

# Record

## Investing in service enhancements

Record's Q4 update showed a modest reduction in AUME, but FX rate moves and an adjustment in fee structure for passive hedging prompt a marked estimate reduction for FY19. Over time, performance fees could mean the apparent shortfall will be at least made good, while the changes should aid client retention and help win new mandates. Neither performance fees nor unannounced net AUME flows are included in our estimates.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS** (p)	P/E (x)	Yield (%)
03/16	21.2	7.0	2.54	1.65	16.8	3.9
03/17	23.0	7.9	2.90	2.00	14.7	4.7
03/18e	24.4	8.0	3.07	2.30	13.9	5.4
03/19e	22.5	6.2	2.49	2.42	17.1	5.7

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.

## Q418 update

AUME for end-March 2018 stood at \$62.2bn, an increase of 6.9% on the prior year end's \$58.2bn. Signalling the adverse move in exchange rate between the two year-ends, sterling-denominated AUME was 4.9% lower. Record highlights that while most fee rates have been stable, it has offered an alternative structure to passive hedging clients where it would like to make use of techniques to reduce the clients' hedging costs. Here, Record charges a lower management fee but can earn a performance fee depending on success in managing costs and adding value over a benchmark. The impact on passive hedging management fees is put at 10% for FY19, all else being equal and excluding any performance fees. Record's continued investment in enhanced service levels to clients is a further, smaller factor behind our estimate reduction following the update. (See overleaf for further discussion of the update.)

## Outlook: Focus on client service

The global macro backdrop remains conducive to discussion of hedging strategies with potential clients given the presence of a range of potential tail risks, even though near-term currency volatility has remained more muted and the period of dollar weakness has tended to create a headwind in the US market. Record's focus on bespoke service and added value in passive hedging (>50% of revenue) should help in retaining and winning new clients.

## Valuation

Our earnings estimate for FY18 is little changed but the FY19 forecast is reduced from 3.34p to 2.49p as a result of the move in the £/US\$ rate since our last adjustment, together with allowance for a lower passive hedging fee rate and slightly higher costs than previously. Performance fees could reverse the impact of the fee rate assumption, while positive AUME flows could generate estimate upgrades. The balance sheet remains strong and prospective yield attractive at over 5%.

## Q418 trading update

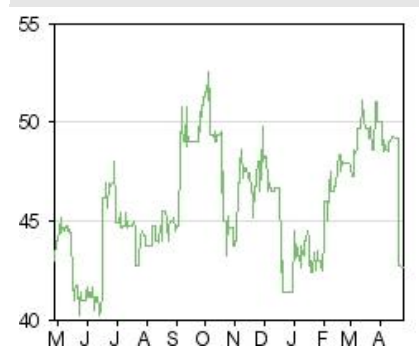
### Financial services

25 April 2018

**Price** 42.60p  
**Market cap** £85m

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	(12.3)	0.4	3.9
Rel (local)	(17.6)	4.4	(0.3)
52-week high/low	52.5p	40.2p	

### 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

FY18 results	15 June 2018
Q119 trading update	20 July 2018

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## Q418 trading update

The quarterly update to the end of March 2018 showed an overall reduction in AUME of 2.7%. This primarily reflected a net client outflow for the quarter equivalent to 2.5% of opening AUME and was similar to the \$1.4bn inflow seen in the prior quarter. Market and foreign exchange movements virtually offset each other. AUME details for Q418 and FY18 are shown in Exhibit 1 and discussed further below.

<b>Exhibit 1: AUME changes</b>					
<b>Year-end March</b>	<b>Q417</b>	<b>Q318</b>	<b>Q418</b>	<b>Q418</b>	<b>FY18</b>
\$bn	AUME	AUME	AUME	Net flows	Net flows
Dynamic hedging	6.3	4.5	4.3	(0.1)	(1.7)
Passive hedging	48.2	54.3	53	(1.5)	(0.5)
Currency for return	1.0	1.7	1.6		0.6
Multi-product	2.5	3.1	3		0.3
Cash and futures	0.2	0.3	0.3		0.1
<b>Total</b>	<b>58.2</b>	<b>63.9</b>	<b>62.2</b>	<b>(1.6)</b>	<b>(1.2)</b>
Markets				(1.4)	1.3
FX				1.3	3.8
Scaling effect (for mandates with volatility targets)					0.1
<b>Total change</b>				<b>(1.7)</b>	<b>4.0</b>
Source: Record, Edison Investment Research					

**AUME** at the period end was \$62.2bn versus \$58.2bn (+6.9%) at the end of FY17, while in sterling terms it stood at £44.3bn compared with £46.6bn (-4.9%), highlighting the impact of strength in sterling between the two year ends. The outflows seen during Q4 were mainly in passive hedging and reflected a number of reductions in size of mandate and two terminations offset by two additions, so can reasonably be regarded as within the range of normal fluctuation in business.

