

# Record

H118 result

AUME at a high, investing in products, services

Record is differentiated from conventional asset managers by its focus on currency markets where it benefits from its independent status and over 30 years of experience. Passive hedging services account for more than half of revenues but its offering is increasingly bespoke. This has pushed costs up but should help secure additional and retain existing mandates. The valuation remains below average in comparison with UK asset managers and the distribution policy is attractive for those seeking income.

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS** (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|-----------|---------|-----------|
| 03/16    | 21.2         | 7.0       | 2.54     | 1.65      | 19.1    | 3.4       |
| 03/17    | 23.0         | 7.9       | 2.90     | 2.00      | 16.7    | 4.1       |
| 03/18e   | 24.6         | 8.1       | 3.13     | 2.30      | 15.5    | 4.7       |
| 03/19e   | 25.2         | 8.4       | 3.34     | 2.42      | 14.5    | 5.0       |

Note: \*PBT and EPS for FY16 exclude non-controlling interests related to seed investments which are also excluded from subsequent years following a change in presentation. EPS are diluted and \*\* DPS excludes special dividends.

## H118 results

Record had already reported the level of AUME at end September in its Q2 update, also signalling that costs were increasing as investment in headcount was made to deliver enhanced service and to cater for regulatory change, notably EMIR. There were therefore few surprises in the first half figures. AUME reached \$61.2bn, a new high, with currency moves being the main positive driver in the half year. Flows were negative but, at \$1bn, this was equivalent to less than 2% of the total. Fee margins were broadly stable by segment with mix changes resulting in a small reduction in the average versus H117. The operating margin was down two points to 31% reflecting the increase in costs but pre-tax profits were still up 6% and, helped by the £10m tender offer during the period, diluted earnings per share increased by 14% from H117.

## Outlook

Currency volatility has remained relatively subdued recently but the uncertainties in the macroeconomic and geopolitical climate continue to generate concerns over possible adverse tail events so conditions remain favourable for Record to market its services to potential clients. Work to broaden the product range, including collateral management and increase customisation should be helpful. Meanwhile the longer-term track record for the currency for return strategies may allow this and the multi-product areas to increase AUME and revenue.

## Valuation: Yield and multiples appealing

Record shares are up by c 50% over 12 months but still trade on earnings and EBITDA multiples below the average for UK asset managers. This combined with an attractive yield (over 6% for FY18e, including our estimated special dividend) suggest scope for further re-rating.

## Financial services

28 November 2017

**Price** 48.5p  
**Market cap** £97m

Net cash and money market instruments at 30 Sept 2017 (£m) 26.3

Shares in issue 199.1m

Free float 32%

Code REC

Primary exchange LSE

Secondary exchange N/A

## Share price performance



| %                | 1m  | 3m    | 12m   |
|------------------|-----|-------|-------|
| Abs              | 4.2 | 3.3   | 53.7  |
| Rel (local)      | 5.9 | 3.3   | 41.0  |
| 52-week high/low |     | 52.5p | 30.8p |

## 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

Q3 trading update January 2018

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## Company profile

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. Currency for return, multi-product and related services are the other contributors to revenue.

In H118, passive hedging accounted for 54% of management fees. Passive hedging mandates tend to be sticky and revenues from these clients broadly cover Record's operating expenditure before variable remuneration and one-off costs related to the tender offer. Record emphasise that passive hedging is far from being a commoditised service with requirements including strong expertise in execution, operational efficiency and ability to customise the offering with related activities such as collateral management. Dynamic hedging also targets systematic reduction of currency risk while seeking to modify the level of hedging to allow clients to gain some benefit from weakness in their own currency. Currency for return strategies aim to exploit stable inefficiencies in currency markets and include a number of strategies such as forward rate bias, emerging market currencies, momentum and value. The multi-product category includes mandates where hedging and return-seeking strategies are combined on a bespoke basis.

