

F&C Asset Management (FCAM LN)

Overweight (V)

Target price (GBPp)	100
Share price (GBPp)	66
Potential total return (%)	51.5

Dec	2009a	2010e	2011e
HSBC EPS	5.67	7.32	9.26
HSBC PE	11.6	9.0	7.1
Performance	1M	3M	12M
Absolute (%)	4.1	-2.2	-15.9
Relative ^a (%)	5.8	-7.9	-36.1

Note: (V) = volatile (please see disclosure appendix)

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OW(V): Acquisition of Thames River and positive Q1 IMS

- **Acquisition of Thames River is more significant than it first appears, given options over increased economic interests**
- **Q1 IMS reveals turnaround in institutional fund flows and first group-wide net inflow since 2007**
- **We reiterate our OW(V) rating and 100p target price, which implies a 52% potential return**

TRC adds to improving organic growth outlook

Thames River Capital: The Thames River Capital (TRC) acquisition is more significant than it first appears: in addition to providing complementary product offerings and additional distribution and cross-selling opportunities, the transaction has the potential to substantially boost future profits if/when increased economic interests in the underlying investment teams are acquired. This will dilute the group's sensitivity to its two largest management contracts and provide additional protection to the dividend, in our view.

Q1 Interim Management Statement: The Q1 IMS was encouraging in that, despite the loss of the GBP285m Foreign & Colonial Eurotrust mandate, F&C was able to report a turnaround in institutional flows and a group-wide quarterly net inflow of funds for the first time since 2007. This improvement has followed a strong investment performance across the board in 2009 and increased investment consultant support since the demerger from Friends Provident in mid-2009.

FCCPT mandate: The potential loss of the F&C Commercial Property Investment Trust is disappointing, and highlights the risk of loss of other closed-end management contracts. While we estimate that some GBP2.5-3.0m of management fee revenues are potentially at risk, the fact that the trust's board has yet to comment on the proposals it has received indicates that there is no certainty over the outcome.

Reiterate OW(V) rating: We raise our 2011e and 2012e diluted EPS by 2% and 1%, respectively, to reflect expected earnings accretion due to TRC. On our new estimates, the shares trade on 7.1x 2011e PE, a 44% discount to the sector average, and yield 9.1%. We reiterate our OW(V) rating and 100p target, which implies a 52% potential return.

Index ^a	FTSE ALL-SHARE	Free float (%)	88
Index level	2,863	Market cap (USDm)	484
RIC	FCAM.L	Market cap (GBPm)	318
Bloomberg	FCAM LN		

Source: HSBC

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Financials & valuation

Financial statements

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Profit & loss summary (GBPm)				
Revenue	227	268	310	340
EBITDA	63	76	97	124
Depreciation & amortisation	-3	-3	-3	-3
Operating profit/EBIT	60	73	95	121
Net interest	-19	-17	-17	-15
PBT	9	6	28	57
HSBC PBT	41	56	78	107
Taxation	10	-2	-8	-16
Net profit	16	4	20	40
HSBC net profit	28	40	56	77

Cash flow summary (GBPm)

Cash flow from operations	26	54	70	90
Capex	-3	-3	-3	-3
Cash flow from investment	-33	-3	-3	-3
Dividends	-30	-30	-30	-30
Change in net debt	7	-22	-37	-57
FCF equity	23	52	67	88

Balance sheet summary (GBPm)

Intangible fixed assets	591	591	591	591
Tangible fixed assets	0	0	0	0
Current assets	1,098	1,129	1,177	1,245
Cash & others	186	208	245	303
Total assets	1,896	1,877	1,874	1,893
Operating liabilities	954	1,050	1,058	1,067
Gross debt	264	264	264	264
Net debt	78	56	19	-39
Shareholders funds	570	544	533	543
Invested capital	549	462	465	467

Ratio, growth and per share analysis

Year to	12/2009a	12/2010e	12/2011e	12/2012e
Y-o-y % change				
Revenue	-2.2	18.2	15.8	9.5
EBITDA	0.5	21.3	28.2	27.4
Operating profit	0.8	22.3	29.2	28.2
PBT		-29.6	353.8	103.7
HSBC EPS	-22.1	29.0	26.5	21.1

Ratios (%)

