

Record

Q219 trading update

Opportunities to offset hedging outflows

In its second-quarter update, Record reported a broadly stable figure for assets under management equivalent (AUME), but also included news of a noticeable passive hedging outflow due in Q319. While this prompts 3% and 9% reductions in our FY19 and FY20 EPS estimates, the group is seeing good opportunities to win new business and our estimates exclude both potential AUME inflows and performance fees.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/17	23.0	7.9	2.90	2.00	10.3	6.7
03/18	23.8	7.3	2.98	2.30	10.1	7.7
03/19e	23.4	6.6	2.69	2.30	11.1	7.7
03/20e	22.4	5.7	2.31	2.32	12.9	7.7

Note: *EPS are diluted and **DPS excludes special dividends.

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There was a modest net outflow of client AUME during the quarter (\$0.6bn), which exactly matched the aggregate inflow in the first quarter. Other moves (related to market levels and scaling of mandates based on volatility) were a net positive of \$0.5bn, leaving end-September AUME at \$61.8bn, 0.2% below the June figure or, in sterling terms, up 1.1% to £47.4bn. Client terminations in passive hedging are set to result in estimated outflows of \$2.5bn in Q319. These arise from clients switching to a different fund structure or hedging approach, although Record notes that there is continued competitive pressure, particularly in passive hedging.

Outlook: New products and services a key focus

To address competitive pressures and develop the business, Record is continuing to invest in enhanced service levels and new products. The recently introduced enhanced passive hedging product is an example of this, offering clients the opportunity to reduce costs (see discussion of this in our 20 June [note](#)). With this update, Record highlights a new approach to emerging market currency hedging that it believes will have wide application. It has already provided the basis for an extension of its licensing agreement with WisdomTree Asset Management. The level of currency volatility (we track this using the one-year implied volatility of exchange rates between the US dollar and Swiss franc and euro) has remained within a relatively narrow range, but prominence of significant geopolitical and macroeconomic uncertainties means that the environment remains favourable for Record's discussions with potential clients and the company sees encouraging interest across a range of products and geographies.

Valuation

Record's shares have weakened since the update, reflecting the prospective passive hedging outflow. This leaves the shares on below peer-average P/E and EBITDA levels, which appears cautious given the potential for inflows and/or performance fees to reverse the estimate reduction we have made for FY20.

Financial services

25 October 2018

Price **29.95p**

Market cap **£60m**

Net cash (£m) at end-March 2018	22.7
Shares in issue	199.1m
Free float	32%
Code	REC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



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

H119 results 23 November 2018

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The quarterly update to the end of September 2018 showed **AUME** of \$61.8bn, marginally lower than at end-June. Outflows in passive hedging of \$0.6bn matched the overall inflow in the first quarter, which we would regard as within the range of normal business fluctuation. Changes in market levels, scaling related to mandates with volatility targeting and foreign exchange movements were a net positive (+\$0.5bn). AUME details for Q418 to Q219 are shown in Exhibit 1. For H119 as a whole, flows were therefore neutral while market, FX and scaling effects were a net \$0.4bn negative.

Exhibit 1: AUME changes						
Year-end March	Q418	Q119	Q219	Q119	Q219	H119
\$bn	AUME	AUME	AUME	Net flows	Net flows	Net flows
Dynamic hedging	4.3	4.3	4.4	0.4	0.0	0.4
Passive hedging	53.0	52	51.7	(0.4)	(0.6)	(1.0)
Currency for return	1.6	2.3	2.4	0.6	0.0	0.6
Multi-product	3.0	3	3	0.0	0.0	0.0
Cash and futures	0.3	0.3	0.3	0.0	0.0	0.0
Total	62.2	61.9	61.8	0.6	(0.6)	0.0
Markets				1.2	0.1	1.3
FX and scaling for mandate volatility targeting				(2.1)	0.4	(1.7)
Total change				(0.3)	(0.1)	(0.4)

Source: Record, Edison Investment Research

Record reports its **number of clients** as an additional broad indicator and this increased from 60 at the year-end to 64 at the end of the first quarter and 66 at the end of Q219. On a longer view, the client count has increased from 44 in 2013.

A longer-term perspective is relevant when considering the **notification of the termination** of passive hedging mandates for two commercial relationships totalling up to \$2.5bn and involving up to seven clients (the client count is based on separate legal entities, some of which may effectively represent the same commercial relationship). Competitive pressures remain a feature of the market but these terminations reflected specific developments, such as the decision to move investments into a unitised structure, as part of which the client will use the administrator to provide a hedging service. The outflow is expected to take place in the third quarter. While the termination is larger in scale than the net flows seen in the first two quarters, Record did win a \$2.2bn mandate that took effect during Q119 and in its comments reports an encouraging range of opportunities.