We have collated Record's detailed disclosure analysing AUME and management fee exposure in Exhibit 1.

| Exhibit 1: Record profile in numbers (H118)                              |                             |                         |                        |         |
|--|-----------------------------|-------------------------|------------------------|---------|
| Analysis by strategy   |                             |                         |                        |         |
|  | AUME %                      | Management fees %       |                        | Fees bp |
| Dynamic hedging  | 7.4                         | 23%                     |                        | 14      |
| Passive hedging  | 84.5                        | 54%                     |                        | 3       |
| Currency for return  | 2.8                         | 7%                      |                        | 17      |
| Multi-product  | 4.9                         | 16%                     |                        | 18      |
| Cash   | 0.4                         | N/A                     |                        | N/A     |
| Total  | 100.0                       | 100                     |                        | 5.2     |
| Value  | \$61.2bn                    | £12.0m                  |                        |         |
| Client analysis  |                             |                         |                        |         |
| Number (by financial year)   | Type                        | % AUME                  | Concentration          | % fees  |
| 2013   | 44 Public pension funds     | 42                      | Top 10                 | 76      |
| 2014   | 48 Corporate pension funds  | 41                      | Next 10                | 16      |
| 2015   | 55 Foundations & trusts     | 8                       | Balance                | 8       |
| 2016   | 58 Investment/private funds | 6                       |                        |         |
| 2017   | 59 Insurance / corporate    | 3                       |                        |         |
| H118   | 59                          | 100                     |                        | 100     |
| Geographical analysis  |                             | AUME progression (\$bn) |                        |         |
| By Country   | AUME %                      | 2013                    |                        | 34.8    |
| Switzerland  | 60                          | 2014                    |                        | 51.9    |
| UK   | 16                          | 2015                    |                        | 55.4    |
| US   | 11                          | 2016                    |                        | 52.9    |
| Other  | 13                          | 2017                    |                        | 58.2    |
|  | 100                         | H118                    |                        | 61.2    |
| Underlying asset class exposure of dynamic and passive hedging AUME (%)  |                             |                         |                        |         |
|  | Dynamic                     | Passive                 | Est. % of hedging fees |         |
| Equity   | 96                          | 30                      | 50                     |         |
| Fixed income   | -                           | 42                      | 29                     |         |
| Other  | 4                           | 28                      | 21                     |         |
|  | 100                         | 100                     | 100                    |         |
| Source: Record. Edison Investment Research. Note: based on H118 figures. |                             |                         |                        |         |

Source: Record, Edison Investment Research. Note: based on H118 figures.

The first section underlines the predominance of hedging for both AUME and fees despite the relatively low fee rate applied in passive hedging. The client analysis shows that while the number of clients has been stable recently it has increased noticeably since 2013. Reflecting the

institutional nature of Record's market there is quite a high concentration of fees from the top 10 clients (76%). The third section highlights the importance of Switzerland as a market (primarily for hedging services) and the progression of AUME in recent years. Finally, the analysis of exposure of the dynamic and passive hedging mandates to different underlying asset classes shows that, on our estimate, roughly 50% of hedging fees are related to equity assets and 30% to fixed income assets.

## Half-year results

Following Record's Q218 update released in October, which gave details of changes in AUME and commentary highlighting the investment being made in headcount ([see note](#)), the first-half results for the period to end September were in line with expectations. Revenue was up 14% while, reflecting increased costs, the operating margin was two points lower at 31% versus 33% in H117. Even so, pre-tax profits increased by 6% while the ordinary dividend per share was raised by 39%. Key points from the figures are summarised below.

