Record

H121 results

Making progress with strategy

Financial services

Record has set itself the goal of generating greater growth and H121 showed some encouraging steps in this direction. The substantial new dynamic hedging mandate in the period was traditional business for the group, but there was also news of a new currency impact fund, which provides diversification, higher fee margins and the potential for significant development. The implementation of new IT systems is underway, and measures to develop and retain staff have been taken.

Year end	Revenue (£m)	PBT (£m)	EPS* (p)	DPS** (p)	P/E (x)	Yield (%)
03/19	25.0	8.0	3.25	2.30	14.5	4.9
03/20	25.6	7.7	3.26	2.30	14.4	4.9
03/21e	24.8	5.8	2.42	2.30	19.4	4.9
03/22e	29.5	8.9	3.67	2.30	12.8	4.9

Note: *EPS is diluted. **DPS excludes special dividends.

H121: Investment in personnel and technology

Record's end-H121 assets under management equivalent (AUME) were $65.9bn and we calculate that first-half average AUME in sterling terms was up 6.8% y-o-y. The group reported revenue 4% ahead at £11.8m; while like-for-like fee rates were broadly stable, the product/mandate mix meant that the average fee rate for the group was lower at 4.5bp versus 4.8bp for H120. Operating cost growth outpaced revenue, increasing by 10%, reflecting investment in sales capabilities and technology and infrastructure. This left pre-tax profit down from £3.2m in H120 to £2.6m. EPS was 1.10p (1.29p) while the interim dividend (1.15p) was maintained reflecting the board's confidence in the prospects for the full year.

Positive outlook

Supporting management confidence are both an $8bn dynamic hedging mandate win announced in September (not included in the H121 AUME figure) and the important progress that has been made on the collaboration with a European wealth manager to build and manage a Currency Impact Fund. This is expected to be launched with initial investments from the wealth manager's clients of several hundred million (base currency yet to be confirmed) in the first calendar quarter of 2021 (Q421 for Record). The management fee will be consistent with an actively managed fund. Record also made positive comments on other aspects of its new business pipeline. H221 and FY22 should see progressive benefits from the additions to AUME and cost and efficiency gains as the investments being made in personnel and technology take effect.

Valuation

Our earnings per share estimate for FY21 is reduced by 10% to allow for increased investment in personnel and IT costs, but for FY22 the estimate is increased marginally. Neither figure assumes any performance fee (FY20: £1.8m). The shares trade below peer P/E and EV/EBITDA multiples (at 17.9x and 12.3x versus 18.2x and 13.3x respectively) and offer an above-average yield with the potential for a special dividend in FY22 on our estimate.

30 November 2020

Price	**47p**
Market cap	**£93m**
Net cash (£m) at end September 2020 excluding seed fund cash	15.5
Shares in issue	199.1m
Free float	53%
Code	REC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	10.3	30.7	37.5
Rel (local)	22.6	39.9	20.3
52-week high/low		47.5p	26.3p

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

Q321 trading update	22 January 2021

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Edison profile page

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Record in numbers

We have updated our compilation of the information Record provides on AUME, fee income, clients and asset class exposure (Exhibit 1). This also includes our calculations of estimated average fee rates by strategy and hedging fee exposure by underlying asset class.

Within this, we highlight a number of points:

- The importance of hedging services that in total account for nearly 90% of AUME and 70% of management fees, reflecting the lower fees that apply to passive hedging. Based on our estimate for FY22, the addition of the new $8bn mandate would mean that the contribution of dynamic hedging would increase from nearly 17% to 30% of management fees.
- The number of clients has risen from 58 to 74 (plus two clients in H121) and AUME from $52.9bn to $65.9bn since 2016 (compound annual growth of 9.5% in AUME).
- The institutional nature of the client base: pension funds account for 81% AUME and examples of the client base include the London Pension Fund Authority, Florida State Board of Administration, the Swiss Federal Pension Fund and the Calouste Gulbenkian Foundation.
- The longevity of clients with 76% by AUME in place for over six years.
- Geographically, Switzerland accounts for the largest portion of fees and AUME, although the addition of the $8bn dynamic hedging mandate from a US client will increase the US contribution.
- 45% of hedging services fees relate to underlying equity assets and 30% fixed income.