Record has been notified of the termination of one passive hedging mandate of \$1.7bn. Positively, a new passive hedging mandate of \$2.2bn has been awarded, subject to contract and a \$0.3bn multi-strategy mandate. These changes are expected to take place during Q119 and are factored into our estimates.

**Fee margins** were stable for most products, while Record highlights an important exception to this in passive hedging. Here, it has responded to changes in the FX market and new opportunities to add value and reduce costs for clients. Among the market changes is the emergence of a difference between money market interest rates and those implied in foreign exchange forward contracts (basis). This partly reflects capital requirements for banks, which would have previously been more active in arbitraging the differential. The difference creates an opportunity for Record to provide a service exploiting this to manage the cost of passive hedging. Techniques used include active management of the tenor of the contracts employed. This is not suitable for all clients as it can involve more frequent cash payments that do not fit the underlying management mandate, but for others it can provide added value. As returns from this incremental service are episodic, Record offers the option of charging a lower management fee but with the potential to earn a performance fee. Over time, the performance fees are expected to match or exceed the management fee forgone. There is not expected to be a noticeable impact on FY18 but Record guides that the passive hedging management fee level for FY19 would be reduced by c 10% by the change, all else being equal and excluding any performance fees. Information on any performance fees earned will be included in quarterly updates.

While factoring in the guidance acts as a drag on our earnings forecast, there is the potential to generate positive surprises through performance fees, which we have not included in our forecasts. The adjustment to fees is also important as a way of both defending Record's existing client base

and facilitating new mandate wins through further development of a customised service offering, a theme which Record has been consistently pursuing.

On this front the company indicates that it has continued to invest (modestly) in additional resources to support its service levels and, reflecting this, we have allowed for a slightly higher number of employees than previously in our FY19 forecast.

On **performance**, Record reports that while the value strategy return was positive in the quarter, the emerging market, momentum and FRB10 index all recorded negative returns. As a consequence, the multi-strategy product (ungeared) returned -0.68% during the quarter. Even so, the longest-standing multi-strategy mandate (since inception end July 2012) is still showing a return of 1.30% per annum on an ungeared basis: a marketable proposition for a differentiated strategy.

To this end, the company has seeded a fund based on the strategy and encouragement is provided by the client win noted above in this area. Although the fund is new, the availability of a track record of over five years for the strategy should be helpful in attracting external investors.

## Financials

Exhibit 2 shows the changes in key figures from our forecasts following the trading update. Our estimate for FY18 is little changed, while the main drivers of the reduction in forecast for FY19 are the movement in the £/US\$ exchange rate (-6%) and the indicated potential impact of the change in fee structure on passive hedging management fees as outlined above. On this point, it is important to note that we have not allowed for any performance fees in our forecasts. Also, we have only allowed for the net business flows signalled in the Q418 statement.

While the FY19 estimate change shown below is substantial, it should be considered in light of the potential upside from this level that performance fees, positive net new business flows or a favourable move in exchange rates could deliver. Flexing just one of these assumptions as an example, if we factor in a stable (c 3.4bp) rather than reduced fee margin for passive hedging, on the basis that performance fees do make up for the reduction in base management fees, then FY19 earnings would be about 2.9p, roughly halving the forecast reduction. As a UK-based exporter of services, movements in exchange rates have a leveraged effect on Record profits only partly softened by movements in the level of variable compensation.

**Exhibit 2: Estimate changes**

	Revenue (£m)		% chg.	PBT (£m)*		% chg.	EPS (p)*		% chg.	DPS (p)**		% chg.
	Old	New		Old	New		Old	New		Old	New	
03/18e	24.6	24.4	(1%)	8.1	8.0	(2%)	3.13	3.07	(2%)	2.30	2.30	0%
03/19e	25.2	22.5	(10%)	8.4	6.2	(25%)	3.34	2.49	(25%)	2.42	2.42	0%

Source: Edison Investment Research. Note: \*normalised. \*\*Dividend excludes any special payment.

## Valuation

We have updated our comparative table, which shows valuation multiples for UK asset managers and Record. While Record's role as a specialist currency manager differs from those of the asset managers, there is a similarity in terms of charging structure and exposure to underlying equity and other markets.