- **AUME** in dollar terms increased from \$58.2bn at end March to \$61.2bn at end September (+5.2%). AUME in sterling terms was down slightly (-2.1%), reflecting dollar weakness. There was a net outflow of \$1bn in the half year including \$1.7bn for dynamic hedging and \$0.3bn for passive hedging. There was a \$0.6bn positive flow into currency for return. FX and market moves together with a small scaling effect on mandates with volatility targets had a material positive impact of \$4bn, equivalent to 7% of opening AUME (see Exhibit 2).
- **Client numbers** at 59 were unchanged from the end of March, down from 61 at the end of H117 but, on a longer view, have increased from 48 in 2014.
- **Revenue** was £12.2m, vs £10.7m in H117 (+14%). There were no performance fees in the period. Within management fees of £12m the main contributor to growth was passive hedging with an increase of 14% while the strongest percentage growth was recorded in currency for return (+76%) broadly reflecting the increase in average AUME between the two periods.
- **Fee margins** are indicated to be stable (see top right section of Exhibit 1) although mix changes between and within categories does result in movements in the averages. The overall average we calculate for H118 is 5.2bps compared with 5.4bps for the prior year period or 5.3bps for H217.
- **Administrative costs** increased by 19% vs H117 or 2% compared with H217. Personnel costs increased by 18% as headcount rose (to 80 vs the FY17 average of 73) to support innovation and enhanced products. There have also been costs arising from regulatory changes including EMIR and related collateral requirements and to a lesser extent MiFID II. New office leases in the UK and US together with the opening of a small office in Zurich contributed to a rise in non-personnel costs. There were £0.2m of one-off costs related to the tender offer in the period.
- **Earnings per share** (diluted) increased from 1.33p in H117 to 1.52p (+14%).

**Exhibit 2: Analysis of change in AUME**

| Year end March              | Q417        | Q118        | Q218        | Q118       | Q218        | H118        |
|-----------------------------|-------------|-------------|-------------|------------|-------------|-------------|
| \$bn                        | AUME        | AUME        | AUME        | Net flows  | Net flows   | Net flows   |
| Dynamic hedging             | 6.3         | 5.0         | 4.5         | -1.1       | -0.6        | -1.7        |
| Passive hedging             | 48.2        | 50.3        | 51.7        | 0.2        | -0.5        | -0.3        |
| Currency for return         | 1.0         | 1.6         | 1.7         | 0.6        | 0.0         | 0.6         |
| Multi-product               | 2.5         | 2.8         | 3.0         | 0.3        | 0.0         | 0.3         |
| Cash                        | 0.2         | 0.2         | 0.3         | 0.0        | 0.1         | 0.1         |
| <b>Total AUME/Flows</b>     | <b>58.2</b> | <b>59.9</b> | <b>61.2</b> | <b>0.0</b> | <b>-1.0</b> | <b>-1.0</b> |
| Scaling effect              |             |             |             | 0.0        | 0.1         | 0.1         |
| Markets                     |             |             |             | -0.7       | 2.0         | 1.3         |
| FX effects                  |             |             |             | 2.4        | 0.2         | 2.6         |
| <b>Total change in AUME</b> |             |             |             | <b>1.7</b> | <b>1.3</b>  | <b>3.0</b>  |

Source: Record, Edison Investment Research

An interim **dividend** of 1.15p was declared compared with 0.825p last year; this will be paid on 22 December. The thinking behind this increase was that the £10m tender offer in July this year resulted in a c 10% reduction in the share capital and the board wished to preserve the total payment with an addition to maintain its progressive dividend policy. The second half payment is expected to match the first half and the board will consider the return of earnings in excess of the ordinary dividend after allowing for increased capital requirements. On our estimates this could allow a special dividend of up to 0.85p giving a total payment of 3.15p for FY18.

The next table shows **performance figures** for currency for return strategies. This shows mixed performance in H118 with positive performances from emerging markets and currency value more than offset by negative performances in the remaining strategies within the multi-strategy product. Nevertheless, returns since inception remain positive across all strands with the diversified multi-strategy performance in particular offering an interesting track record of positive returns and moderate volatility from a strategy with a low correlation to equity indices.