Exhibit 1: Record profile in numbers (H121 except where shown)

Analysis by strategy

	AUME (%)	Management fees (%)*	Est. average fee rate (bp)**
Dynamic hedging	4.9	16.8	16.6
Passive hedging	84.4	53.7	2.9
Currency for return	5.2	8.3	7.8
Multi-product	5.3	21.2	18.7
Cash	0.3	N/A	N/A
Total	**100.0**	**100.0**	**4.5**
Value	$65.9bn	£11.2m	

Client analysis

Number (by financial year)		Type	% AUME	Concentration	% fees	Longevity (years)	% AUME
2016	58	Corporate pension funds	41	Top 10	68	0-1	5
2017	59	Public pension funds	40	Next 10	20	1-3	10
2018	60	Foundations & trusts	9	Balance	13	3-6	9
2019	65	Other	10			6-10	40
2020	72					>10	36
H121	74		**100**		**100**		**100**

Geographical analysis

By country	% revenue	By base currency (FY20)	% AUME	AUME progression	($bn)
Switzerland	42	Swiss franc	55	2016	52.9
US	29	Sterling	13	2017	58.2
UK	10	US dollar	11	2018	62.2
Other	19	Euro	15	2019	57.3
	100	Other	6	2020	58.6
			100	H121	65.9

Underlying asset class exposure of dynamic and passive hedging AUME (%)

	Dynamic	Passive	Estimated % of hedging fees
Equity	92	30	45
Fixed income	0	39	30
Other	8	31	26
	100	**100**	**100**

Source: Record, Edison Investment Research. Notes: *Management fee excluding performance fees. **Fee rate is our own calculation and within each strategy there will be a range of mandate types and fee structures/levels. Rounding may mean some columns do not sum.

Strategy update: Progress on several fronts

Since she took on the role of CEO in February this year, Leslie Hill has set out to generate greater growth through diversification and innovation; to modernise the business with new technology and infrastructure; and to ensure that the next generation of leaders is retained by providing a means for them to acquire an equity stake in the business.

As part of the work to increase diversification and illustrating the benefits of collaboration with a client, the new Dublin-based Currency Impact Fund is potentially a very significant strategic development. The fund will fulfil the client's requirement for an ESG/impact product, and will employ emerging market and frontier currency overlays with underlying impact bonds. While the fund is a new departure for Record, managing it will employ existing tools and experience. The management fee will be appropriate for an active product and we assume this will be at a similar level to emerging market bond funds (example funds from Robeco, Vanguard and Pimco have ongoing charges of 60–79bp and, deducting an allowance for servicing charges and a competitive discount, we suggest would point towards a level of around 40–45bp). Initially starting with assets of several hundred million (base currency to be confirmed), market liquidity would easily accommodate the potential scaling of the fund with the partner wealth manager to, for example, €2bn. Beyond this, there is ample scope to offer the product to other clients after a period of exclusivity.

On modernisation, the group is now looking to deploy services and software that have become available to enhance its product offering and to increase efficiency or the ability to grow without adding to costs. Notably, the adoption of Xceptor, a SaaS-delivered platform that can be used to capture data from many sources and automate its handling and related processes across the business, is expected to improve the client offering and provide efficiencies that could enable Record to compete in a broader range of services.

Steps have also been taken in developing talent. This has included identifying key individuals within the business and promotions to provide them with opportunities to progress within the group. To help retain those with senior managerial potential, a joint share ownership plan (JSOP) was launched in September to provide equity-based incentives. This was facilitated by the sale of 4m shares by chairman Neil Record. In H121, interests in 2.375m shares were granted to employees. The participants' interest in the shares vest over four years in equal tranches. On each vesting, the participants receive shares equivalent to any value above the market value at the grant date (37.3p).

H121 results analysis

Starting with AUME, Exhibit 2 shows the recent progression of AUME levels and net flows. Overall AUME in US dollar terms increased by 12% in H121 to $65.9bn: the year-on-year increase was 10%. In sterling terms (not shown), AUME increased from £47.3bn to £51.0bn (nearly 8%) in the first half, with the average level increasing by 6.8% y-o-y. There was a marginal outflow for H121 although, within this, the mix was favourable in terms of fee rates as there were inflows into dynamic hedging (recent average fee rate c 16bp) and outflows from passive hedging (average c 3bp).

We calculate that the average AUME in sterling terms for H121 increased by 6.8% when compared with the average for H120, reflecting a combination of positive net inflows, and scaling and foreign exchange movements. As shown below, market moves were strongly negative in H220, which included the impact of the pandemic in the final quarter to end March. H121 saw much of this movement reversed as markets bounced back subsequently.