Revenue/IC (x)	0.5	0.5	0.7	0.7
ROIC	26.2	9.2	14.3	18.5
ROE	4.8	7.3	10.4	14.3
ROA	4.3	1.2	2.2	3.3
EBITDA margin	27.7	28.4	31.5	36.6
Operating profit margin	26.4	27.4	30.5	35.7
EBITDA/net interest (x)	3.3	4.4	5.8	8.4
Net debt/equity	13.2	10.0	3.4	-6.9
Net debt/EBITDA (x)	1.2	0.7	0.2	-0.3
CF from operations/net debt	33.5	97.0	372.1	

Per share data (GBPp)

EPS reported (fully diluted)	3.19	0.71	3.22	5.88
HSBC EPS (fully diluted)	5.67	7.32	9.26	11.21
DPS	6.00	6.00	6.00	6.00
Book value	115.99	105.34	103.37	105.34

Key forecast drivers

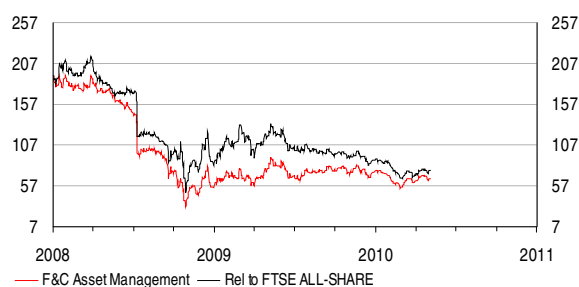
Year to	12/2009a	12/2010e	12/2011e	12/2012e
Management fees/avg AUM (bp)	22	24	26	27
Net revenues/avg AUM (bp)	23	26	27	28
Expenses/avg AUM (bp)	17	19	19	18
Operating profit margin (%)	26	27	31	36
Average AUM (GBPbn)	98	104	113	121
Average AUM growth (%)	-3	6	9	7

Valuation data

Year to	12/2009a	12/2010e	12/2011e	12/2012e
EV/sales	1.8	1.5	1.1	0.9
EV/EBITDA	6.6	5.2	3.6	2.4
EV/IC	0.8	0.9	0.8	0.6
PE*	11.6	9.0	7.1	5.9
P/Book value	0.6	0.6	0.6	0.6
FCF yield (%)	6.9	15.3	19.9	26.0
Dividend yield (%)	9.1	9.1	9.1	9.1

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 03 May 2010

Investment summary

- ▶ Strategic acquisition of Thames River a positive; subject to shareholder approval, anticipated to close in or before Q3
- ▶ Potential to increase share of TRC management fee profits in 2012 a key attraction of the deal
- ▶ Continued net fund flow momentum reported for core activities; business trading in line with management expectations

Acquisition of Thames River & positive Q1 IMS

Summary

- ▶ On 28 April, F&C announced the proposed acquisition of Thames River Capital (TRC) for an initial GBP33.6m in cash and up to an additional GBP20m in FCAM shares or loan notes based on performance targets up to June 2012.
- ▶ Founded in 1998, TRC is a London-based specialist asset manager focused on specialist and absolute return products and employing some 135 personnel. TRC has office in London, Luxembourg and Cape Town.
- ▶ As at 31 March 2010, TRC AUM were GBP4.2bn, while net revenues and pre-tax profits in the year to March 2009 were GBP53.1m and GBP6.3m, respectively. Management expects the transaction to be earnings enhancing in first full year post completion; and the achievement of minimum earn-out and retention targets for end-2011 imply 2011 EV/EBITDA and PE exit multiples of approximately 5x and 7x, respectively.
- ▶ The strategic rationale for the acquisition is that TRC fits with F&C's stated strategy to expand in higher growth and higher fee margin product areas, while broadening F&C's range of specialist product offerings. TRC is complementary with F&C's existing businesses and as such allows for cross-selling & additional distribution opportunities.
- ▶ F&C's Q1 IMS confirmed the continued recovery of the core business on the back of a strong investment performance last year: end-March 2010 AUM was GBP101.5bn, up 4% on the GBP97.8bn reported for end-December 2009.
- ▶ Net inflows in Q1 were GBP117m and included the first net inflow into the group's institutional segment since 2007. The business as a whole was reported to be trading in line with management's expectations.
- ▶ We have amended our earnings estimates to reflect the TRC transaction and the positive Q1 interim management statement. We reduce 2010e diluted EPS by 1% and raise 2011e and 2012e EPS by 2% and 1%, respectively.

Thames River: more significant than it looks

The acquisition of Thames River is more significant than it first appears in two respects.