### Exhibit 3: Performance

| Fund name                                       | Gearing | Half year return | Return SI pa | Volatility SI pa | Inception |
|---|---------|------------------|--------------|------------------|-----------|
| FTSE FRB10 Index Fund                           | 1.8     | -1.40%           | 1.73%        | 7.21%            | Dec-10    |
| Emerging Market Currency Fund                   | 1.0     | 3.16%            | 1.54%        | 6.35%            | Dec-10    |
| <b>Index/Composite returns</b>                  |         |                  |              |                  |           |
| FTSE Currency FRB10 GBP excess return           |         | -0.73%           | 2.28%        | 4.59%            | Dec-87    |
| Currency Value                                  |         | 0.70%            | 2.78%        | 3.02%            | Jul-12    |
| Currency Momentum                               |         | -2.85%           | 1.08%        | 3.70%            | Jul-12    |
| Record Multi-Strategy (USD excess gross return) |         | -1.02%           | 2.04%        | 2.41%            | Jul-12    |

Source: Record plc. Note: SI = since inception.

Following the appointment of new auditors the first half figures were marked by a **presentational change** relating to seed investments in three funds that are consolidated in the accounts. External investments in these funds are now shown as financial liabilities on the balance sheet rather than a non-controlling interest. Gains and losses attributable to external investors in these funds are no longer included in operating profits and there is no figure on the profit and loss account relating to non-controlling interests. Gains or losses relating to the seed funds previously included within revenue are now shown within the other income or expense line. On restating last year's figures there is no change in the earnings or equity attributable to ordinary shareholders.

## Outlook

The uncertain global macroeconomic and geopolitical background continue to create a generally favourable backdrop for Record's conversations with potential hedging clients even when currency volatility remains relatively low (see Exhibit 4).

### Exhibit 4: Implied volatility for one year at the money options CHF and EUR versus USD



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

The company note that although clients and potential clients may acknowledge the value of maintaining a hedge even when there are periods of base currency weakness, the persistence of cash outflows to retain this position while near-term currency gains could have been realised can act as a deterrent in markets such as the US where hedging tends to be viewed more tactically. For the moment therefore the US may prove a less fertile source of mandates while Europe (given euro strength) is more promising.

At the time of the results Record noted that some smaller clients might cease hedging following the introduction of EMIR (European Market Infrastructure Regulation) at the beginning of 2018. This is because of the requirement it brings for the posting and hence management of collateral for deliverable forward foreign exchange contracts, adding to the cost and administration involved. Since then Record has highlighted that these requirements may now be amended before their introduction, but has also confirmed it does not expect the revenue impact to be material in either case.

Under a licencing agreement Record continues to provide WisdomTree Investments with signals used to hedge currency exposures dynamically for WisdomTree's rules-based indices. This is included within other currency services income (£0.25m H118) and, while not large currently, could with the addition of other clients, become a more significant contributor to revenue.

## Financials

As shown below there has been very little change in our revenue, profit and EPS estimates following the first half figures. Further details are shown in the financial summary (Exhibit 7). We have increased our ordinary dividend assumptions by 10% following the declaration of a 1.15p interim. There is a marginal increase in our estimated total dividends (now 3.15p and 3.36p for FY18 and FY19 respectively) as the assumed special dividend has been correspondingly reduced to retain earnings cover.

**Exhibit 5: Earnings revisions**

|        | Revenue (£m) |      | % chg. | PBT (£m) |     | % chg. | EPS (p) |      | % chg. | DPS (p) |      | % chg. |
|--------|--------------|------|--------|----------|-----|--------|---------|------|--------|---------|------|--------|
|        | Old          | New  |        | Old      | New |        | Old     | New  |        | Old     | New  |        |
| 03/18e | 24.6         | 24.6 | 0%     | 8.1      | 8.1 | 1%     | 3.11    | 3.13 | 1%     | 2.10    | 2.30 | 10%    |
| 03/19e | 25.0         | 25.2 | 1%     | 8.2      | 8.4 | 1%     | 3.30    | 3.34 | 1%     | 2.20    | 2.42 | 10%    |

Source: Record, Edison Investment Research. Note: dividend excludes any special payment

## Valuation

We have updated our comparative table showing the P/E and EBITDA multiples for Record in the context of UK fund managers.