Following the reduction in estimates shown above, Record stands on an above-average prospective calendar 2018 PER; although, were it able to earn sufficient performance fees to offset the change in passive hedging management fees, the multiple would fall to 14.6x, still above the average but more centrally placed. The historical EV/EBITDA for Record shown in the table does not capture the FX and fee-rate driven downgrades, and is markedly lower than average. However,

even looking at a calendar 2018 multiple, which includes a large element of our FY19 estimate, this would still leave a multiple only modestly above the average at 9.1x versus 8.9x.

**Exhibit 3: Earnings and EBITDA multiples for UK fund managers**

	Price (p)	Market cap (£m)	P/E (x)	EV/EBITDA (x)
Ashmore	418	2,978	18.6	14.1
City of London Inv Group	439	118	10.5	8.7
Impax Asset Management	160	208	14.4	27.2
Janus Henderson	32	4,611	11.3	12.7
Jupiter	455	2,080	13.0	8.8
Liontrust	580	293	13.5	22.0
Man Group	184	2,969	9.8	8.0
Polar Capital	520	486	14.8	21.6
Schroders	3,286	8,752	14.8	8.3
<b>Average</b>			<b>13.4</b>	<b>14.6</b>
<b>Record</b>	<b>43</b>	<b>85</b>	<b>16.3</b>	<b>7.4</b>

Source: Bloomberg, Edison Investment Research. Note: P/E and EV/EBITDA using calendar 2018 estimated earnings and last reported EBITDA, respectively. Priced as at 23 April 2018.

**Exhibit 4: 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	24,361	22,529
Revenue	21,057	21,134	22,952	24,361	22,529
Operating expenses	(13,521)	(14,344)	(15,365)	(16,500)	(16,398)
Other income/(expense)			157	49	0
Operating Profit (before amort. and except.)	7,536	6,790	7,744	7,910	6,130
Finance income	146	143	112	64	107
Profit Before Tax	7,682	6,933	7,856	7,974	6,238
Taxation	(1,708)	(1,523)	(1,540)	(1,595)	(1,248)
Minority interests	(192)	131	0	0	0
Attributable profit	5,782	5,541	6,316	6,379	4,990
Normalised revenue (underlying)	20,865	21,246	22,952	24,361	22,529
Operating expenses (excl. dep'n and amortisation)	(13,206)	(14,023)	(15,023)	(16,150)	(16,073)
EBITDA	7,659	7,223	7,929	8,211	6,455
Depreciation and amortisation	(315)	(321)	(342)	(350)	(325)
Other income/(expense)			157	49	0
Normalised Operating profits	7,344	6,902	7,744	7,910	6,130
Finance income	146	143	112	64	107
Profit Before Tax (norm)	7,490	7,045	7,856	7,974	6,238
Normalised revenue/AuME (excl. perf fees) bps	6.2	6.0	5.2	5.2	4.9
Normalised operating margin (%)	35.2	32.5	33.7	32.5	27.2
Average Number of Shares Outstanding (m) (FD)	218.4	217.9	218.0	207.5	200.1
Basic EPS (p)	2.66	2.55	2.91	3.09	2.51
EPS - normalised fully diluted (p)	2.65	2.54	2.90	3.07	2.49
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	0.79	0.09
Total dividend (p)	1.65	1.65	2.91	3.09	2.51
<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	34,705	33,448
Debtors	6,324	5,695	6,972	6,930	6,464
Cash	12,010	21,720	19,120	13,942	13,151
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)	(9,253)	(9,031)
Creditors	(2,949)	(2,372)	(3,013)	(3,292)	(3,070)
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	26,664	25,504
Minority interests	3,876	4,019	0	0	0
Net assets attributable to ordinary shareholders	31,928	33,689	36,831	26,664	25,504
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	13.4	12.8
<b>CASH FLOW</b>					
Operating Cash Flow	6,472	5,509	7,107	7,241	5,453
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)	(6,151)
Other financing activities	(2,571)	7,737	(5,163)	(5,374)	107
Other	0	282	136	(27)	0
Net Cash Flow	507	9,710	(2,600)	(5,178)	(791)
Opening cash/(net debt)	11,503	12,010	21,720	19,120	13,942
Other	0	0	0	0	0
Closing net (debt)/cash	12,010	21,720	19,120	13,942	13,151
Closing net debt/(cash) inc money market instruments	30,110	34,740	37,222	27,246	26,455
<b>AUME</b>					
Opening (\$'bn)	51.9	55.4	52.9	58.2	62.2
Net new money flows	2.9	(1.4)	3.1	(1.2)	0.8
Market/other	0.6	(1.1)	2.2	5.2	1.1
Closing (\$'bn)	55.4	52.9	58.2	62.2	64.1

Source: Company accounts, Edison Investment Research

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