Cost

Ultimately, the acquisition is likely to cost substantially more than the headline transaction consideration suggests. Including the maximum amounts payable in conditional consideration to the vendors, retention and incentive schemes for management and staff, and the cost of additional economic interests in the underlying management teams, we estimate the potential total cost of the acquisition could amount to GBP173m.

Thames River – potential total acquisition consideration

Component	GBPm	Shares / cash
Initial Consideration	33.6	F&C shares
Management Retention Plan	15.0	F&C shares
Known acquisition cost	48.6	
Conditional Consideration	20.0	F&C shares / loan notes
Management Incentive Plan	23.0	F&CM shares / GBP3m cash
Potential acquisition cost*	91.6	
Commutation Arrangements	81.4	F&C shares & cash
Maximum cost**	173.0	

Note: *For initial economic interest; **for increased economic interest.
Source: Company data, HSBC estimates

Although some of these additional and contingent costs can include cash payments (usually at F&C's discretion), the significant majority involve additional share issuance.

Thames River – potential new F&C share issuance

	Shares	Basis
Placing	24,807,145	Actual
Management Retention Plan	21,747,152	Maximum
Management Incentive Plan	28,996,202	Maximum
Commutation Arrangements	122,511,485	Maximum
Known maximum issuance	198,061,984	
Conditional Consideration*	30,769,231	Max consideration
Estimated maximum issuance	228,831,215	

Note: *Assumes GBP20m in shares valued at 65p.
Source: Company data, HSBC estimates

Profit contribution

The table below shows the effect on our 2012 and 2013 forecasts for TRC EBIT available to F&C from the exercise of Commutation Arrangements in full.

Thames River Capital – EBIT forecasts

Year to December (GBPm)	2010e	2011e	2012e	2013e
Management fees	39.2	45.5	51.8	58.1
Performance fees	10.9	12.6	14.4	16.1
Net revenues	50.0	58.1	66.1	74.2
-Staff costs	-20.0	-23.2	-16.1	-18.1
-Other operating expenses	-19.0	-19.4	-19.8	-20.2
Operating expenses	-39.0	-42.6	-35.9	-38.2
EBIT	11.0	15.5	30.3	36.0

Source: HSBC estimates

(Note: For forecasting purposes we have assumed the maximum increase in economic interest beginning in 2012, although in practise some of the arrangements come into effect on completion of the acquisition and some not until mid-2012.)

The uplift to EBIT attributable to F&C is reflected in a reduced share of management fee profits being paid out to the various Thames River investment teams, which is reflected in lower staff costs. Based on our forecasts, the effect is to increase the EBIT margin on net revenues from 27% in 2011e to almost 49% in 2013e.

Transaction positives

Strategic positives

The key strategic reasons for the acquisition are:

- ▶ Broader product range and cross-selling opportunities: TRC's high-alpha and absolute return products complement F&C's existing mainly long-only products, which should allow significant cross-selling opportunities.
- ▶ Enhanced distribution: TRC has distribution capabilities in the wholesale and wealth management channels where F&C is largely absent. In 2009, 89% of TRC gross sales were via the third-party wholesale/retail channel compared with only 30% for F&C.
- ▶ Enhanced revenue margins: TRC achieved an average net management fee margin on AUM of 90bp in calendar 2009, compared with F&C's average of around 22bp. TRC earned performance fees equal to an additional 15bp in 2009, compared with F&C's 2bp.

- Extension of F&C's multi-boutique business model: following F&C REIT, TRC is another example of F&C adding semi-autonomous, entrepreneurial businesses to its offering.

Financial positives

- Near term accretive: management has stated that it expects TRC to be earnings enhancing in the first full year following completion (ie calendar 2011) – on an underlying basis, excluding exceptional costs and share-based payment accounting costs.
- Further accretion from commutation arrangements: additional management fee profit participations will be valued at a 25% discount to F&C's own EV/EBITDA multiple, thus ensuring earnings accretion on purchase.
- Option value: perhaps the most significant strategic positives of the transaction is that the commutation arrangements give F&C's management the option to increase the group's economic exposure to TRC. This could prove particularly useful should revenues from one or more of the group's key term contacts be threatened.