Fees. Allowing for the introduction of the enhanced passive hedging product, which has a lower management fee with the opportunity to earn a performance fee, rates for most products have been broadly unchanged during the second quarter. Within our forecast changes, we have factored in a slightly lower fee margin for passive hedging prospectively as we assume the mandates terminating will have been on a higher management fee basis than the newer enhanced product. There was no performance fee crystallised during the quarter (\$1m during Q119).

On **performance**, Record reported negative returns during its second quarter; for the FTSE Currency FRB10 index and the emerging market products, at -0.40% and -1.24% respectively. The multi-strategy product (ungeared) returned -0.74% during the quarter, compared with a negative return of 1.09% in Q119. Even so, the longest-standing multi-strategy mandate (since inception end-July 2012) is still showing a positive return of 0.89% per annum on an ungeared basis.

In its other comments, Record notes that it is continuing to invest in client service levels and new products, providing differentiation and supporting overall fee rates in the face of pressure seen in passive hedging in particular. One example of this investment has been the engagement of New

Change FX to provide independent foreign exchange data, which in turn helps to give clients transparency over best execution.

The group sees a range of new business opportunities both geographically and by product. An example of new product development is the extension of Record's licensing relationship with WisdomTree Asset Management, under which it will provide signals derived from a new emerging market hedging approach, which is seen as having a wide range of applications.

Financials

Exhibit 2 shows the changes in key figures from our forecasts following the trading update. Our estimate for FY19 is slightly reduced with a more favourable £/\$ rate partly offsetting the time-weighted impact of the AUME outflow indicated for Q319. There is a modest revenue and higher profit impact in 2020e, reflecting the full-year effect of the outflow. We have not allowed for any performance fees in our forecasts beyond the £1m crystallised in Q119. Also, we have only allowed for the net business flows signalled in the trading updates for the first two quarters.

Exhibit 2: Estimate changes												
	Revenue (£m)			PBT (£m)*			EPS (p)*			DPS (p)**		
	Old	New	% chg	Old	New	% chg	Old	New	% chg	Old	New	% chg
03/19e	23.7	23.4	-1%	6.9	6.6	-3%	2.78	2.69	-3%	2.37	2.30	-3%
03/20e	23.2	22.4	-3%	6.3	5.7	-9%	2.54	2.31	-9%	2.44	2.32	-5%

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

Valuation

We have updated our valuation table showing Record's valuation in the context of a group of UK asset managers. While Record is differentiated by its role as a specialist currency manager, its fees are primarily based on the size of AUME so, like the asset managers, it is exposed to movements in underlying equity and fixed income markets and flows.

Exhibit 3: Earnings and EBITDA multiples for UK fund managers				
	Price (p)	Market capitalisation (£m)	P/E (x)	EV/EBITDA (x)
Ashmore	356	2,535	14.2	10.2
City of London Inv Group	385	103	10.0	6.5
Impax Asset Management	248	323	22.2	50.2
Jupiter	339	1,553	10.5	6.3
Liontrust	650	329	12.7	20.2
Man Group	147	2,317	9.4	5.1
Polar Capital	610	574	12.9	24.5
Schroders	2,765	7,481	12.4	11.0
Average			13.0	16.7
Record	29.5	59	10.7	6.0

Source: Bloomberg, Edison Investment Research. Note: P/E and EV/EBITDA using calendar 2018 estimated earnings and last reported EBITDA, respectively. Priced as at 22 October 2018.

The shares have weakened noticeably following the trading update, leaving them below the peer-average P/E ratio (calendar 2018). Our Record estimate for FY19 includes the £1m performance fee already crystallised but FY20 has no performance fee and the full impact of the outflow highlighted above; for this year, Record is trading on an estimated P/E of c 12.9x, which could prove cautious if positive net inflows resume and further performance fees are crystallised. The EV/EBITDA ratios are historical and, within a wide range, Record is significantly below both the average (16.7x) and median (10.6x) values. For reference, based on our reduced FY20 estimate, Record trades on a 7.6x EV/EBITDA.

