

# Ashmore Group (ASHM.L)

## The Price is Not Right

- **Downgrade to Sell** — We downgrade from Neutral to Sell. We expect consensus EPS downgrades over the next year, and look to FY 12 results (11 Sep) as a potential negative catalyst. We are -1% below consensus FY12E and -6% FY13E.
- **Slow flows** — Modest EM Debt fund flows at Ashmore are in contrast to industry data that suggests H1 Calendar 2012 has been a strong period for EM Bond fund flows. Ashmore appears to be 'missing out' on these trends. (Page 6). We believe this could – at least in part – be due to the higher fees on Ashmore funds (Page 7).
- **Underperforming funds** — As the EM Bond Fund industry matures, we expect investors to rely more on performance track records for allocation decisions. Our analysis suggests key Ashmore funds have underperformed over 1 and 5 years. 3 year returns are better, but the quantum of outperformance is small. (Page 7).
- **Margin decline** — Ashmore's management fee revenue margin has fallen in recent years, from 107bp in FY 09, to 76bp in H1 12. We believe this could fall further, to as low as 65bp, as fund flow bias to segregated mandates continues. (Page 10).
- **Falling operating margins** — We forecast operating margins fall from 72% FY11 to 64% FY13, due to declining management fee revenue margins and rising variable compensation costs as a proportion of EBVCIT. These are high margins in absolute terms, but the negative trend affects our EPS growth forecasts. (Page 11).
- **5% to 11% EPS decline** — Falling margins mean we forecast -5% fall in PBT in both FY12 and FY13, and -11% EPS decline FY12, -5% FY13. We amend EPS forecasts by 1% to reflect new revenue margin assumptions. As a result, our target price falls from 305p to 300p.
- **P/E** — As such, we find it hard to justify Ashmore's PE "growth premium" vs. its UK asset management peers. (13.3x CY 13E PE vs. peer group 10.3x average).
- **Citi Best Ideas** — We replace Schroders with Ashmore as our Least Preferred asset management stock.

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

<b>Sell</b>	<b>3</b>
from Neutral	
Price (23 Aug 12)	£3.47
Target price	£3.00
from £3.05	
Expected share price return	-13.6%
Expected dividend yield	4.2%
<b>Expected total return</b>	<b>-9.5%</b>
Market Cap	£2,457M
	US\$3,903M

### Price Performance (RIC: ASHM.L, BB: ASHM LN)



### Ashmore Group (GBP)

Year to 30 Jun	2010A	2011A	2012E	2013E	2014E
Net Income (£M)	160.0	189.0	167.6	159.6	174.8
Diluted EPS (p)	22.5	26.6	23.6	22.6	24.7
Diluted EPS (Old) (p)	22.5	26.6	23.4	22.7	25.1
PE (x)	15.4	13.0	14.7	15.4	14.1
P/BV (x)	6.3	4.7	4.4	4.4	4.5
DPS (p)	13.0	14.5	14.5	14.5	17.5
Net Div Yield (%)	3.7	4.2	4.2	4.2	5.0
ROE (%)	47.1	43.5	32.3	29.6	32.4

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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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ASHM.L: Fiscal year end 30-Jun						Price: £3.47; TP: £3.00; Market Cap: £2,455m; Recomm: Sell					
Profit & Loss (£m)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	286	334	339	338	368	PE (x)	15.4	13.0	14.7	15.4	14.1
Cost of sales	-39	-50	-66	-69	-76	PB (x)	6.3	4.7	4.4	4.4	4.5
Gross profit	247	284	273	269	291	EV/EBITDA (x)	10.1	8.5	8.5	8.8	8.2
Gross Margin (%)	86.4	85.2	80.5	79.5	79.2	FCF yield (%)	6.9	7.3	7.2	6.6	7.2
EBITDA (Adj)	211	241	232	226	243	Dividend yield (%)	3.7	4.2	4.2	4.2	5.0
EBITDA Margin (Adj) (%)	73.6	72.1	68.5	66.7	66.1	Payout ratio (%)	58	54	61	64	71
Depreciation	-1	-1	-9	-9	-9	ROE (%)	47.1	43.5	32.3	29.6	32.4
Amortisation	0	0	0	0	0	Cashflow (£m)					
EBIT (Adj)	209	239	223	217	234	EBITDA	211	241	232	226	243
EBIT Margin (Adj) (%)	73.1	71.7	65.8	64.1	63.6	Working capital	26	-17	7	-2	-2
Net interest	8	7	11	5	5	Other	-37	-31	-50	-50	-52
Associates	0	0	0	0	0	Operating cashflow					
Non-op/Except	0	0	0	0	0	Capex	-30	-13	-11	-11	-11
Pre-tax profit	217	246	234	222	239	Net acq/disposals	0	-41	0	0	0
Tax	-57	-56	-61	-55	-57	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	-1	-1	-5	-7	-7	Investing cashflow					
Reported net profit	160	189	168	160	175	Dividends paid	-83	-94	-107	-107	-129
Net Margin (%)	na	na	na	na	na	Financing cashflow					
Core NPAT	160	189	168	160	175	Net change in cash	-117	-105	-168	-168	-190
Per share data						Free cashflow to s/holders					
Reported EPS (p)	22.5	26.6	23.6	22.6	24.7	Assets Under Mgmt \$bn					
Core EPS (p)	22.5	26.6	23.6	22.6	24.7	Opening AUM	24.9	35.3	65.8	63.7	69.7
DPS (p)	13.0	14.5	14.5	14.5	17.5	Gross subscriptions	11.3	32.9	12.8	12.0	14.0
CFPS (p)	28.1	27.1	26.7	24.5	26.6	Redemptions	-3.7	-7.5	-11.4	-9.2	-9.8
FCFPS (p)	23.9	25.3	25.1	23.0	25.0	Net subscriptions	7.6	25.4	1.4	2.9	4.3
BVPS (p)	55.4	74.0	78.6	78.3	76.9	Market appreciation	2.8	5.1	-3.5	3.1	4.3
Wtd avg ord shares (m)	670	673	685	692	697	Closing AUM	35.3	65.8	63.7	69.7	78.3
Wtd avg diluted shares (m)	710	710	709	708	708	External Debt	19.4	14.3	15.9	17.5	19.3
Growth rates						Blended Debt	0.0	10.9	12.4	13.7	15.6
Sales revenue (%)	40.6	16.6	1.5	-0.2	8.6	Local Currency	7.0	9.4	10.0	10.9	12.5
EBIT (Adj) (%)	39.0	14.4	-6.8	-2.8	7.9	Alternatives	3.4	2.8	2.6	2.9	3.3
Core NPAT (%)	39.1	18.1	-11.3	-4.8	9.5	Equity	0.2	10.1	6.2	6.5	7.4
Core EPS (%)	40.8	18.2	-11.2	-4.6	9.5	Corporate High Yield	0.9	1.3	2.4	3.0	3.9
Balance Sheet (£m)						Multi-Strategy	2.0	8.4	5.6	6.2	6.9
Cash & cash equiv.	344	369	383	378	365	Overlay / Liquidity	2.4	8.6	8.6	8.9	9.4
Accounts receivables	46	68	66	72	79	Fee Margins bps					
Inventory	na	na	na	na	na	Management fee margin	94.8	86.0	73.6	71.1	70.0
Net fixed & other tangibles	18	21	16	17	18	External Debt	71.0	75.0	70.0	68.0	65.5
Goodwill & intangibles	9	7	5	3	1	Blended Debt	na	47.0	50.0	50.0	50.0
Financial & other assets	88	210	230	236	243	Local Currency	99.0	90.0	75.0	73.0	70.0
Total assets	505	676	699	705	706	Alternatives	217.0	217.0	240.0	230.0	220.0
Accounts payable	90	95	100	105	110	Equity	171.0	102.0	65.0	65.0	65.0
Short-term debt	0	0	0	0	0	Corporate High Yield	172.0	169.0	110.0	105.0	100.0
Long-term debt	0	0	0	0	0	Multi-Strategy	147.0	129.0	125.0	120.0	120.0
Provisions & other liab	43	66	45	43	43	Overlay / Liquidity	20.0	17.0	17.0	17.0	17.0
Total liabilities	132	161	144	148	153	Other Ratios					
Shareholders' equity	371	499	538	541	536	Var Comp % EBITVC	18.3	19.0	20.0	21.0	22.0
Minority interests	2	16	16	16	16	Comp to Rev (%)	-20.9	-21.4	-23.7	-24.9	-25.8
Total equity	373	515	555	558	553						
Net debt	-344	-369	-383	-378	-365						
Net debt to equity (%)	-92.3	-71.7	-69.1	-67.7	-66.0						

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For definitions of the items in this table, please click [here](#).