Exhibit 2: AUME changes

$bn	AUME			Net flows		
	H120	H220	H121	H120	H220	H121
Dynamic hedging	3.2	2.5	3.2	0.2	0.0	0.5
Passive hedging	50.4	50.3	55.6	1.6	2.5	(0.8)
Currency for return	2.9	2.6	3.4	0.2	0.1	0.0
Multi-product	3.1	3.0	3.5	0.0	0.0	0.0
Cash and futures	0.3	0.2	0.2	0.0	0.0	0.0
Total	**59.9**	**58.6**	**65.9**	**2.0**	**2.6**	**(0.3)**
Markets				1.3	(4.5)	4.1
FX and scaling for mandate volatility targeting				(0.7)	0.6	3.5
Total change				**2.6**	**2.6**	**2.6**

Source: Record

Exhibit 3 sets out an analysis of the P&L over the last three half-year periods. Our comments on the key areas relate to the comparison with H120 unless stated.

Management fees in total were slightly ahead of the prior year period against the 6.8% increase in average total AUME in sterling terms noted above. The difference reflects a combination of movements in average AUME and average fee rates for each strategy. These in turn are the result of net flows, market, foreign exchange and scaling moves, together with mix changes for average fee rates. Using quarterly AUME figures and average exchange rates, we can calculate approximate average sterling AUME movements. So, taking two examples, in dynamic hedging estimated average sterling AUME was down nearly 13% but the average fee rate increased, resulting in management fees down only 5%, while in currency for return, average AUME was up 12% but the average fee rate was down, leaving management fees down 2%.

There were no performance fees in the period (nil and £1.8m for the first and second halves of FY20 respectively).

Exhibit 3: H121 P&L analysis

£000s	H120	H220	H121	Change versus H120	Change versus H220
Dynamic hedging	1,994	2,001	1,889	-5.3%	-5.6%
Passive hedging	5,880	6,146	6,027	2.5%	-1.9%
Currency for return	958	1,024	937	-2.2%	-8.5%
Multi-product	2,301	2,829	2,379	3.4%	-15.9%
Management fees	**11,133**	**12,000**	**11,232**	**0.9%**	**-6.4%**
Performance fees	0	1,819	0	N/A	N/A
Other investment services income	252	359	606	140.5%	68.8%
Total revenue	**11,385**	**14,178**	**11,838**	**4.0%**	**-16.5%**
Cost of sales	-119	-136	-213	79.0%	56.6%
Gross profit	**11,266**	**14,042**	**11,625**	**3.2%**	**-17.2%**
Administrative expenses	-8,232	-9,509	-9,016	9.5%	-5.2%
Other income/expense	50	32	-36	-172.0%	-212.5%
Operating profit	**3,084**	**4,565**	**2,573**	**-16.6%**	**-43.6%**
Net finance income	83	5	20	-75.9%	300.0%
Profit before tax	**3,167**	**4,570**	**2,593**	**-18.1%**	**-43.3%**
Taxation	-652	-713	-449	-31.1%	-37.0%
Profit after tax	**2,515**	**3,857**	**2,144**	**-14.8%**	**-44.4%**
Minority interests	28	20	7	-75.0%	-65.0%
Attributable net profit	**2,543**	**3,877**	**2,151**	**-15.4%**	**-44.5%**
Diluted EPS (p)	**1.29**	**1.97**	**1.10**	**-15.0%**	**-44.3%**
DPS (p)	1.15	1.56	1.15	0.0%	
Tax rate	21%	16%	19%		

Source: Record, Edison Investment Research

The sharp rise in **other investment services** income reflected an increase in tactical currency management services provided to existing customers. This income was previously expected to be more episodic than has been the case, and for the moment the related AUME is not included in the reported figures. In future, both the AUME and income may be allocated to the multi-product category.

Overall **administrative expenses** rose by 9.5%, within which personnel costs were up 13% comprising a 19% rise in fixed costs and a 7% reduction in gross profit share. The rise in fixed costs reflected a small increase in the average number of employees together with salary increases, promotions and some costs associated with management changes. The gross profit share was struck at 33% within the range set at between 25% and 35%. Non-personnel costs increased by 3%.

This left **pre-tax** profit lower at £2.6m versus £3.2m and **EPS** 15% lower at 1.1p. The **dividend** was maintained at 1.15p, reflecting the board's confidence in the outlook for the full year. The dividend policy remains unchanged with the target being that the dividend should be at least covered by earnings, after allowing for anticipated increases in costs and regulatory capital requirements.

Turning briefly to the **balance sheet**, this remains strong with no debt and cash and cash equivalents of £19.3m or £15.5m excluding seed fund cash. Shareholders' funds at the period end stood at £25.8m, which compares with a Pillar 2 regulatory capital requirement of £9.4m and operating expenses (less variable remuneration), which we estimate at £15.7m for FY21.