**Exhibit 6: Earnings and EBITDA multiples for UK fund managers**

|                          | Price<br>(local) | Market capitalisation<br>(£m) | P/E<br>(x)  | EV/EBITDA<br>(x) |
|--------------------------|------------------|-------------------------------|-------------|------------------|
| Ashmore                  | 365.5            | 2,605                         | 17.4        | 11.3             |
| City of London Inv Group | 405.0            | 109                           | 10.6        | 8.1              |
| Impax Asset Management   | 158.8            | 203                           | 28.5        | 42.2             |
| Janus Henderson          | 36.1             | 5,441                         | 15.2        | 12.7             |
| Jupiter                  | 578.5            | 2,648                         | 16.6        | 13.4             |
| Liontrust                | 504.0            | 250                           | 18.1        | 18.4             |
| Man Group                | 194.6            | 3,205                         | 12.1        | Loss             |
| Polar Capital            | 478.0            | 444                           | 15.2        | 19.1             |
| Schroders                | 3,425.0          | 9,136                         | 16.5        | 16.4             |
| <b>Average</b>           |                  |                               | <b>16.7</b> | <b>17.7</b>      |
| <b>Record</b>            | <b>48.5</b>      | <b>97</b>                     | <b>15.9</b> | <b>8.2</b>       |

Source: Bloomberg, Edison Investment Research. Note: Using calendar 2017 estimated earnings and last reported EBITDA. Priced as at close 27 November 2017.

This shows that even though Record shares are up c 50% over the last 12 months they are still trading on multiples below the average for the UK fund managers shown. With a balance sheet that remains strong following the tender offer and a distribution policy that means that earnings are set to be largely distributed there appears to be scope for further re-rating.