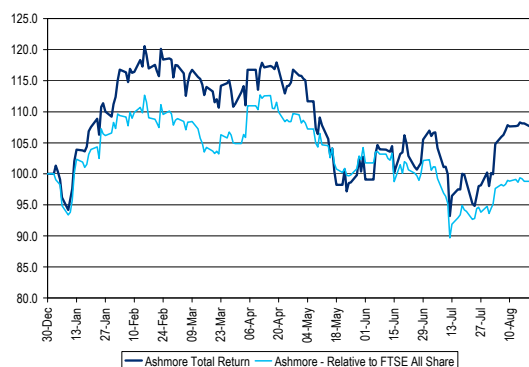
# Contents

<b>Starting Point</b>	<b>4</b>
<b>Earnings Momentum</b>	<b>5</b>
<b>Changing Competitive Landscape</b>	<b>6</b>
<b>US Open End Funds – A Case Study</b>	<b>6</b>
<b>Mis-Priced Funds</b>	<b>7</b>
<b>Underperforming Funds</b>	<b>7</b>
<b>EMM – still working it out</b>	<b>9</b>
<b>Revenue Margin Decline</b>	<b>10</b>
<b>Operating Margin Pressure</b>	<b>11</b>
<b>Upcoming Catalysts</b>	<b>13</b>
<b>Valuation</b>	<b>15</b>
<b>Citi Best Ideas</b>	<b>16</b>
<b>Ashmore Group</b>	<b>17</b>
<b>Appendix A-1</b>	<b>23</b>

## Starting Point

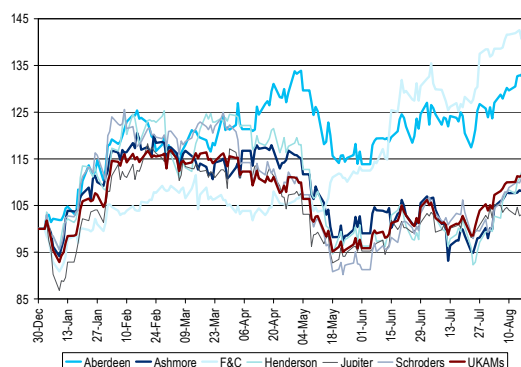
**Underperformed year to date.** Ashmore has underperformed both its UK Asset Management peers and the wider UK market year to date. In that context, it might seem odd to downgrade to Sell now.

Figure 1. Ashmore total return YTD, actual and relative to FTSE



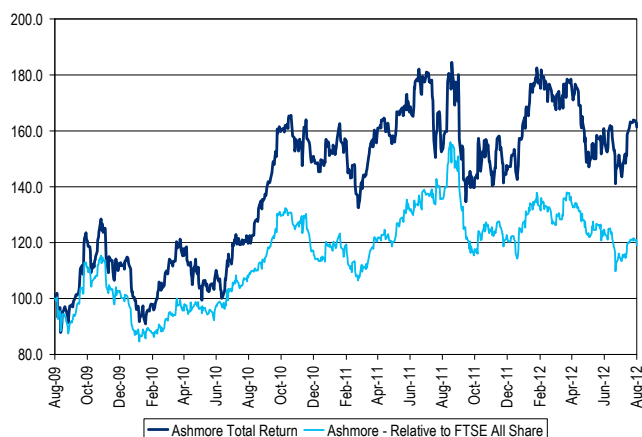
Source: DataStream, Citi Research. Rebased to start at 100 on 31 Dec 2011

Figure 2. Ashmore and UK Asset Manager peer group total returns YTD



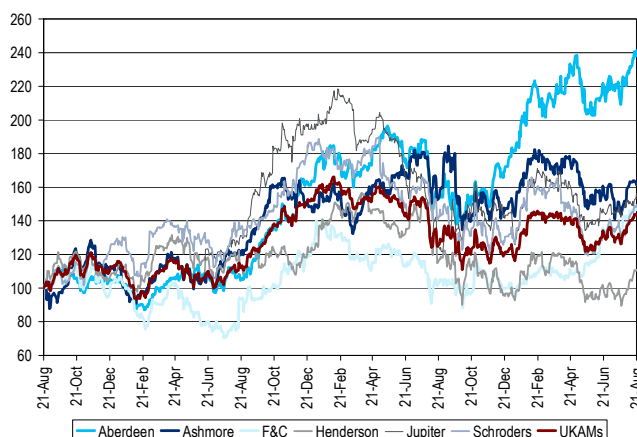
Source: DataStream, Citi Research. Rebased to start at 100 on 31 Dec 2011

Figure 3. Ashmore total return over 3 years, actual and relative to FTSE



Source: DataStream, Citi Research. Rebased to start at 100 at T-3Y

Figure 4. Ashmore and UK Asset Manager peer group total returns -3Y



Source: DataStream, Citi Research. Rebased to start at 100 at T-3Y

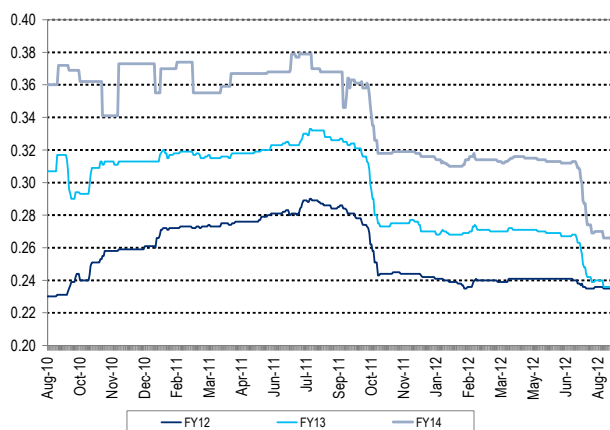
However, we believe share price underperformance will continue, for these reasons:

- **Competition.** Ashmore was an early market participant in EM Debt investment management. We see the market becoming more challenging and competitive.
- **Underperforming funds.** Ashmore's flagship funds have underperformed benchmarks over 1 and 5 years, with mixed 3 year relative performance.
- **Revenue margin decline.** Strong inflows into segregated mandates, competitive pressure and negative AUM mix continue to affect the revenue margin outlook.
- **Operating margin pressure.** We see this threatened both by falling revenue margins and rising compensation to revenue ratios.
- **Unjustified PE premium.** Ashmore benefits from a PE growth-premium vs. peers, in our view. We do not believe this is justified for Citi forecast -2% p.a. 3 year average annual EPS growth FY11-FY14E, or 4% FY12E-FY15E.

## Earnings Momentum

**Downward trend in consensus EPS.** As Figure 5 below shows, consensus EPS forecasts for Ashmore have trended down in recent months.

Figure 5. Consensus EPS forecasts: FY Jun 12, 13 and 14.



Source: Bloomberg, Citi Research

Figure 6. Consensus 12m rolling forward PE, Aug 2009 to date



Source: Bloomberg, Citi Research

**But consensus PE has risen.** At the same time, consensus 12 month forward rolling PE has jumped up to the top end of its historical 12x-15x range. (Figure 6).

**Odd: Consensus EPS downgrades, accompanied by Consensus PE re-rating**

**Performance fees.** This could be seen as an illustration of the low PE applied by the market to performance fee earnings. Recent consensus downgrades (e.g. July 2012) have, in the main, reflected lower performance fee expectations. (See our recent note, [“Beyond Q4 Flow Surprise – Now Look to September”](#)).

**Management fees.** We estimate management fee EPS by allocating all non-staff and fixed staff costs, and 75% of variable staff costs, to management fee revenues. In this way, we derive FY June 2011 management fee EPS of 20.4p, which we forecast grows 10% to 22.5p FY 2012, falls 3% to 22.0p FY 2013, and then grows again at 6%-7% p.a. in FY 2014 and 2015.

**Why the premium?** We find it hard to justify Ashmore’s premium 14.5x forward PE on the basis of this forecast management fee EPS growth progression.

**A Structural EM Growth story is no longer enough to justify this PE premium**

**Structural growth.** The most common response we get from investors is that Ashmore’s PE premium reflects its exposure to a strong structural long term growth story in EM Debt. Investor allocations to this asset class are rising: EM offers strong GDP growth, improving fiscal discipline and developing capital markets, helped by increasing intra-EM trade and reduced dependency on developed markets. Ashmore itself has identified EM capital as a significant source of future flow growth.

**Set against this... “easy returns” are over?** With many Emerging Markets now already upgraded to investment grade or almost investment grade credit ratings, and spreads over Treasuries near historical lows, we expect investment returns in EM Debt to be lower than in recent years.

**Stock specific.** We do not disagree with a structural growth prognosis for EM fund flows. But we are unconvinced that an investment case for Ashmore can be built on an industry view alone, when we see clear stock-specific reasons for relatively low near-term growth.

## Changing Competitive Landscape

The EM Bond Fund industry is maturing, competition is increasing

**First mover advantage.** We believe Ashmore benefited from being an early 'blue-chip' name in the EM Debt investment space. This helped it to win mandates from institutions, and to partner with wholesale distributors to gather retail funds in Asia.

**2012 – strong industry flows.** EPFR Global, a subsidiary of Informa plc INF.L, gathers data from selected fund groups (which we suspect do not include Ashmore, given the 'industry' numbers cited). According to EPFR, EM Bond funds have seen \$29bn net inflows in the first seven months of 2012, compared to \$16bn in the whole of 2011, putting 2012 on track to match the \$54bn net inflows seen in 2010.

Ashmore has missed out in the U.S.

**History compared.** In line with the industry, Ashmore saw strong flows in 2010, gathering \$12.3bn net inflows that year (\$3.7bn in H2 Jun 10 and \$8.6bn in H1 Dec 10). In contrast, Ashmore has seen only \$0.7bn net inflows in H2 Jun 2012.