Forecast revisions, valuation and rating

Forecast revisions

We have amended our earnings estimates to reflect the TRC transaction and the positive Q1 interim management statement. The net result is a 1% reduction in diluted EPS for 2010e, 2% accretion in 2011e and 1% accretion in 2012e. We continue to assume a maintained dividend as fully diluted cover is rebuilt. Our forecasts assume the achievement of the minimum EBITDA targets required to ensure full contingent consideration, and staff retention and incentivisation plan payments. The potential for F&C to increase the share of TRC management fee profits in 2012 could lead to further revisions and boost our valuation of the company; however, this is currently excluded, given the uncertain nature of the option.

Valuation

Based on these estimates, the shares currently trade on 9.0x and 7.1x 2010e and 2011e diluted underlying earnings, respectively, while the yield is 9.1%. The shares are undervalued, in our view, and we reiterate our OW(V) rating and 100p target price, which implies a 52% potential return.

Forecast revisions

Year to December	2010e			2011e			2012e		
	Old	New	Chg %	Old	New	Chg %	Old	New	Chg %
Income & expenses (GBP)									
Net revenues	232.8	267.8	15%	252.4	310.0	23%	274.8	339.5	24%
Expenses	-164.8	-194.5	18%	-173.3	-215.4	24%	-183.8	-218.2	19%
Operating profit	68.0	73.2	8%	79.1	94.6	20%	90.9	121.3	33%
Other income/expense	-16.6	-17.1	3%	-16.3	-16.8	3%	-14.2	-14.7	4%
Underlying PBT	51.4	56.1	9%	62.8	77.8	24%	76.7	106.6	39%
Per share data (GBP)									
Diluted EPS	7.4	7.3	-1%	9.1	9.3	2%	11.1	11.2	1%
DPS	6.0	6.0	0%	6.0	6.0	0%	6.0	6.0	0%
AUM (GBPbn)									
Opening AUM	97.8	97.8	0%	104.9	109.6	4%	111.8	117.2	5%
Net inflows/acquisitions	0.9	5.3	485%	1.8	2.2	22%	2.2	2.6	18%
Investment returns	6.2	6.5	5%	5.1	5.4	6%	5.5	5.8	5%
Closing AUM	104.9	109.6	4%	111.8	117.2	5%	119.5	125.6	5%

Source: HSBC estimates

Our DCF valuation methodology produces a fair fundamental value estimate of 98p, which we round up to a target price of 100p per share. Our key assumptions are: risk-free rate 4.5%; equity risk premium 7.0%; cost of equity 11.5%; weighted average cost of capital 10.0%.

Under HSBC's research model, the Overweight (V) rating requires the implied return to exceed the hurdle rate of 8%, by at least 10%. Given that our 100p target price implies a potential total return greater than 18%, we maintain our Overweight (V) rating on F&C.

Investment thesis

Newly independent following the de-merger from Friends Provident in July 2009, and with the uncertainty over its future now resolved, F&C has seen a significant increase in investor interest in its products. As a 'multi-boutique', F&C focuses on a relatively small number of product areas in which it has competitive advantage, including UK and European equities, liability-driven investment, emerging market bonds, socially responsible investment and real estate.

Risks

The main risks to our Overweight (V) rating are generic asset management risks – a sustained fall in equity markets and/or sustained underperformance of F&C's funds, which could lead to lower revenues and increased fund outflows. In addition, since F&C's management has expressed a willingness to consider acquisitions, there is also the potential for transaction execution risk.

Risks specific to the TRC acquisition include:

- ▶ The terms of the transaction are complex, including initial and conditional payments to the sellers, retention and incentive plans for non-investment management staff, and commutation arrangements to incentivise the investment teams.
- ▶ The final consideration and share issuance related to the deal are unknown – although the totals are capped – which makes an assessment of the valuation being put on TRC earnings difficult.
- ▶ Nevsky Capital products accounted for two-thirds of the TRC gross sales in 2009 and around 50% of sales in Q1 2010. Since TRC's minority interest in Nevsky is being demerged from TRC prior to the F&C transaction, this could demotivate the TRC sales staff that were more reliant on Nevsky products.

Acquisition of Thames River Capital

- ▶ Acquisition of a UK-based specialist asset manager focused on specialist and absolute return products
- ▶ GBP4.2bn in AUM, Q1 2010 net inflows of GBP204m, 9 investment teams and 135 personnel
- ▶ Complementary product range brings higher revenue margin and cross-selling opportunities

Acquisition of Thames River Capital

On 28 April, F&C announced the proposed acquisition of Thames River Capital (TRC) for an initial GBP33.6m in cash and up to an additional GBP20m in FCAM shares or loan notes based on performance targets up to June 2012.