Exhibit 4 shows **performance measures** for Record's multi-strategy fund, multi-strategy composite and dynamic macro currency strategy. All were in negative territory in the period, while both the multi-strategy composite and dynamic macro currency strategy have positive returns since inception. In the half year multi-strategy returns were affected by negative returns from the momentum strand of the strategy following the switch from a risk-off trend since March. Forward rate bias and emerging markets strands of the strategy were positive. The dynamic macro strategy, which has a more discretionary process, performed well in the period of market weakness at the onset of the pandemic, but was hurt by the post-March bounce in markets.

Exhibit 4: Currency for return investment performance to end September 2020

	Scaling	H121 return	Return SI pa	Volatility SI pa	Inception
Record Currency Multi-Strategy Fund (£ base)	1.85	-2.46%	-5.31%	8.28%	Feb-18
Record Multi-Strategy composite		-1.85%	0.33%	3.12%	Jul-12
Dynamic Macro Currency		-3.78%	3.88%	9.20%	Jan-04

Source: Record. Note: Record Multi-Strategy Composite and Record Dynamic Macro Currency are on a US dollar base and show excess returns gross of fees. SI = since inception.

Record also reports the performance of the value added by its enhanced passive hedging service relative to a fixed tenor benchmark (using a representative account). This shows a positive return of 0.02% in H121 and 0.09% since inception (October 2014). This is despite adverse conditions for the service as central banks cut rates and sought to increase liquidity. More recently, market conditions have normalised, providing greater opportunities for the process to capture relative gains. Following a negative return of 0.05% in FY20, it may still take some time for these mandates to generate further performance fees.

Outlook, estimate changes

Although the recent performance figures for the currency for return strategies are negative, there is still scope to market the differentiated and longer-term record of the strategies. For hedging services, the substantial spike in currency volatility that accompanied the beginning of the pandemic provides a favourable background for discussions with potential clients.

As highlighted above, the addition of the new $8bn dynamic hedging mandate is a significant driver of expected growth in revenues in the second half of this year and for FY22; this was allowed for in our forecast upgrade in October. We assume that the $8bn will be included in AUME over three quarters and that it will result in a noticeable dilution in the average fee rate for dynamic hedging given the size-related scaling of fees. We have also allowed for an inflow of c $400m of AUME in Q421 as the Currency Impact Fund is launched. We have not allowed for further allocations of assets to the fund in subsequent periods given the difficulty of estimating the likely pace of any build-up. Nevertheless, increases do appear likely and could provide useful upside to estimates in due course. Otherwise, as far as our revenue estimates are concerned, there is a small negative adjustment related to updating the sterling/US dollar rate. As usual, our estimates do not include any assumed performance fees so any that are crystallised would represent upside from our figures.

Following the H121 results, we have increased our cost assumptions to allow for investment in people and IT, which results in a lower pre-tax profit and EPS estimate for this year (-10%). For FY22, with a slightly higher revenue assumption and costs expected to be contained as IT-related efficiencies flow through, our pre-tax profit is maintained and EPS is marginally higher.

Exhibit 5: Estimate changes

	Revenue (£m)			PBT (£m)			EPS (p)			DPS (p)*		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
03/21e	24.9	24.8	0%	6.5	5.8	-10%	2.68	2.42	-10%	2.30	2.30	0%
03/22e	28.7	29.5	3%	8.9	8.9	0%	3.65	3.67	0%	2.30	2.30	0%

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

Our dividend estimates shown above exclude special dividends. Given the allowance for costs and regulatory capital in the board's dividend policy, we do not expect a special payment for FY21 but based on our FY22 earnings estimate (3.67p), we would pencil in a special payment of 0.70p for that year giving a total dividend of 3.0p.

Valuation

An updated version of our comparative valuation table, which puts Record in the context of a group of UK asset managers, is shown in Exhibit 6. Record is differentiated by its role as a specialist currency manager but 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.

Our table shows calendarised figures for 2020 P/E and EV/EBITDA. Record shares trade below the peer averages for both measures, although the range is wide and removing the high multiples for Impax, for example, would put Record broadly above the adjusted average. The earnings and EBITDA for calendar year 2020 benefit from a quarter of the performance fee earned in FY20 although, more significantly, the three quarters contribution from FY21 only includes a partial benefit from the new dynamic hedging mandate. The dividend yield of 4.9% is above the peer average and there is the potential for this to be enhanced with a special dividend in due course (on our estimate the FY22 yield would be 6.4%).