Why is Ashmore not benefiting alongside wider industry fund flow growth this time? We see two likely reasons:

- **U.S. vs. Asian retail.** Recent EM Bond fund flows have been particularly strong in US open-end funds<sup>1</sup>. Despite launching a US mutual fund family in December 2010, Ashmore has not seen significant inflows in this space. This is in contrast to H1 Dec 10 when Ashmore was helped by a strong retail fund launch in Japan.
- **Not hard currency focused.** Recent EM Bond flows have been hard currency led, with EPFR data suggesting hard currency funds accounted for \$20bn of the \$29bn net inflows in the first seven months of 2012. We estimate Ashmore saw \$1.0bn net inflows into its External Debt (hard currency) theme in H2 June 2012, but that this benefit was offset by outflows elsewhere, in particular from equities.

## US Open End Funds – A Case Study

We see two key reasons:

**US open end funds market is significant.** Morningstar estimates total EM Bond US open end fund assets at \$64bn. Strategic Insight estimates \$78bn, with PIMCO (unsurprisingly) the largest single player at approximately \$21bn AUM, followed by Fidelity at around \$9bn. Ashmore's ~\$0.5bn fund family places it outside the top 30.

**Retail catch up.** A generous interpretation of fund flow trends would be that strong, hard-currency focused EM Bond fund flows reflect retail investor 'catch-up' in this space. As an institutional manager, Ashmore has not benefited from this trend.

**Or losing out in a maturing market.** A less generous view would point out that Ashmore has, in the past, benefited from retail investor demand for EM debt. That it is not doing so now is disappointing, especially as its launch of US mutual funds in December 2010 would suggest historical intent to benefit from US retail demand.

1. Expensive funds vs. peers

In support of a less generous view, we highlight the following:

2. Recent fund underperformance

- **Mis-priced funds.** We note some discrepancy between the costs of funds offered by Ashmore, and those offered by its key US competitors.
- **Recent poor fund performance.** We believe recent poor relative fund performance has played its part in Ashmore 'missing out' on the recent stronger fund flows seen elsewhere in the EM bond fund industry.

<sup>1</sup> Net flows into US open end EM Bond funds have been \$12.5bn in the 7 months to end July, a significant proportion compared to total fund net assets of \$64bn. See <http://corporate.morningstar.com/US/documents/JulyFlows12/JulyFlows12.pdf>.

## Mis-Priced Funds

Ashmore offers a range of seven US funds: Sovereign Debt, Local Currency Bond, Local Currency, Corporate Debt, Total Return, Equity and Small Cap Equity.

**Ashmore institutional asset classes are more expensive than PIMCO, Fidelity etc.**

**Are Ashmore funds too expensive?** A brief comparison of Ashmore funds to those of its key competitors suggests that Ashmore funds are, in general, more expensive than those of the main US houses.

For example, the institutional class July factsheet for the hard-currency Ashmore EM Sovereign Debt fund shows a total expense ratio of 2.97%, although this is reduced to 0.92% p.a. under an expense limitation agreement. This runs until at least 28 February 2013. But even this is high relative to many peers, in our view.

We compare Ashmore's EM Bond fund charges to those offered by the main US houses in Figure 7 below.

**Figure 7. Ashmore fund charges compared to major US peers**

Total Annual operating expense %	Fund Size	Institutional Class	A Class	Only one class
Ashmore Emerging Markets Total Return	\$0.40bn	1.02%	1.30%	
Ashmore Emerging Markets Local Currency Bond	\$0.07bn	0.97%	1.25%	
Ashmore Emerging Markets Sovereign Debt	\$0.03bn	0.92%	1.20%	
Ashmore Emerging Markets Local Currency	\$0.02bn	0.85%	1.12%	
Ashmore Emerging Markets Corporate Debt	\$0.02bn	1.17%	1.45%	
PIMCO Emerging Markets Local Bond	\$13.2bn	0.90%	1.35%	
PIMCO Emerging Markets Bond	\$7.4bn	0.83%	1.25%	
Fidelity New Markets Income	\$6.0bn			0.87%
MFS Emerging Markets Debt	\$5.5bn	0.89%	1.14%	
TCW Emerging Markets Income	\$4.7bn	0.87%	1.15%	
T Rowe Price Emerging Markets Bond	\$3.6bn			0.94%
Dreyfus Emerging Market Debt Local Currency	\$3.0bn	0.93%	1.22%	
Goldman Sachs Local Emerging Markets Debt	\$1.9bn	0.93%	1.27%	
Stone Harbor Local Markets	\$1.9bn	0.89%		

Source: Morningstar

## Underperforming Funds

**Ashmore is fond of citing its long term strong performance track record**

**Good medium term performance?** In Ashmore's latest available investor presentation (May 2012), it cites end December 2011 performance figures: 100% of Ashmore local currency, corporate debt and blended debt funds, and 90% of external debt funds, were ahead of benchmark over 3 years. Over 1 year, the figures were a little lower: 40% External Debt, 80% Local Currency, 70% Blended debt and 0% Corporate Debt funds were ahead of benchmark.

**Updated figures.** We look to the FY results presentation on 11 September 2012 for Ashmore to provide updated performance figures to the market. In the mean time, we look to key fund factsheets for to provide us with our best up to date guide.

**Recent fund factsheets suggest that 2012 has dented this record**

**Poor 1 year, Solid 3 year, Poor 5 year.** These factsheets suggest to us a relatively poor performance track record over 1 year and 5 years. Performance is better over 3 years, with many funds ahead of benchmark, but the quantum of outperformance is quite small. We summarise the data from the factsheets in Figure 8, with relative underperformance highlighted in shaded boxes.



Figure 8. Funds Performance – As at 31 July 2012

31-Jul-12	1 Month	1 Year	3 Year	5 Year	10 Year	Inception
<b>External Debt</b>						
EMLIP (\$4.1bn) (31 Oct 02)	2.1%	6.4%	15.5%	8.2%	14.6%	16.5%
JPM EMBI GD	3.7%	11.8%	13.3%	10.2%	11.9%	12.0%
Relative	-1.6%	-5.3%	2.2%	-2.0%	2.7%	4.5%
AEMDF (\$2.7bn) (31 May 03)	2.1%	3.7%	12.4%	7.4%		10.8%
JPM EMBI GD	3.7%	11.8%	13.3%	10.2%		9.7%
Relative	-1.6%	-8.1%	-0.9%	-2.8%		1.1%
<b>Local Currency</b>						
LCD (\$0.9bn) (Inception 31 Mar 97)	0.8%	-6.3%	3.8%	2.9%	8.1%	9.7%
JP Morgan ELMI+	0.4%	-6.8%	2.2%	3.8%	7.8%	7.0%
Relative	0.4%	0.5%	1.5%	-0.9%	0.4%	2.8%
SICAV LCBF (\$1.6bn) (25 Feb 10)	2.5%	-3.0%				8.6%
JPM GBI-EM GD	2.2%	-0.9%				9.2%
Relative	0.2%	-2.2%				-0.6%
<b>Corporate Debt</b>						
EMCHY (\$0.9bn) (31 Aug 07)	1.7%	-0.2%	15.3%			8.0%
JPM CEMBI BD NON-IG	2.4%	2.3%	13.5%			9.2%
Relative	-0.7%	-2.4%	1.8%			-1.2%
SICAV CDF (\$1.1bn) (25 Feb 10)	2.5%	1.2%				7.5%
JPM CEMBI BD	2.4%	6.6%				9.0%
Relative	0.1%	-5.4%				-1.5%
<b>Blended Debt</b>						
AEMDCF (\$1.5bn) (14 Dec 04)	0.8%	-0.1%	10.7%	6.6%		9.1%
50/25/25 Composite	2.5%	3.8%	9.7%	8.4%		8.9%
Relative	-1.7%	-3.8%	1.0%	-1.8%		0.3%
<b>Equity</b>						
The EM Investors Fund (\$0.4bn) (4 Apr 88)	0.6%	-19.3%	4.5%	-2.6%	14.4%	12.8%
MSCI EM NET	2.0%	-14.8%	6.6%	-0.6%	15.3%	8.6%
Relative	-1.4%	-4.5%	-2.1%	-2.0%	-0.9%	4.2%

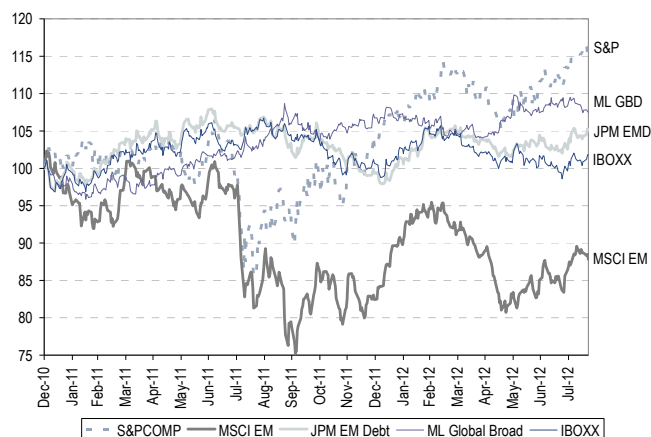
Source: www.ashmoregroup.com and www.ashmoreemm.com Fund Factsheets.

Returns for periods greater than 1 year are annualized. For the Equity fund, returns are shown gross of fees.