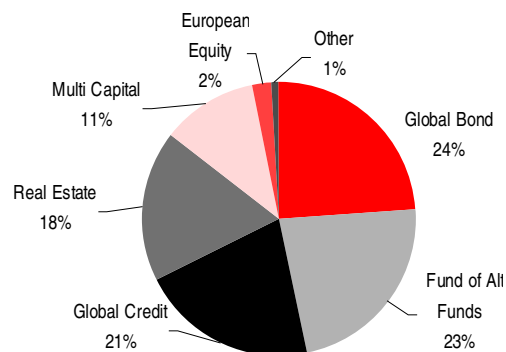
Thames River Capital

Founded in 1998, TRC is a London-based specialist asset manager focused on specialist and absolute return products and employing some 135 personnel. TRC has offices in London, Luxembourg and Cape Town.

Assets under management

As at 31 March 2010, TRC AUM were GBP4.2bn, spread across 9 investment teams, split 24% AUM in Global Bonds, 23% Funds of Alternative Funds, 21% Global Credit, 18% Real Estate, 11% Multi-Manager, 2% European Long-Only, 1% Long/Short, and c1% in 2 other teams (Aqua and Quantum). 11 funds managed by TRC are rated from A to AAA by S&P.

Thames River Capital – end-March 2010 AUM by investment team



Source: Company

The client base is largely UK and European, but extends to Asia and the Middle East. The group's focus is on the wholesale and wealth management segments of the market, with AUM primarily in pooled investment funds (98% AUM). As at 31 March 2010, 89% funds by AUM had management and performance fee structures. Of these funds, 31% exceeded their high water marks and were earning performance fees as at 31 March.

Gross fund flows have been strong, although the company saw net outflows in 2009 following difficult markets in 2008. Q1 net inflows were GBP204m.

Thames River Capital – Net new business (GBPm)

Year to December	2007	2008	2009	Q1 2010
Inflows	1,722	1,784	1,193	503
Outflows	-1,431	-1,559	-1,600	-300
Net inflows	291	225	-407	204

Source: Company

Income & expenses

In year to March 2009, TRC revenues were GBP53.1m and profits GBP6.3m. Expenses comprised GBP23m in payments to Members (fund manager management and performance fee profit shares) and GBP25m in other operating expenses. FCAM management has indicated that other operating expenses have since been reduced by around 25%.

Corporate structure

TRC is the holding company for Thames River Capital UK (TRC UK), which is the corporate member of two limited liability partnerships – Thames River Capital LLP and Thames River Multi-Capital LLP. Between them, the LLPs have 9 investment teams operating under a centralised administrative and operational platform. TRC also has a central management team, led by Charlie Porter, the CEO of TRC UK and the LLPs.

Other members of the LLPs are the managers of the funds managed by the investment teams or members of TRC's central management team. Since the governing deeds of the LLPs reserve significant rights over key business decisions to these other members, TRC UK's control of the LLPs is limited by these rights. Based on the 11 months to end-February 2010, TRC UK had an approximate 40% aggregate economic interest in management and performance fee profits of the

investment teams, although the economic interests differ by investment team.

Transaction details

On 28 April, F&C announced the proposed acquisition of Thames River Capital (TRC) for an initial GBP33.6m in cash and up to an additional GBP20m in FCAM shares or loan notes based on performance targets up to June 2012. The acquisition does not include TRC's minority interest in Nevsky Capital, which will remain with the current owners of TRC. Consideration payable at completion will be subject to adjustment based on the net asset value of Thames River at completion (the announced initial consideration assumes an NAV on completion of GBP9m, we believe). We expect the transaction will close at around end-June 2010.

Initial consideration

The initial consideration is to be funded through a combination of: (i) last week's cash placing of 24,807,145 FCAM shares (approximately 5% of the group's issued share capital) at 59p per share, raising gross proceeds of GBP14.6m; (ii) existing cash resources; and (iii) a GBP15m bridge facility with HSBC Bank repayable on 31 December 2010 (FCAM is considering refinancing this facility by a further issue of its existing bonds due 2016). HSBC is also providing a GBP20m revolving credit facility for general working capital purposes.