Exhibit 4: Financial summary

£'000s	2015	2016	2017	2018	2019e	2020e
March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue (underlying)	20,865	21,246	22,952	23,834	23,412	22,424
Revenue	21,057	21,134	22,952	23,834	23,412	22,424
Operating expenses	(13,521)	(14,344)	(15,365)	(16,735)	(16,874)	(16,853)
Other income/(expense)	0	0	157	173	0	0
Operating Profit (before amort. and except.)	7,536	6,790	7,744	7,272	6,538	5,570
Finance income	146	143	112	56	107	138
Profit Before Tax	7,682	6,933	7,856	7,328	6,645	5,708
Taxation	(1,708)	(1,523)	(1,540)	(1,182)	(1,263)	(1,085)
Minority interests	(192)	131	0	0	0	0
Attributable profit	5,782	5,541	6,316	6,146	5,383	4,624
Normalised revenue (underlying)	20,865	21,246	22,952	23,834	23,412	22,424
Operating expenses (excl. dep'n and amortisation)	(13,206)	(14,023)	(15,023)	(16,430)	(16,564)	(16,543)
EBITDA	7,659	7,223	7,929	7,404	6,848	5,880
Depreciation and amortisation	(315)	(321)	(342)	(305)	(310)	(310)
Other income/(expense)	0	0	157	173	0	0
Normalised Operating profits	7,344	6,902	7,744	7,272	6,538	5,570
Finance income	146	143	112	56	107	138
Profit Before Tax (norm)	7,490	7,045	7,856	7,328	6,645	5,708
Normalised revenue/AuME (excl. perf fees) bps	6.2	6.0	5.2	5.1	4.8	4.8
Normalised operating margin (%)	35.2	32.5	33.7	30.5	27.9	24.8
Average Number of Shares Outstanding (m)	218.4	217.9	218.0	206.5	200.1	200.1
Basic EPS (p)	2.66	2.55	2.91	3.03	2.70	2.32
EPS - normalised (p)	2.65	2.54	2.90	2.98	2.69	2.31
Dividend per share (p)	1.65	1.65	2.00	2.30	2.30	2.32
Special dividend per share (p)	0.00	0.00	0.91	0.50	0.40	0.00
Total dividend (p)	1.65	1.65	2.91	2.80	2.70	2.32
BALANCE SHEET						
Fixed Assets	3,273	423	1,228	2,339	2,229	2,179
Intangible Assets	504	299	245	228	178	178
Tangible Assets	129	81	881	910	850	800
Investments	2,567	0	0	1,115	1,115	1,115
Deferred tax assets	73	43	102	86	86	86
Current Assets	37,053	40,541	44,247	29,737	29,552	28,851
Debtors	6,324	5,695	6,972	6,775	6,507	6,556
Cash	12,010	21,720	19,120	12,498	12,581	11,830
Money market instruments	18,100	13,020	18,102	10,198	10,198	10,198
Other	619	106	53	266	266	266
Current Liabilities	(4,522)	(3,256)	(8,644)	(5,525)	(5,421)	(5,440)
Creditors	(2,949)	(2,372)	(3,013)	(2,630)	(2,526)	(2,545)
Financial liabilities	0	0	(4,779)	(2,467)	(2,467)	(2,467)
Other	(1,573)	(884)	(852)	(428)	(428)	(428)
Net Assets	35,804	37,708	36,831	26,551	26,360	25,590
Minority interests	3,876	4,019	0	0	0	0
Net assets attributable to ordinary shareholders	31,928	33,689	36,831	26,551	26,360	25,590
No of shares at year end	217.5	217.2	221.4	199.1	199.1	199.1
NAV per share p	14.7	15.5	16.6	13.3	13.2	12.9
CASH FLOW						
Operating Cash Flow	6,472	5,509	7,107	2,746	5,749	4,766
Capex	(128)	(29)	(899)	(236)	(150)	(160)
Cash flow from investing activities	0	(39)	(189)	(82)	(50)	(100)
Dividends	(3,266)	(3,750)	(3,592)	(6,810)	(5,574)	(5,394)
Other financing activities	(2,571)	7,737	(5,163)	(2,386)	107	138
Other	0	282	136	146	0	0
Net Cash Flow	507	9,710	(2,600)	(6,622)	83	(751)
Opening cash/(net debt)	11,503	12,010	21,720	19,120	12,498	12,581
Other	0	0	0	0	0	0
Closing net (debt)/cash	12,010	21,720	19,120	12,498	12,581	11,830
Closing net debt/(cash) inc money market instruments	30,110	34,740	37,222	22,696	22,779	22,028
AUME						
Opening (\$bn)	51.9	55.4	52.9	58.2	62.2	63.3
Net new money flows	2.9	(1.4)	3.1	(1.2)	0.0	0.0
Market/other	0.6	(1.1)	2.2	5.2	1.1	1.2
Closing (\$bn)	55.4	52.9	58.2	62.2	63.3	64.5

Source: Company accounts, Edison Investment Research

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