Fund performance is more important in a competitive market, in our view

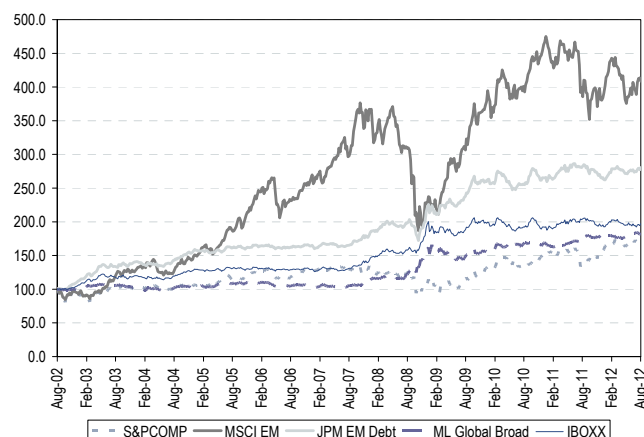
Important as sector outperformance tails off. We expect investors' reliance on performance track records for allocation decisions to increase as the EM Bond fund market matures and superior sector returns normalize.

Figure 9. Since end 2010, EM Equity and Debt have not outperformed



Source: DataStream

Figure 10. EM Equity and Debt outperformed significantly longer term



Source: DataStream



## EMM – still working it out

**“EMM Option” is disappointing so far**

**Acquired May 2011.** Ashmore acquired 62.9% of Emerging Markets Management LLC, a Virginia based EM Equity manager, on 31 May 2011. Now renamed AshmoreEMM LLC, this business managed \$9.9bn AUM at the time of acquisition.

**£93m total consideration, £51m goodwill.** At the time, total fair value of purchase consideration was considered to be £93m (\$153m), comprising £49.5m (\$81.5m) cash, £15.4m (\$25.4m) equity (4.4m new Ashmore shares) and £28.1m (\$46.1m) contingent consideration. Goodwill generated on acquisition was £50.8m.

**Writing back contingent payment expectations helps short term...**

**H1 already saw £6.1m benefit.** The £28.1m contingent consideration reflected potential earnouts payable in December 2011, 2012 and 2013, dependent on AshmoreEMM management fee revenues for those years. In its H1 December 2011 results, with Ashmore Group Equity AUM at \$7.0bn, Ashmore already saw a £6.1m net credit to income from the reduction in the fair value of contingent payments.

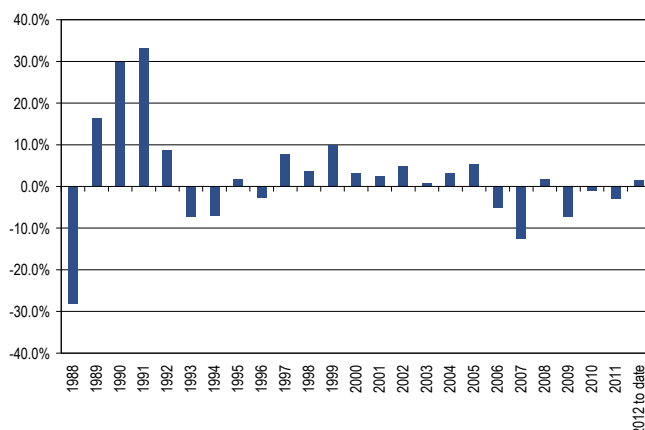
**H2 could see further short term benefit from poor performance.** With Equity AUM now at \$6.2bn, the fair value of contingent payments has likely fallen again, which will result in a further net credit to income. Whilst this would have a short term beneficial impact on near-term earnings, it is not a desirable outcome in our view, as it suggests that the EMM acquisition is still not living up to initial expectations.

**...but indicates EMM is not doing well. Goodwill impairment looks likely.**

**Write down of goodwill?** The goodwill of £50.8m arising on the acquisition was principally attributable to “the value expected to be derived from the acquired platform through future growth, additional business from new clients, and the value of the assembled workforce”. We think it likely that Ashmore will have to recognize an impairment of its goodwill balance at the FY June 2012 year end.

**Building a performance track record will take time.** Ashmore has indicated that the future growth at AshmoreEMM will first require the establishment of a good 3 year track record. For AshmoreEMM's largest strategy (Broad Global Active, 70% of AUM), this looks set to take at least a 3 years. More encouragingly, Global Small Cap (10% of AUM) has a better recent performance track record.

Figure 11. Broad Global Active: net returns vs. benchmark (MSCI EM)



Source: www.ashmoreEMM.com, Citi Research. Based on Composite Performance data provided on the website, available up to end March 2012

Figure 12. Global Small Cap: net returns vs. benchmark (MSCI EM SC)



Source: www.ashmoreEMM.com, Citi Research

**Slow burn, at best.** We view the “EMM Option” at Ashmore as a slow burn growth option at best. At worst, it is an unnecessary management distraction, and a questionable use of £49.5m group cash (compared to £98m paid out as ordinary dividends in FY11, and a relatively low 4% group dividend yield).

## Revenue Margin Decline

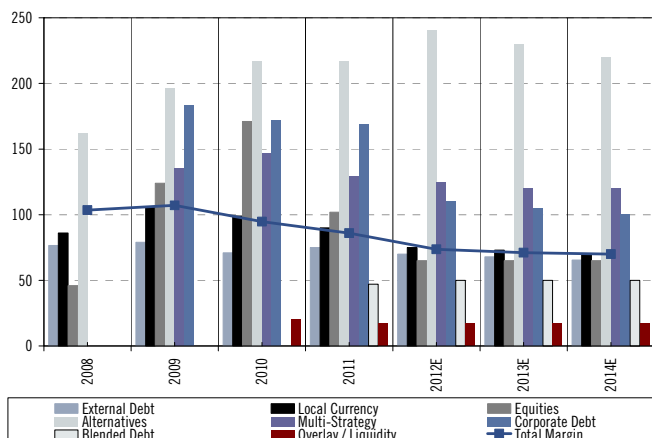
Ashmore has seen its group management fee revenue margin fall in recent years, from 107bp in FY June 2009, to 76bp in H1 December 2011.

The worst revenue margin decline has already happened

This has reflected two key dynamics:

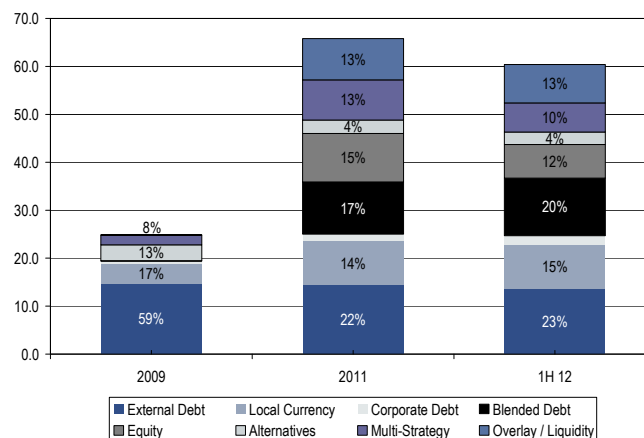
- **Shift to segregated.** Ashmore has seen revenue margins fall as flows into low margin segregated mandates have increased. External debt margins in H1 12 (Dec 2011) were 71bp, vs. 79bp FY Jun 09. Local currency margins H1 12 were 77bp, vs. 106bp FY 09. The newly separated theme, Blended Debt, saw margins at 51bp H1 12, reflecting its reliance on two big segregated mandates.
- **Negative AUM mix.** As Figure 14 shows, AUM mix has changed significantly over the last two years. High margin alternatives funds (ca. 2.2% fee margin) accounted for 13% group AUM at end June 2009, vs. only 4% at end December 2011. At the same time, lower margin fund themes (Blended Debt at ca. 50bp, Equities at ca. 65bp, Overlay at ca. 17bp) have grown in importance.

Figure 13. Management fee revenue margin trends, FY 2008 – FY 2014E



Source: Company Reports, Citi Research

Figure 14. Mix of Ashmore Group AUM by theme, FY 09, FY 11, H1 12



Source: Company reports, Citi Research

**Segregated business margin pressure to continue.** We believe Ashmore's revenue margin pressure will continue. We believe that the ~50bp margins earned by Blended Debt (mostly segregated) set a benchmark for where External Debt and Local Currency margins will trend to over time, as the group continues to win segregated mandates, and not wholesale / retail funds.

But we see continued bias to segregated fund flows taking the margin down as low as 65bp (12% fall)

**Mix dynamics are harder to call.** FY 2012 saw modest net inflows (\$1.4bn, 2% opening AUM), but within this we believe most debt themes saw net inflows, offset by net outflows from Equities and Multi-Strategy. This is likely to be slightly negative for group management fee margins in FY13, as Multi-Strategy (127bp in H1 12) is one of the higher margin earning themes. Longer term, however, we do not forecast material change in AUM mix FY12-FY15. We see the continuing shift to segregated mandates as the main driver of revenue margin pressure from here.

**12% fall to 65bp?** Maintaining FY June 2012 actual AUM mix by theme, but assuming 50bp management fee margins for External Debt and Local Currency, would reduce our forecast of group management fee margin from 74bp to 65bp. Whilst we do not forecast such a rapid fall (we forecast 69bp FY Jun 15), this is a useful indicator of the headwind that falling margins present, in our view.