**Exhibit 7: Financial summary**

| £'000s   | 2015     | 2016     | 2017     | 2018e    | 2019e    |
|--|----------|----------|----------|----------|----------|
| March  | IFRS     | IFRS     | IFRS     | IFRS     | IFRS     |
| <b>PROFIT &amp; LOSS</b>                             |          |          |          |          |          |
| Revenue (underlying)                                 | 20,865   | 21,246   | 22,952   | 24,587   | 25,156   |
| Revenue  | 21,057   | 21,134   | 22,952   | 24,587   | 25,156   |
| Operating expenses                                   | (13,521) | (14,344) | (15,365) | (16,581) | (16,910) |
| Other income/(expense)                               |          |          | 157      | 49       | 0        |
| Operating Profit (before amort. and except.)         | 7,536    | 6,790    | 7,744    | 8,055    | 8,246    |
| Finance income                                       | 146      | 143      | 112      | 65       | 110      |
| Profit Before Tax                                    | 7,682    | 6,933    | 7,856    | 8,119    | 8,357    |
| Taxation   | (1,708)  | (1,523)  | (1,540)  | (1,624)  | (1,671)  |
| Minority interests                                   | (192)    | 131      | 0        | 0        | 0        |
| Attributable profit                                  | 5,782    | 5,541    | 6,316    | 6,495    | 6,685    |
| Normalised revenue (underlying)                      | 20,865   | 21,246   | 22,952   | 24,587   | 25,156   |
| Operating expenses (excl. dep'n and amortisation)    | (13,206) | (14,023) | (15,023) | (16,231) | (16,585) |
| Normalised EBITDA                                    | 7,659    | 7,223    | 7,929    | 8,356    | 8,571    |
| Depreciation and amortisation                        | (315)    | (321)    | (342)    | (350)    | (325)    |
| Other income/(expense)                               |          |          | 157      | 49       | 0        |
| Normalised Operating profits                         | 7,344    | 6,902    | 7,744    | 8,055    | 8,246    |
| Finance income                                       | 146      | 143      | 112      | 65       | 110      |
| Profit Before Tax (norm)                             | 7,490    | 7,045    | 7,856    | 8,119    | 8,357    |
| Normalised revenue/AUME (excl. perf fees) bps        | 6.2      | 6.0      | 5.2      | 5.2      | 5.2      |
| Normalised operating margin (%)                      | 35.2     | 32.5     | 33.7     | 32.8     | 32.8     |
| Average Diluted Shares Outstanding (m)               | 218.4    | 217.9    | 218.0    | 207.5    | 200.1    |
| Basic EPS (p)  | 2.66     | 2.55     | 2.91     | 3.15     | 3.36     |
| EPS - diluted (p)                                    | 2.65     | 2.54     | 2.90     | 3.13     | 3.34     |
| Dividend per share (p)                               | 1.65     | 1.65     | 2.00     | 2.30     | 2.42     |
| Special dividend per share (p)                       | 0.00     | 0.00     | 0.91     | 0.85     | 0.94     |
| Total dividend (p)                                   | 1.65     | 1.65     | 2.91     | 3.15     | 3.36     |
| <b>BALANCE SHEET</b>                                 |          |          |          |          |          |
| Fixed Assets   | 3,273    | 423      | 1,228    | 1,212    | 1,087    |
| Intangible Assets                                    | 504      | 299      | 245      | 145      | 70       |
| Tangible Assets                                      | 129      | 81       | 881      | 811      | 761      |
| Investments  | 2,567    | 0        | 0        | 0        | 0        |
| Deferred tax assets                                  | 73       | 43       | 102      | 256      | 256      |
| Current Assets                                       | 37,053   | 40,541   | 44,247   | 34,882   | 35,488   |
| Debtors  | 6,324    | 5,695    | 6,972    | 7,059    | 7,199    |
| Cash   | 12,010   | 21,720   | 19,120   | 13,990   | 14,457   |
| Money market instruments                             | 18,100   | 13,020   | 18,102   | 13,304   | 13,304   |
| Other  | 619      | 106      | 53       | 529      | 529      |
| Current Liabilities                                  | (4,522)  | (3,256)  | (8,644)  | (9,314)  | (9,380)  |
| Creditors  | (2,949)  | (2,372)  | (3,013)  | (3,353)  | (3,419)  |
| Financial liabilities                                |          |          | (4,779)  | (4,761)  | (4,761)  |
| Other  | (1,573)  | (884)    | (852)    | (1,200)  | (1,200)  |
| Net Assets   | 35,804   | 37,708   | 36,831   | 26,780   | 27,195   |
| Minority interests                                   | 3,876    | 4,019    | 0        | 0        | 0        |
| Net assets attributable to ordinary shareholders     | 31,928   | 31,928   | 33,689   | 36,831   | 26,780   |
| 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     |
| <b>CASH FLOW</b>                                     |          |          |          |          |          |
| Operating Cash Flow                                  | 6,472    | 5,509    | 7,107    | 7,290    | 6,827    |
| Capex  | (128)    | (29)     | (899)    | (130)    | (150)    |
| Cash flow from investing activities                  | 0        | (39)     | (189)    | (50)     | (50)     |
| Dividends  | (3,266)  | (3,750)  | (3,592)  | (6,839)  | (6,270)  |
| Other financing activities                           | (2,571)  | 7,737    | (5,163)  | (5,373)  | 110      |
| Other  | 0        | 282      | 136      | (27)     | 0        |
| Net Cash Flow  | 507      | 9,710    | (2,600)  | (5,130)  | 467      |
| Opening cash/(net debt)                              | 11,503   | 12,010   | 21,720   | 19,120   | 13,990   |
| Other  | 0        | 0        | 0        | 0        | 0        |
| Closing net (debt)/cash                              | 12,010   | 21,720   | 19,120   | 13,990   | 14,457   |
| Closing net debt/(cash) inc money market instruments | 30,110   | 34,740   | 30,110   | 34,740   | 37,222   |
| <b>AUME</b>  |          |          |          |          |          |
| Opening (\$'bn)                                      | 51.9     | 55.4     | 52.9     | 58.2     | 58.29    |
| Net new money flows                                  | 2.9      | (1.4)    | 3.1      | (1.0)    | 0.0      |
| Market/other   | 0.6      | (1.1)    | 2.2      | 1.1      | 1.1      |
| Closing (\$'bn)                                      | 55.4     | 52.9     | 58.2     | 58.3     | 59.4     |

Source: Company accounts, Edison Investment Research

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