Conditional consideration

The Conditional Consideration Payment of up to GBP20m is payable in two instalments, shortly after 31 December 2011 and 30 June 2012 and contingent on the achievement of the following financial targets:

- ▶ The first instalment depends on run-rate EBITDA at 31 December 2011, and becomes payable if run-rate EBITDA exceeds GBP12.5m and increases at a linear basis from zero to a maximum of GBP10m if the run-rate exceeds GBP15m.

- ▶ The second instalment depends on run-rate EBITDA at 30 June 2012, and becomes payable if run-rate EBITDA exceeds GBP15m and increases at a linear basis from zero to a maximum of a further GBP10m if this exceeds GBP17m.

Retention and incentives schemes

In addition to the initial and conditional consideration payable to existing Thames River shareholders, the terms of the acquisition also include retention and incentive schemes for key staff members:

- ▶ Under the Management Retention Plan, awards over a total of 12.7m new F&C shares, valued at approximately GBP15m, will be granted to key individuals. These awards will vest 3 years after completion of the acquisition.
- ▶ Under the Management Incentive Plan, awards over a total of 29.0m new F&C shares, valued at approximately GBP20m will be granted.
- ▶ 25% of these shares (7.2m shares, valued at cGBP5m) will vest on the achievement of the same financial targets as with the Conditional Consideration Payment: half of these shares will vest 30m following completion, provided end-December 2011 run-rate EBITDA lies between GBP12.5 and GBP15m; and half 36m following completion, provided end-June 2012 run-rate EBITDA lies between GBP15m and GBP17m.
- ▶ The remaining 75% of Management Incentive Plan shares (21.8m shares, valued at ~GBP15m) will vest in two equal instalments on the 5th and 6th anniversaries of completion provided that cumulative EBITDA in the 4 years to end-March 2014 amounts to GBP100m or more (no shares vest for EBITDA less than GBP60m, with the proportion vesting increasing linearly for EBITDA between GBP60-100m). In addition, participants in the incentive plan will receive a cash payment up to GBP3m payable at the time these shares are delivered and in proportion to the percentage of shares vesting.

Commutation arrangements

Under these arrangements, TRC UK's participation in the management fee profits of the 9 investment teams can increase by up to an additional 20%, typically from c50% to 70%. TRC UK's participation in the performance fee profits of the teams remains unchanged. The general features of these arrangements can be summarised as follows:

- ▶ 18 months post-completion investment teams have the option to sell an additional 10% of their management fee share to FCAM; these options are exercisable only if the teams have seen positive net inflows over the preceding 12 months (although this can be waived at FCAM's option).
- ▶ 36 months post-completion, FCAM has the option to buy an additional 10% (or the full 20% if the investment teams did not previously exercise their put option).
- ▶ Consideration for additional economic interests acquired will primarily be in F&C shares, although in cash in certain circumstances. The price paid will be calculated in relation to the profits acquired, at a 25% discount to FCAM's 12-month EV/EBITDA multiple, to ensure that additional purchases are earnings accretive.

- ▶ The arrangements are different for the two largest investment teams, however. TRC will acquire an additional 10% of the management fee profit entitlement of the Global Bond team on completion of the acquisition, with consideration payable in F&C shares and cash. TRC will acquire a further 10% of the management fee profit entitlement of one of the funds of the Alternative Funds team, with consideration payable in F&C shares.
- ▶ These accelerated commutation arrangements relate to profits generated by approximately 30% of TRC's AUM at end-March 2010.
- ▶ In aggregate, these arrangements will involve the issue of up to an additional 122,511,485 new F&C shares, and a maximum consideration payable of GBP81.4m.

Q1 2010 IMS

- ▶ F&C reported group-wide net inflows during Q1 2010, the first quarter of net inflows since 2007
- ▶ These included net inflows in institutional funds (GBP233m), sub-advisory (GBP46m), OEICs (GBP106m) and SICAVs (GBP169m)
- ▶ Net outflows from Insurance (GBP147m) and Investment Trusts (GBP280m, including loss of GBP285m F&C Eurotrust mandate)

Q1 2010 IMS

Continued recovery in fund flows

F&C's Q1 IMS confirmed the continued recovery of the core business following the demerger from Friends Provident in mid-2009 and on the back of a strong investment performance last year: end-March 2010 AUM was GBP101.5bn, up 4% on the GBP97.8bn reported for end-December 2009.

Net inflows in Q1 were GBP117m and included the first net inflow into the group's institutional segment since 2007. The business as a whole was reported to be trading in line with management's expectations.