## Operating Margin Pressure

**We forecast operating margins fall to 64% FY 14E. Still a great number, but the negative trend means EPS decline**

**Operating margin pressure.** We see this threatened both by falling revenue margins and rising compensation to revenue ratios.

**Compensation costs.** Key principles of Ashmore's staff compensation are:

- All employees are subject to capped salaries.
- Performance-related pay is based on the principle of profit sharing.
- Part of individuals' bonuses are deferred for a period of 5 years for the majority of employees through participation in long-term incentive plans.
- Discretionary variable compensation includes both an annual cash bonus and deferred share awards.
- Ashmore's intention is to pay to staff an amount in total of up to 25% of earnings before variable compensation, interest and tax ("EBVCIT") in respect of its total variable compensation.

**Our key concerns: rising share based compensation costs and an upward trend in Variable Compensation as % EBVCIT**

**Variable compensation.** This has trended up as a proportion of EBVCIT, from 14% in FY Jun 09, to 18% FY10, 19% FY11 and Citi forecast 20% FY12. We expect this rising % trend to continue, not least because we forecast 6% decline in EBVCIT in FY12E, 2% decline in FY13E, before returning to growth (9%) in FY14E.

**"Hangover" from past years.** Under IFRS 2, the fair value of share based payments are measured at grant date and then spread over the vesting period. In FY09, the share based payments expense in the P&L included £4.7m relating to awards granted in prior years. In FY10, this rose to £5.9m, and in FY11 to £10.9m. We attribute this rise to the dropping off of older, lower SBP charges, and their replacement by more recent, higher SBP charges.

Even though we forecast a fall in performance fee revenues, from £85.4m FY11 to £25.0m FY12E, we do not forecast an immediate fall in Variable Compensation as a proportion of EBVCIT, because of the expected "hangover" effect of having to charge for past share based awards.

**Figure 15. Share based payments: FY08 – FY13E**

	FY08	FY09	FY10	FY11	FY12E	FY13E
Share based payments £m	10.0	11.9	21.3	23.3	23.9	24.6
Total Variable Costs	40.8	25.2	46.9	57.1	55.8	57.6
SBP % VC	25%	47%	45%	41%	43%	43%
VC % EBVCIT	18%	14%	18%	19%	20%	21%

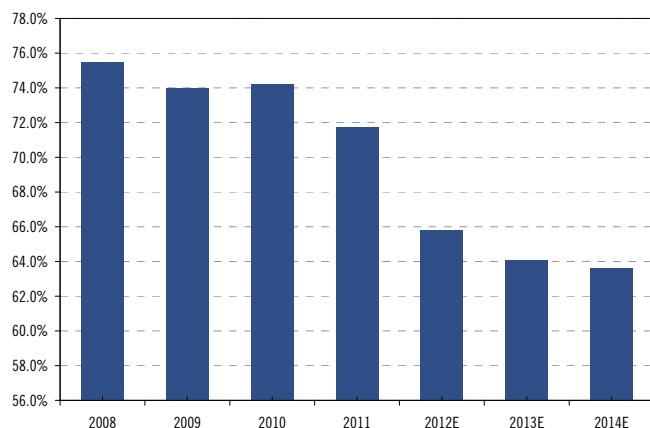
Share based payments expense split by year of grant:

FY04	0.1	0.0				
FY05	0.1	0.1	0.0			
FY06	0.8	0.2	0.2	0.0		
FY07	1.4	2.1	2.0	1.8	0.0	
FY08	7.6	2.3	2.2	2.1	2.0	0.0
FY09		7.2	1.5	1.4	1.3	1.2
FY10			15.4	5.6	5.5	5.4
FY11				12.4	3.1	3.0
FY12E					12.0	3.0
FY13E						12.0

Source: Company reports, Citi Research

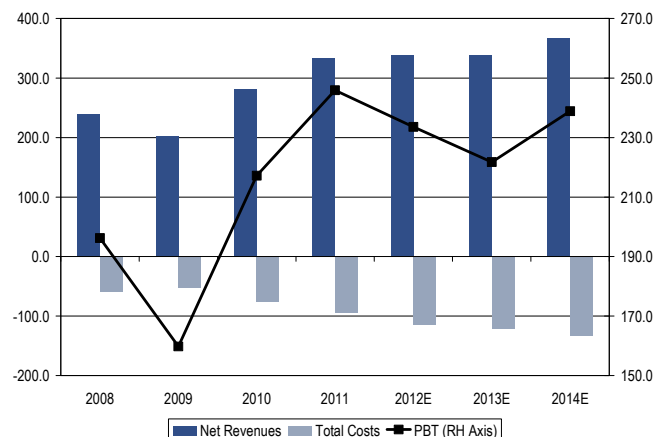
**Admittedly still high.** With our forecast of falling management fee margins, and rising variable compensation costs as a proportion of EBVCIT, we forecast a fall in operating margins from 72% FY Jun 11 to 66% FY 12, 64% FY 13. These are still extremely high margins in absolute terms, despite this negative trend.

Figure 16. Operating margin falls from 75.5% FY08 to 63.6% FY14E



Source: Company Reports, Citi Research estimates

Figure 17. Forecast 5% p.a. PBT decline, FY12E and FY13E



Source: Company reports, Citi Research

**Nonetheless – PBT falls.** This means we forecast -5% decline in PBT in both FY12 and FY13, and even more significant -11% EPS decline FY12, -5% FY13. The greater EPS decline in FY12 reflects the yoy impact of inclusion of the minority interest (37% of AshmoreEMM that is not owned) for a full year.

**Unjustified PE premium.** As such, it is hard – in our view – to justify Ashmore's PE "growth premium" vs. its UK asset management peers.

Figure 18. Ashmore PE and EV/EBITDA valuation vs. UK peers

Company	Ticker	Rec.	Year end	Mkt Cap US\$m	Price Current	Price Target	Upside %	Citi P/E 2012E	Citi P/E 2013E	EV/EBITDA 2012E	EV/EBITDA 2013E	Divi Yld 2012E	Divi Yld 2013E
Aberdeen Asset Management	ADN.L	1	Sep	5,101	2.79	3.00	7%	12.0	10.7	8.3	7.4	6.1%	8.6%
<b>Ashmore Group</b>	<b>ASHM.L</b>	<b>3</b>	<b>Jun</b>	<b>3,890</b>	<b>3.46</b>	<b>3.00</b>	<b>-13%</b>	<b>13.6</b>	<b>13.3</b>	<b>9.1</b>	<b>8.9</b>	<b>4.2%</b>	<b>4.6%</b>
F&C Asset Management Plc	FCAM.L	1H	Dec	795	0.90	1.10	22%	11.3	9.3	6.2	5.4	3.3%	3.3%
Henderson Group Plc	HGGH.L	2	Dec	1,930	1.09	1.10	1%	8.7	8.5	7.0	6.3	6.8%	7.1%
Jupiter Fund Management	JUP.L	2	Dec	1,651	2.27	2.50	10%	12.4	11.1	8.4	7.8	3.4%	3.8%
Man Group PLC	EMG.L	1H	Dec	2,258	0.78	0.90	15%	12.0	7.9	4.3	3.7	17.7%	8.9%
Schroders PLC	SDR.L	2	Dec	6,174	14.32	13.40	-6%	13.5	11.6	9.6	8.4	2.7%	2.9%
Schroders PLC NV	SDRt.L	2	Dec	6,174	11.59	10.65	-8%	10.6	9.1	7.4	6.4		3.6%
Schroders (theoretical combi)					13.78	12.85	-7%	12.9	11.1				
<b>UK Average Asset Manager</b>								<b>11.9</b>	<b>10.3</b>	<b>7.2</b>	<b>6.6</b>	<b>6.9%</b>	<b>6.1%</b>

Source: Powered by dataCentral. Ratings: 1 = Buy, 2 = Neutral, 3 = Sell, H = High Risk. EPS estimates for companies that have a non-December year end are calendarized. In the Schroders SDR.L row, we calculate EV (for the whole company) as market capitalisation - surplus cash of £463m. In the Schroders SDRt.L row, we calculate EV (for the whole company) as market capitalisation - surplus capital of £1,270m. In this way investors can use the EV/EBITDA ratios they think are most appropriate

## Upcoming Catalysts

### We expect consensus EPS downgrades

**FY12 results.** Ashmore releases its FY June 2012 results on 11 September. Having already published its end June AUM on 12 July, we expect investor focus to be on:

- **Details of fund flows by theme.** Although Ashmore has indicated directions of fund flows by theme, it will not release actual flow figures until the FY results.
- **Revenue margin trends.** Management fee margins were 75.6bp H1 Dec 2011. We forecast further decline, such that FY 12 margins fall to 74bp.
- **Earnings, and future profitability.** We forecast variable compensation will have risen to 20% of EBIT before charging Variable Compensation.

### We are 6% below consensus for FY13E

**Citi below consensus.** We are only 1% below consensus for FY12, but 6% below for FY13. We believe this principally reflects our more conservative assumptions on management fee revenue margins, and near-term fund flow trends.

