. 03/17 new = actual, old = estimate. **Ordinary DPS.

Financial position

The group figure for net cash and money market instruments managed as cash increased from £34.7m to £37.2m during FY17. Stripping out the cash held by seed funds (non-controlling interests) gives a year-end own cash figure of £29.2m. The year-end NAV was £41.6m; including adjustments for the final and special dividends declared, the surplus capital stood at £23.1m providing scope for the capital return detailed above. Allowing for a full take-up of the tender offer and implementation of the dividend policy, we would expect own cash and money market instruments at the end of FY18 and FY19 of approximately £19m.

Valuation

Record is differentiated from UK asset managers by its specialist focus on currency management, but the level of AUME is linked to stock and other market levels (this applies to almost all hedging programmes and some of the multi-product and currency for return products), while fees are related to the level of AUME, as for asset managers with AUM. We therefore continue to use a group of UK asset managers as a qualified basis for valuation comparison (Exhibit 5).

Record's shares have seen a considerable re-rating (the price is up over 80% in the last 12 months), but still trades modestly below average P/E and EV/EBITDA ratios for the asset manager peers, as shown below. It could be argued that the proposed tender offer trims the regulatory cushion and could theoretically influence client choices acting as a drag on future earnings and the potential earnings multiple the market would be prepared to pay, but the remaining level of capital headroom still appears substantial. Therefore, with little impact on earnings from reduced interest income and assuming no adverse influence on prospective customer decisions, the capital return appears unlikely to have an adverse valuation impact and will leave the group with a more efficient balance sheet (prospectively generating a return on average equity of over 26% in FY19e).

Given the strength of the capital position, even after the tender offer, and the dividend policy under which earnings are set to be fully or largely distributed (prospective ordinary yield 4.5% or 7.3% including a special dividend at a price of 47p) the shares could see a further re-rating.

Exhibit 5: Earnings and EBITDA multiples for UK fund managers

	Price (local)	Market capitalisation (£m)	P/E* (x)	EV/EBITDA (x)
Aberdeen Asset Management	293.6	3,869	13.5	9.8
Ashmore	354.5	2,527	16.9	11.0
City of London Inv Group	405.0	109	11.3	8.9
Impax Asset Management	93.8	120	18.1	12.4
Janus Henderson	32.9	5,210	21.3	11.2
Jupiter	502.5	2,300	14.9	10.1
Liontrust	460.0	228	25.8	8.4
Man Group	150.5	2,497	10.0	6.6
Polar Capital	431.0	394	18.3	12.9
Schroders	3128.0	8,340	15.8	8.5
Average			**16.6**	**10.0**
Record	**46.9**	**104**	**16.2**	**9.5**

Source: Bloomberg, Edison Investment Research. Note: *Using calendar 2017 estimated earnings. Priced as at 22 June 2017.

Exhibit 6: Financial summary

£'000s	2015	2016	2017	2018e	2019e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	21,057	21,134	23,928	25,126	25,557
Operating expenses	(13,521)	(14,344)	(15,365)	(16,395)	(16,693)
Operating Profit (before amort. and except.)	7,536	6,790	8,563	8,731	8,864
Finance income	146	143	112	64	109
Profit Before Tax	7,682	6,933	8,675	8,795	8,973
Taxation	(1,708)	(1,523)	(1,540)	(1,759)	(1,795)
Minority interests	(192)	131	(819)	0	0
Attributable profit	5,782	5,541	6,316	7,036	7,178
Normalised revenue (underlying)	20,865	21,246	23,128	25,126	25,557
Operating expenses (excl. dep'n and amortisation)	(13,206)	(14,023)	(15,023)	(16,066)	(16,364)
Normalised EBITDA	7,659	7,223	8,105	9,060	9,193
Depreciation and amortisation	(315)	(321)	(342)	(329)	(329)
Normalised Operating profits	7,344	6,902	7,763	8,731	8,864
Finance income	146	143	112	64	109
Profit Before Tax (norm)	7,490	7,045	7,875	8,795	8,973
Normalised revenue/AuME (excl. perf fees) bps	6.0	5.4	5.9	5.8	5.7
Normalied operating margin (%)	35.2	32.5	33.6	34.7	34.7
Average Diluted Shares Outstanding (m)	218.4	217.9	218.0	207.5	200.1
Basic EPS (p)	2.66	2.55	2.91	3.41	3.61
EPS - normalised (p)	2.65	2.54	2.90	3.39	3.59
Ordinary dividend per share (p)	1.65	1.65	2.00	2.10	2.20
Special dividend per share (p)	0.00	0.00	0.91	1.31	1.41
Total dividend	1.65	1.65	2.91	3.41	3.61
BALANCE SHEET					
Fixed Assets	3,273	423	1,228	1,129	1,030
Intangible Assets	504	299	245	115	(15)
Tangible Assets	129	81	881	912	943
Investments	2,567	0	0	0	0
Deferred tax assets	73	43	102	102	102
Current Assets	37,053	40,541	44,247	34,748	35,200
Debtors	6,324	5,695	6,972	7,574	7,704
Cash	12,010	21,720	19,120	9,019	9,341
Money market instruments	18,100	13,020	18,102	18,102	18,102
Other	619	106	53	53	53
Current Liabilities	(4,522)	(3,256)	(3,865)	(4,173)	(4,229)
Creditors	(2,949)	(2,372)	(3,013)	(3,273)	(3,329)
Other	(1,573)	(884)	(852)	(900)	(900)
Net Assets	35,804	37,708	41,610	31,704	32,000
Minority interests	3,876	4,019	4,779	4,779	4,779
Net assets attributable to ordinary shareholders	31,928	33,689	36,831	26,925	27,221
No of shares at year end	217.5	217.2	221.4	199.1	199.1
NAV per share p	14.7	15.5	16.6	13.5	13.7
CASH FLOW					
Operating Cash Flow	6,472	5,509	7,166	7,007	7,325
Capex	(128)	(29)	(899)	(130)	(130)
Cash flow from investing activities	0	(39)	(189)	(100)	(100)
Dividends	(3,266)	(3,750)	(3,592)	(6,942)	(6,882)
Other financing activities	(2,571)	7,737	(5,222)	(9,936)	109
Other	0	282	136	0	0
Net Cash Flow	507	9,710	(2,600)	(10,101)	322
Opening cash/(net debt)	11,503	12,010	21,720	19,120	9,019
Other	0	0	0	0	0
Closing net (debt)/cash	12,010	21,720	19,120	9,019	9,341
Closing net (debt)/cash inc money market instruments	30,110	34,740	37,222	27,121	27,443
AUME					
Opening ($'bn)	51.9	55.4	52.9	58.2	58.09
Net new money flows	2.9	(1.4)	3.1	(1.2)	0.0
Performance	0.6	(1.1)	2.2	1.1	1.1
Closing ($'bn)	55.4	52.9	58.2	58.1	59.2

Source: Company accounts, Edison Investment Research

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