Q1 2010 fund flows

(GBPm)	Inflows	Outflows	Net flows
Insurance Funds	0	-147	-147
Institutional Funds	862	-639	223
Sub-Advisory	138	-92	46
Investment Trusts	18	-298	-280
OEICs (UK Mutual Funds)	204	-98	106
SICAVs (Mutual Funds)	256	-87	169
	1,478	-1,361	117

Source: Company

- ▶ 2010 began with an improved outlook for fund flows on a strong investment performance in 2009 and an improved position with investment consultants.
- ▶ Institutional gross inflows of GBP862m reflected the partial funding of the GBP1.6bn pipeline reported at end-2009 and further mandates won during the quarter.
- ▶ Gross inflows of GBP460m were seen in third-party mutual funds (OEICs and SICAVs) during the quarter.
- ▶ Net inflows totalled GBP117m and were positive across institutional funds, OEICs, SICAVs and sub-advisory clients.

AUM by client / product category

(GBPbn)	Dec-09	Mar-10	Chg GBPbn	Chg %
Insurance Funds	57.2	59.1	1.9	3%
Institutional Funds	27.7	28.9	1.2	4%
Sub-Advisory	4.0	4.2	0.2	5%
Investment Trusts	5.1	5.1	0.0	0%
OEICs (UK Mutual Funds)	2.5	2.7	0.2	8%
SICAVs (Mutual Funds)	1.3	1.5	0.2	15%
	97.8	101.5	3.7	4%

Source: Company

- ▶ Key products attracting new business were emerging market debt, global convertibles and equity-linked bond funds.
- ▶ Insurance funds and investment trusts experienced net outflows, although insurance outflows of GBP147m were at their lowest level for 5 years. Investment trust net outflows of GBP280m reflected the loss of GBP285m because of the previously announced loss of the Foreign & Colonial Eurotrust mandate.

AUM by asset class

(GBPbn)	Dec-09	Mar-10	Chg GBPbn	Chg %
Fixed Interest	58.3	61.5	3.2	5%
Equities	24.8	25.6	0.8	3%
Property	8.0	8.1	0.1	1%
Other Alternative Inv	1.6	1.8	0.2	13%
Money Market	5.1	4.5	-0.6	-12%
	97.8	101.5	3.7	4%

Source: Company

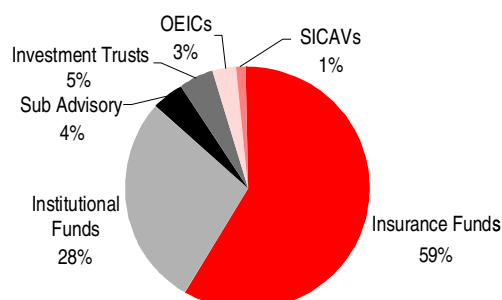
F&C Commercial Property Trust

On 23 April, F&C Commercial Property Investment Trust (FCPT) announced it had received a proposal that would result in the merger of FCPT with UK Commercial Property Trust, and Ignis Asset Management assuming investment management responsibilities for the combined entity.

In its Q1 IMS, F&C notes that the board of FCPT has not yet issued any recommendation to its shareholders in relation to these proposals, and hence that the loss of the FCPT management contract is not a foregone conclusion.

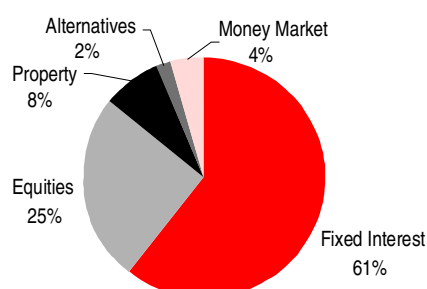
The IMS did report that, in 2009, F&C's share of fees earned from FCPT amounted to approximately GBP5.3m, including performance fees of around GBP2.5m. We therefore estimate the potential loss of annual management fee revenues from this contract to be within the range GBP2.5-3.0m.

F&C: End-March 2010 AUM by client / product category



Source: Company

F&C: End-March 2010 AUM by asset class



Source: Company

Financial forecasts

- ▶ Thames River transaction earnings accretive on a fully diluted basis from 2011
- ▶ Significant step-up in profits forecast in 2012 given increased economic interests in Thames River investment teams
- ▶ Forecasts assume minimum EBITDA contributions from Thames River to trigger maximum conditional consideration, retention and incentive plan payments

TRC accretive from 2011

The following tables set out our earnings forecasts for F&C's existing businesses, for TRC and for the combined entity for the years 2010-13. These tables show the acquisition of TRC to be earnings accretion on a fully diluted basis from 2011.