Figure 19. Financial History and Forecast

In £m (unless otherwise stated)	2008	2009	2010R	2011	H112	H212E	2012E	2013E	2014E	2015E
Net Management Fees	182.0	183.2	189.9	249.3	151.4	149.6	301.0	310.0	330.0	349.0
Performance Fees	44.7	52.5	78.7	85.4	23.0	2.0	25.0	20.3	28.7	34.8
Other revenues	13.3	-32.2	13.4	-0.9	6.6	6.4	13.0	8.0	8.8	9.7
<b>Net Revenues</b>	<b>240.0</b>	<b>203.5</b>	<b>282.0</b>	<b>333.8</b>	<b>181.0</b>	<b>158.0</b>	<b>339.0</b>	<b>338.4</b>	<b>367.6</b>	<b>393.5</b>
Net Management Fee Margin	104	107	95	86	77	72	74	71	70	69
Employee Costs - Variable	-40.3	-24.5	-46.0	-56.2	-30.6	-25.2	-55.8	-57.6	-65.9	-72.5
Employee Costs - Non Variable	-7.4	-11.5	-12.8	-15.3	-11.7	-12.8	-24.5	-26.6	-28.8	-30.8
Total Employee Costs	-47.7	-36.0	-58.8	-71.5	-42.3	-38.0	-80.3	-84.3	-94.7	-103.3
VC as % EBIT net of Variable Compensation	18.2%	14.0%	18.3%	19.0%	20.1%	19.9%	20.0%	21.0%	22.0%	22.5%
Compensation costs / Revenues	-20%	-18%	-21%	-21%	-23%	-24%	-24%	-25%	-26%	-26%
Depreciation and Amortisation	-0.3	-0.8	-1.3	-1.3	-4.8	-4.2	-9.0	-9.0	-9.0	-9.0
Other Costs	-10.8	-16.1	-16.8	-21.6	-12.3	-14.3	-26.6	-28.3	-30.0	-31.5
<b>Total Costs</b>	<b>-58.8</b>	<b>-52.9</b>	<b>-76.9</b>	<b>-94.4</b>	<b>-59.4</b>	<b>-56.5</b>	<b>-115.9</b>	<b>-121.6</b>	<b>-133.7</b>	<b>-143.8</b>
Operating Profits	181.2	150.6	209.3	239.4	121.6	101.5	223.1	216.8	233.8	249.7
Operating Profit Margin, %	75.5%	74.0%	74.2%	71.7%	67.2%	64.3%	65.8%	64.1%	63.6%	63.5%
Net Interest	15.0	9.2	7.9	6.5	8.2	2.3	10.5	5.0	5.0	5.0
<b>PBT, £m</b>	<b>196.2</b>	<b>159.8</b>	<b>217.2</b>	<b>245.9</b>	<b>129.8</b>	<b>103.8</b>	<b>233.6</b>	<b>221.8</b>	<b>238.8</b>	<b>254.7</b>
of which Management fees (Citi estimate)	175.0	117.4	155.2	188.6	114.5	108.1	222.5	215.9	226.6	238.1
of which Performance fees (Citi estimate)	21.2	42.4	61.9	57.3	15.4	-4.3	11.1	5.9	12.3	16.7
EBIT before Variable Compensation	221.5	175.1	251.1	295.6	152.2	126.7	278.9	274.4	299.8	322.2
Total Tax	-55.2	-44.3	-56.6	-55.7	-33.7	-27.0	-60.7	-55.4	-57.3	-58.6
Effective Tax Rate, %	-28.1%	-27.7%	-26.1%	-22.7%	-26.0%	-26.0%	-26.0%	-25.0%	-24.0%	-23.0%
Minority Interest	-0.2	-0.5	-0.6	-1.2	-2.3	-3.0	-5.3	-6.7	-6.7	-8.0
Attributable Profits	140.8	115.0	160.0	189.0	93.8	73.8	167.6	159.6	174.8	188.1
							-2%	-21%	-14%	-8%
<b>Diluted EPS, Pence</b>	<b>19.9</b>	<b>16.0</b>	<b>22.5</b>	<b>26.6</b>	<b>13.23</b>	<b>10.4</b>	<b>23.6</b>	<b>22.6</b>	<b>24.7</b>	<b>26.5</b>
of which Management fees (Citi estimate)	17.7	11.8	16.1	20.4	11.7	10.9	22.5	22.0	23.4	24.8
of which Performance fees (Citi estimate)	2.1	4.2	6.4	6.2	1.6	-0.4	1.1	0.6	1.3	1.7
<b>DPS, Pence</b>	<b>12.0</b>	<b>12.0</b>	<b>13.0</b>	<b>14.5</b>	<b>4.25</b>	<b>10.3</b>	<b>14.5</b>	<b>14.5</b>	<b>17.5</b>	<b>18.0</b>
Average Number of Diluted Shares, Millions	708.0	719.0	710.4	709.9	708.9	709.4	709.1	707.8	707.8	708.8

Source: Company reports, Citi Research

Figure 20. AUM History and Forecast, \$bn

Y/E June	2008	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Opening AuM:</b>								
External Debt	21.2	20.9	14.7	12.3	14.3	15.9	17.5	19.3
Local Currency	5.0	7.2	4.2	6.0	9.4	10.0	10.9	12.5
Corporate Debt				0.8	1.3	2.4	3.0	3.9
Blended Debt				8.4	10.9	12.4	13.7	15.6
Equities	2.0	0.5	0.1	0.2	10.1	6.2	6.5	7.4
Alternatives				3.4	2.8	2.6	2.9	3.3
Multi-Strategy		3.8	2.0	2.0	8.4	5.6	6.2	6.9
Overlay / Liquidity				2.2	8.6	8.6	8.9	9.4
<b>Total Opening AUM</b>	<b>31.6</b>	<b>37.5</b>	<b>24.9</b>	<b>35.3</b>	<b>65.8</b>	<b>63.7</b>	<b>69.7</b>	<b>78.3</b>
<b>Market Appreciation / FX</b>								
External Debt	1.5	-1.7	2.3	2.0	1.0	1.0	1.1	1.2
Local Currency	0.9	-1.3	0.4	1.1	-0.5	0.5	0.8	0.9
Corporate Debt				0.1	0.2	0.2	0.3	0.4
Blended Debt				1	0.9	0.7	0.9	1.1
Equities	0.0	-0.3	0.1	0.0	-1.8	0.3	0.5	0.5
Alternatives				0.0	-0.1	0.2	0.2	0.2
Multi-strategy		-0.7	0.1	0.3	-2.1	0.3	0.4	0.5
Overlay / Liquidity				0.6	-1.1	0.1	0.2	0.2
<b>Total Market Appreciation / FX</b>	<b>2.9</b>	<b>-5.1</b>	<b>2.8</b>	<b>5.1</b>	<b>-3.5</b>	<b>3.1</b>	<b>4.3</b>	<b>4.9</b>
% Opening AUM	9.2%	-13.6%	11.2%	14.4%	-5.3%	4.9%	6.2%	6.3%
<b>Net Fund Flows:</b>								
External Debt	0.0	-4.5	2.4	0.0	0.6	0.6	0.7	0.8
Local Currency	2.6	-1.7	2.4	2.3	1.1	0.4	0.8	0.9
Corporate Debt				0.4	0.8	0.5	0.6	1.0
Blended Debt				1.5	0.5	0.6	1.0	1.1
Equities	-1.2	-0.1	0.0	-0.1	-2.1	0.0	0.5	0.7
Alternatives				-0.6	-0.1	0.2	0.2	0.2
Multi-strategy		-1.1	-0.1	6.1	-0.6	0.3	0.3	0.3
Overlay / Liquidity				5.8	1.1	0.3	0.3	0.3
<b>Total Net Fund Flows</b>	<b>3.0</b>	<b>-7.5</b>	<b>7.6</b>	<b>15.4</b>	<b>1.4</b>	<b>2.9</b>	<b>4.3</b>	<b>5.2</b>
% Opening AUM %	9.5%	-20.0%	30.5%	43.6%	2.1%	4.5%	6.1%	6.7%
<b>Closing AuM, US\$bn:</b>								
External Debt	20.9	14.7	19.4	14.3	15.9	17.5	19.3	21.2
Local Currency	7.2	4.2	7.0	9.4	10.0	10.9	12.5	14.3
Corporate Debt	0.5	0.5	0.9	1.3	2.4	3.0	3.9	5.3
Blended Debt				10.9	12.4	13.7	15.6	17.7
Equity	0.5	0.1	0.2	10.1	6.2	6.5	7.4	8.6
Alternatives	4.6	3.3	3.4	2.8	2.6	2.9	3.3	3.7
Multi-Strategy	3.8	2.0	2.0	8.4	5.6	6.2	6.9	7.8
Overlay / Liquidity	0.0	0.1	2.4	8.6	8.6	8.9	9.4	9.9
<b>Total AuM, US\$bn</b>	<b>37.5</b>	<b>24.9</b>	<b>35.3</b>	<b>65.8</b>	<b>63.7</b>	<b>69.7</b>	<b>78.3</b>	<b>88.4</b>
Increase, %	18.6%	-33.6%	41.8%	86.4%	-3.2%	9.4%	12.3%	12.9%
<b>AUM Mix</b>								
External Debt	55.7%	59.0%	55.0%	21.7%	25.0%	25.2%	24.6%	24.0%
Local Currency	19.2%	16.9%	19.8%	14.3%	15.7%	15.7%	16.0%	16.2%
Corporate Debt	1.3%	2.0%	2.5%	2.0%	3.7%	4.3%	5.0%	6.0%
Blended Debt				16.6%	19.4%	19.6%	19.9%	20.0%
Equities	1.3%	0.4%	0.6%	15.3%	9.7%	9.3%	9.4%	9.7%
Alternatives	12.3%	13.3%	9.6%	4.3%	4.0%	4.2%	4.2%	4.2%
Multi-Strategy	10.1%	8.0%	5.7%	12.8%	8.8%	8.9%	8.9%	8.8%
Overlay / Liquidity	0.0%	0.4%	6.8%	13.1%	13.5%	12.8%	12.0%	11.2%

Source: Company reports, Citi Research

## Valuation

### We set a new 300p price target

**DCF.** To derive fair value, we use a 4-stage DCF, in which we explicitly forecast management fee cash flows to y/e June 2015 (the 1st stage). In the 2nd stage, we assume 10% medium term AUM growth and a steady decline in management fee margins. In the 3rd stage, we assume long-term 5% p.a. AUM growth. In the final stage, we assume 2% p.a. AUM growth into perpetuity, at stable margins.