Exhibit 6: Comparing valuation with UK fund managers

	Price (p)	Market cap (£m)	P/E 2020e (x)	EV/EBITDA 2020e (x)	Dividend yield (%)
Ashmore	429	3,056	17.2	11.1	3.9
City of London Investment Group	441	223	11.8	N/A	6.8
Impax Asset Management	564	736	38.5	29.0	1.0
Jupiter	246	1,363	11.5	6.8	6.9
Liontrust	1,360	829	21.2	15.4	2.4
Man Group	120	2,341	13.5	8.9	6.6
Polar Capital	610	601	13.1	9.5	5.4
Schroders	3,177	8,345	18.0	12.3	3.6
Average			**18.1**	**13.3**	**4.6**
Record	**42.0**	**83**	**16.0**	**10.9**	**5.5**

Source: Refinitiv, Edison Investment Research. Note: P/E and EV/EBITDA on a calendar-year basis. Record's dividend yield excludes the special dividend. Priced at 30 November 2020.

Exhibit 7: Financial summary

£'000s	2018	2019	2020	2021e	2022e
March					
PROFIT & LOSS					
Revenue	23,834	24,973	25,563	24,845	29,473
Operating expenses	(16,735)	(17,089)	(17,996)	(19,034)	(20,628)
Other income/(expense)	173	(8)	82	(36)	0
Operating Profit (before amort. and except.)	7,272	7,876	7,649	5,775	8,845
Finance income	56	113	88	40	42
Profit Before Tax	7,328	7,989	7,737	5,815	8,887
Taxation	(1,182)	(1,559)	(1,365)	(1,105)	(1,689)
Minority interests	0	0	48	60	30
Attributable profit	6,146	6,430	6,420	4,770	7,229
Revenue/AuME (excl. perf fees) bps	5.1	4.9	4.9	4.6	5.0
Operating margin (%)	30.5	31.5	29.9	23.2	30.0
Average Number of Shares Outstanding (m)	206.5	198.1	197.1	197.1	197.1
Basic EPS (p)	3.03	3.27	3.26	2.43	3.68
EPS - diluted (p)	2.98	3.25	3.26	2.42	3.67
Dividend per share (p)	2.30	2.30	2.30	2.30	2.30
Special dividend per share (p)	0.50	0.69	0.41	0.00	0.70
Total dividend (p)	2.80	2.99	2.71	2.30	3.00
BALANCE SHEET					
Non-current assets	2,339	2,161	4,868	4,492	3,827
Intangible Assets	228	288	470	455	440
Tangible Assets	910	761	751	601	451
Investments	1,115	1,112	2,472	2,759	2,759
Other	86	0	1,175	677	177
Current Assets	29,737	31,427	31,149	27,368	30,548
Debtors	6,775	7,562	8,704	7,994	9,180
Cash	12,498	12,966	14,294	6,725	8,719
Money market instruments	10,198	10,735	7,958	12,491	12,491
Other	266	164	193	158	158
Current liabilities	(5,525)	(6,158)	(6,955)	(5,371)	(5,266)
Creditors	(2,630)	(2,736)	(3,009)	(2,661)	(3,056)
Financial liabilities	(2,467)	(2,621)	(2,191)	(1,800)	(1,800)
Other	(428)	(801)	(1,755)	(910)	(410)
Non-current liabilities	0	(29)	(901)	(353)	(353)
Net Assets	26,551	27,401	28,161	26,136	28,756
Minority interests	0	60	132	72	42
Net assets attributable to ordinary shareholders	26,551	27,341	28,029	26,064	28,714
No of shares at year end	199.1	199.1	199.1	199.1	199.1
NAV per share p	13.3	13.7	14.1	13.1	14.4
CASH FLOW					
Operating Cash Flow	2,746	7,026	6,543	5,190	7,320
Capex	(236)	(72)	(243)	(140)	(140)
Cash flow from other investing activities	7,899	(561)	1,513	(5,381)	(108)
Dividends	(6,810)	(5,517)	(5,888)	(5,357)	(4,578)
Other financing activities	(10,367)	(613)	(943)	(2,026)	(500)
Other	146	205	346	145	0
Net Cash Flow	(6,622)	468	1,328	(7,569)	1,994
Opening cash/(net debt)	19,120	12,498	12,966	14,294	6,725
Closing net (debt)/cash	12,498	12,966	14,294	6,725	8,719
Closing net debt/(cash) inc money market instruments	22,696	23,701	22,252	19,216	21,210
AUME					
Opening ($'bn)	58.2	62.2	57.3	58.6	71.8
Net new money flows	(1.2)	(4.5)	4.6	5.4	2.7
Market/other	5.2	(0.4)	(3.3)	7.8	0.4
Closing ($'bn)	62.2	57.3	58.6	71.8	74.8

Source: Record accounts, Edison Investment Research

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