We use a 12.3% discount rate, reflecting our assumptions of i) 1.75% risk-free rate, ii) 1.62 beta (source: Datastream) and iii) 6.5% equity risk premium.

Adding in performance fees at 7x forecast 2013 earnings and net cash balance at 19% of par value suggests a fair value for the group of £2,147m, or 303p per share, which supports our rounded 300p target price. This is lower than our previous 305p price target, reflecting the impact on forecast cashflows of our 1% reduction in FY13 and FY14 EPS estimates today. The EPS reduction reflects slightly greater management fee revenue margin pressure than we previously forecast.

We include net cash at 19% of par because we assume it generates 4% return vs. 12.4% discount and 2% long-term growth rates, giving a theoretical P/B value of  $(4\%-2\%)/(12.4\%-2\%) = 19\%$ .

Figure 21. DCF Valuation

Year End: 30 June	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Average assets under management	40,868	43,635	47,121	50,228	55,251	60,776	66,854	73,539	80,893	84,938	89,185	93,644	98,326	103,243
growth rate		7%	8%	7%	10.0%	10.0%	10.0%	10.0%	10.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Management Fee PBT	222.5	215.9	226.6	238.1	256.6	276.6	298.2	321.5	346.6	356.6	366.9	377.6	388.5	399.8
Margin	0.54%	0.49%	0.48%	0.47%	0.46%	0.46%	0.45%	0.44%	0.43%	0.42%	0.41%	0.40%	0.40%	0.39%
Tax Charge	-57.9	-54.0	-54.4	-54.8	-64.2	-69.2	-74.6	-80.4	-86.6	-89.2	-91.7	-94.4	-97.1	-100.0
Add back Depreciation	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Deduct Capex	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3	-11.3
Cash Earnings	162.4	159.6	169.9	181.1	190.2	205.2	221.4	238.9	257.7	265.2	273.0	280.9	289.2	297.6
PV Cash Earnings		144.6	137.1	130.1	121.7	117.0	112.4	108.0	103.7	95.1	87.1	79.9	73.2	67.1
PV Near-Term Cashflows	1377													
PV Terminal Cashflows	666													
TOTAL PV, £m	2043													
Add Performance Fees at 7 Times	30													
Add cash/(net debt)	75	19%												
Equity Valuation, £m	2147													
Number of Shares	708													
Theoretical valuation, Pence	303													

Source: Citi Research

### Implied Target Price PE is 11.2x, still a one point premium to peers

**PE.** Adjusted for forecast net cash, and an assumed 3% return on cash, Ashmore trades at 13.3x CY 2013 PE, a full 3 PE points above its UK peer group average. (See Figure 18).

We do believe some PE premium is warranted, given the strong structural growth outlook for EM Debt. However, given our forecast of negative EPS growth FY11–FY14E, and only modest 4% p.a. EPS growth FY12E–FY15E, a full 3 point premium seems excessive, in our view.

At our 300p target price, Ashmore would trade at 11.2x CY13E cash adjusted PE, a more justifiable 1 point premium to peers, in our view.



## Citi Best Ideas

### Replacing Schroders with Ashmore as our Least Preferred asset manager

**Summary** — We name ASHM.L a Least Preferred stock relative to our fundamental analyst coverage for the next 3 Months, replacing SDR.L, which we last selected on 25 Jun 2012.

**Rationale** — We replace Schroders with Ashmore as our least preferred asset management stock. Our catalyst date for Schroders (H1 results on 2 August) has now passed, with the stock surprising on the upside with better retail fund flows (driven by US) than expected, and more cost control than previously indicated. Also, more positive body language on potential future return of some of the group's surplus capital to investors is a new message. We select Ashmore as Least Preferred for the reasons set out below.

### Ashmore Group

(ASHM.L; £3.47; 3)

**Catalyst and Thesis** — **Catalyst:** FY 12E results on 11 September. **Thesis:** We continue to believe in a long-term EM Debt structural growth story but question the extent to which Ashmore will take part. Recent fund flows have "missed out" on positive industry trends, key flagship funds appear to be underperforming benchmark over 1 and 5 years. We expect revenue margins to continue to fall. We forecast -11% EPS decline FY Jun 12E and -5% FY Jun 13E and so find Ashmore's "growth premium" PE hard to justify.

## Ashmore Group

### Company description

Ashmore is an emerging markets manager focused primarily on EM Debt, with plans to grow in EM Equity. It managed \$63.7bn AUM end Jun 2012, including \$6.2bn Equity AUM. Asset mix: 25% External Debt, 19% Blended Debt, 16% Local Currency, 13% Other, 10% Equity, 9% Multi-Strategy, 4% Alternatives and 4% Corporate Debt.

### Investment strategy

We rate Ashmore Group Sell

**Revenue margin decline.** Strong inflows into segregated mandates, and competitive pressure are negative for the revenue margin outlook.

**Competition.** Ashmore held a “first mover” advantage in EM Debt. We are concerned that competitive pressure is increasing, putting pressure on flows and margins

**Sustainability of operating margin.** We see this threatened both by falling revenue margins and rising compensation to revenue ratios.

**Underperforming funds.** Ashmore's flagship fund range have underperformed benchmarks over 1 year and 5 years. 3 year performance is mixed.

Set against this we note:

**Structural growth.** Ashmore is primarily an EM debt manager. We expect structural growth in institutional EM debt flows.

**Sticky client mix.** At end 2011, the majority of AUM was held by institutions, including: 29% Corporate and Public pension plans, 31% Governments

**Lumpy fund launches.** Ashmore has past strength in Asian retail fund launches.

### Valuation

To derive a fair value, we use a 4-stage DCF model, in which we explicitly forecast management fee cash flows to y/e June 2015 (the 1st stage). In the 2nd stage, we assume 10% medium term AUM growth and a steady decline in management fee margins. In the 3rd stage, we assume long-term 5% p.a. AUM growth. In the final stage, we assume 2% p.a. AUM growth into perpetuity, at stable margins.

We use a 12.3% discount rate, reflecting our assumptions of i) 1.75% risk-free rate, ii) 1.62 beta (source: Datastream) and iii) 6.5% equity risk premium.

Adding in performance fees at 7x forecast 2013 earnings and net cash balance at 19% of par value suggests a fair value for the group of £2,147m, or 303p per share, which supports our rounded 300p target price.

We include net cash at 19% of par because we assume it generates 4% return vs. 12.4% discount and 2% long-term growth rates, giving a theoretical P/B value of  $(4\%-2\%)/(12.4\%-2\%) = 19\%$ .

## Risks

The following risks could prevent the achievement of our target price:

- i) Improvement in the wider credit environment, or a rally in EM debt markets, leading to stronger performance of investment portfolios, fund flows and performance fee earnings than we forecast.
- ii) Less revenue margin pressure than we forecast, due to more fund flows in higher-margin segments (e.g. due to retail or alternatives fund launches).
- iii) Better cost control than we forecast, with variable compensation costs reduced as a percentage of EBVCIT.
- iv) Higher dividend payout. If Ashmore opts to alleviate the impact of slowing / negative EPS growth by returning more of its cashflow generation to investors in the form of dividends.
- v) Over 60% of shares are held by company staff and directors. Even the limited free float is closely held, with a couple of institutions holding ~5% each. As such, low trading liquidity could lead to high volatility in the share price.

## Schroders PLC

### Valuation

We value Schroders on a sum-of-the-parts approach, as set out below.

- We derive a £3.4bn value for management fee earnings using a DCF, with 11.4% cost of equity, assuming 2.0% long-run growth.
- We value post-tax performance fee earnings at 7x 2013E P/E, at £216m.
- We value post-tax underlying group costs at 12x 2013E PE, at negative -£275m
- We value surplus capital (£1.27bn at end June 2012) at 0.2x P/B, at £272m

Our valuation for surplus capital reflects our view that Schroders will continue to hold this on its balance sheet, not returning it to investors, but instead generating low returns vs. Schroders' cost of equity. We assume Schroders can deliver 4% p.a. return on investment in the long term.

As such, we estimate a total fair value for Schroders of £3.6bn, split into 1339p for voting shares, and 1066p for non-voting shares. (This assumes the current actual 20% non-voting to voting share discount is maintained).

We use these values to set our rounded 1340p and 1065p target prices.

### Risks

We note the following company specific/industry risks which could affect the achievement of our target price:

Schroders is exposed to market risk. It has significant exposure to UK, European & Asian equities in its Assets under Management (and so its share price), somewhat moderated by its strong balance sheet. In addition to this:

Negative risks:

The main negative risk to our earnings forecasts and target price is a decline in the level of global stock markets. This would reduce AUM and revenues - which for a business with significant operational leverage like Schroders, would lead to disproportionate impact on EPS.

Any deterioration in investment performance could hit the group's net fund flows and performance fees.

Increased competitive pressures could dampen revenue margins.

Positive risks:

Stronger equity market appreciation, better fund flows, or higher performance fees.

Redeployment of a significant amount of spare cash in buybacks, or M&A.

**Notes**

**Notes**

**Notes**



# Appendix A-1

## Analyst Certification

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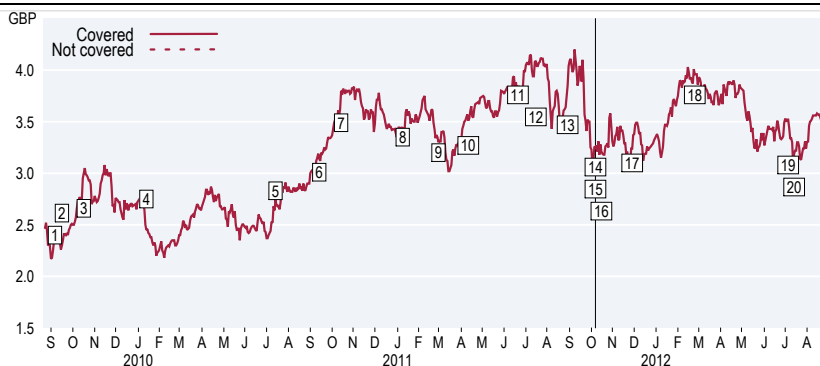
## IMPORTANT DISCLOSURES

### Ashmore Group (ASHM.L)

#### Ratings and Target Price History

#### Fundamental Research

Analyst: Haley A Tam, CFA  
Covered since May 20 2010



Date	Rating	Target Price	Closing Price
1 7-Sep-09	1M	*2.65	2.38
2 16-Sep-09	1M	*2.85	2.30
3 16-Oct-09	1M	*3.60	3.00
4 13-Jan-10	1M	*3.25	2.45
5 14-Jul-10	*2M	*3.00	2.74
6 14-Sep-10	2M	*3.40	3.14
7 14-Oct-10	2M	*4.00	3.80

\* Indicates change

Date	Rating	Target Price	Closing Price
8 10-Jan-11	2M	*3.65	3.40
9 1-Mar-11	2M	*3.40	3.30
10 12-Apr-11	2M	*3.50	3.51
11 21-Jun-11	2M	*3.85	3.84
12 15-Jul-11	2M	*4.00	4.09
13 30-Aug-11	*1M	4.00	3.85
14 7-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
15 7-Oct-11	*1	4.00	3.25
16 17-Oct-11	1	*3.70	3.21
17 29-Nov-11	1	*3.75	3.24
18 24-Feb-12	*2	*4.00	3.96
19 5-Jul-12	2	*3.50	3.52
20 13-Jul-12	2	*3.05	3.19

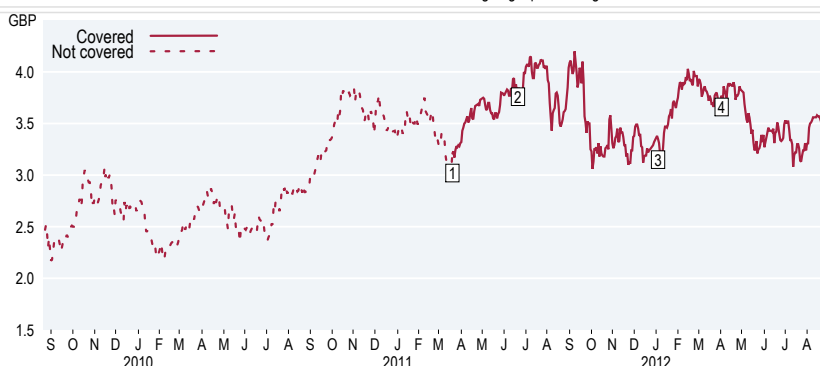
Rating/target price changes above reflect Eastern Standard Time

### Ashmore Group (ASHM.L)

#### Ratings and Target Price History

#### Best Ideas Research Relative Call (3 Month)

Analyst: Haley A Tam, CFA  
Covered since May 20 2010



Date	Rating	Target Price	Closing Price
1 21-Mar-11	*ADD LP	-	3.21
2 21-Jun-11	*REM LP	-	3.84

\* Indicates change

Date	Rating	Target Price	Closing Price
3 4-Jan-12	*ADD MP	-	3.35
4 3-Apr-12	*REM MP	-	3.77

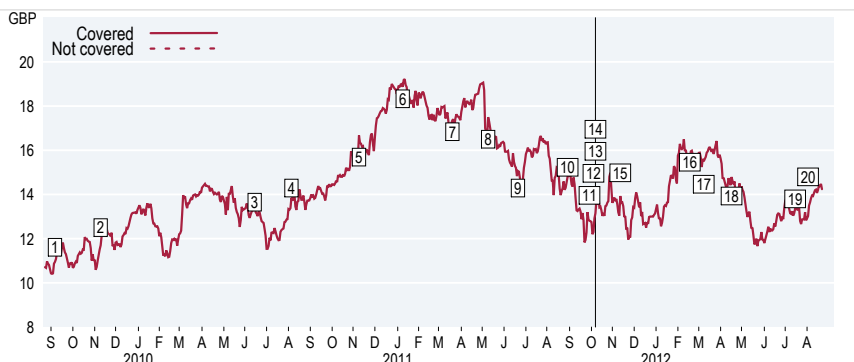
Rating/target price changes above reflect Eastern Standard Time

## Schroders PLC (SDR.L)

### Ratings and Target Price History

### Fundamental Research

Analyst: Haley A Tam, CFA  
Covered since May 20 2010



Date	Rating	Target Price	Closing Price
1 7-Sep-09	1M	*12.30	10.95
2 10-Nov-09	1M	*13.65	11.70
3 15-Jun-10	*3M	*12.00	13.65
4 5-Aug-10	3M	*12.30	13.85
5 9-Nov-10	*2M	*16.60	16.67
6 10-Jan-11	2M	*19.60	18.87
7 21-Mar-11	*1M	*20.00	17.36

\* Indicates change

Date	Rating	Target Price	Closing Price
8 10-May-11	*2M	*18.50	17.50
9 21-Jun-11	*1M	*17.10	15.06
10 30-Aug-11	*2M	*15.30	14.81
11 29-Sep-11	2M	*14.00	12.81
12 5-Oct-11	2M	*12.30	12.30
13 7-Oct-11	Stock rating system changed		
14 7-Oct-11	*2	12.30	13.15

Date	Rating	Target Price	Closing Price
15 11-Nov-11	2	*13.10	13.93
16 17-Feb-12	*3	*13.70	15.59
17 8-Mar-12	3	*13.90	15.50
18 17-Apr-12	*2	*14.20	14.79
19 16-Jul-12	2	*13.10	13.36
20 2-Aug-12	2	*13.40	13.02

Rating/target price changes above reflect Eastern Standard Time

## Schroders PLC (SDR.L)

### Ratings and Target Price History

### Best Ideas Research

### Relative Call (3 Month)

Analyst: Haley A Tam, CFA  
Covered since May 20 2010



Date	Rating	Target Price	Closing Price
1 11-Feb-11	*ADD LP	-	18.02

\* Indicates change

Date	Rating	Target Price	Closing Price
2 21-Mar-11	*REM LP	-	17.36

Date	Rating	Target Price	Closing Price
3 4-Jan-12	*ADD LP	-	13.15

Rating/target price changes above reflect Eastern Standard Time

**BEST IDEAS UNIVERSE:** The best ideas universe from which Ashmore Group (covered by Haley A Tam, CFA), Schroders PLC (covered by Haley A Tam, CFA) were chosen comprises: Henderson Group Plc (HGGH.L, £1.08), Aberdeen Asset Management (ADN.L, £2.77), Ashmore Group (ASHM.L, £3.47), Hargreaves Lansdown PLC (HRGV.L, £6.14), Man Group PLC (EMG.L, US\$0.79), Schroders PLC (SDR.L, £14.18), Schroders PLC NV (SDRt.L, £11.39), F&C Asset Management Plc (FCAM.L, £0.91), Jupiter Fund Management (JUP.L, £2.25), BME (BME.MC, €17.93), ICAP PLC (IAP.L, £3.27), Deutsche Boerse AG (DB1Gn.DE, €41.52), Tullett Prebon (TLPR.L, £2.92), 3i Group Plc (III.L, £2.09), Gottex Fund Management Holdings Ltd (GFMN.S, US\$3.78), GAM Holding Ltd (GAMH.S, SFr11.6), Intermediate Capital Group (ICPL.L, £2.87). All prices as of 23 Aug 2012.

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#### Data current as of 30 Jun 2012

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
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44%	43%	40%	48%	43%	45%

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Citigroup Global Markets Ltd	Haley A Tam, CFA; Nese Guner
Citigroup Global Markets India Private Limited	Abhijeet Sakhare

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