Key assumptions underpinning our forecasts are:

- ▶ No significant changes to our forecasts for the existing F&C businesses.
- ▶ Thames River AUM rises to GBP4.7bn by end-2010, reflecting continued net fund inflows at a run-rate broadly equal to those seen in Q1 2010.
- ▶ TRC annual management fee margin of 90bp and performance fees equal to an additional 25bp of average AUM, for all forecast years.
- ▶ Operating profit margin of 22% in 2010, which reflects 50% economic interest in investment team management and performance fee profits paid in investment management staff compensation.
- ▶ TRC AUM increases by 15% in 2011, average AUM by 16%. Operating profit margin rises to 27%, reflecting relatively fixed other operating expenses element to TRC cost base.
- ▶ TRC AUM grows by 13% and 11% in 2012 and 2013, respectively, average AUM by 14% and 12%. Step-up in operating profit margin to 46% in 2012 and 48% in 2013 following increase in economic interest in management fee profit from investment teams of another 20% (reflected in forecasts through a reduced investment management staff profit share).
- ▶ Diluted shares in issue 605.2m in 2011, reflecting assumed maximum payout of conditional consideration and staff retention/incentivisation plans, priced at 65p per F&C share where applicable.
- ▶ Diluted shares in issue 684.8m in 2012 and 2013, reflecting additional issue of 79.6m shares for additional profit shares.

Full details are set out in the tables below.

F&C Asset Management: Pro forma forecast summary

Year to December (GBPm)	2010e*	2011e	2012e	2013e
EXISTING BUSINESS				
Net revenues	232.8	252.4	274.8	299.7
-Staff costs	-121.8	-130.3	-140.4	-151.1
-Other operating expenses	-43.0	-43.0	-43.4	-43.8
Operating expenses	-164.8	-173.3	-183.8	-194.9
EBIT	68.0	79.1	91.0	104.8
Net finance income	-16.6	-16.3	-14.2	-13.5
Underlying profit	51.4	62.8	76.8	91.3
Tax	-14.6	-17.9	-21.9	-26.0
Net profit	36.8	44.9	55.2	65.3
Diluted shares in issue	498.9	498.9	498.9	498.9
Diluted EPS	7.4	9.1	11.1	13.2
Opening AUM	97.8	104.9	111.8	119.5
Flows	0.9	1.8	2.2	2.5
Returns	6.2	5.1	5.5	5.9
Closing AUM	104.9	111.8	119.5	128.0
Avg AUM	101.4	108.4	115.7	123.7
Net revs/avg AUM	0.23%	0.23%	0.24%	0.24%
Op profit margin	29%	31%	33%	35%
THAMES RIVER CAPITAL				
Management fees	39.2	45.5	51.8	58.1
Performance fees	10.9	12.6	14.4	16.1
Net revenues	50.0	58.1	66.1	74.2
-Staff costs	-20.0	-23.2	-16.1	-18.1
-Other operating expenses	-19.0	-19.4	-19.8	-20.2
Operating expenses	-39.0	-42.6	-35.9	-38.2
EBIT	11.0	15.5	30.3	36.0
Net finance income	-0.5	-0.5	-0.5	-0.5
Underlying profit	10.5	15.0	29.8	35.5
Tax	-3.0	-4.3	-8.5	-10.1
Net profit	7.5	10.7	21.3	25.3
-Basic diluted shares	106.3	106.3	106.3	106.3
-Diluted shares on commutation	0.0	0.0	79.6	79.6
Diluted shares in issue	106.3	106.3	185.9	185.9
Diluted EPS	7.1	10.1	11.4	13.6
Opening AUM	4.0	4.7	5.4	6.1
Flows	0.4	0.4	0.4	0.4
Returns	0.3	0.3	0.3	0.3
Closing AUM	4.7	5.4	6.1	6.8
Avg AUM	4.4	5.1	5.8	6.5
Mgmt fees/avg AUM	0.90%	0.90%	0.90%	0.90%
Performance fees/ avg AUM	0.25%	0.25%	0.25%	0.25%
Op profit margin	22%	27%	46%	48%
COMBINED PRO FORMA				
Net revenues	282.8	310.5	340.9	373.9
-Staff costs	-141.8	-153.5	-156.5	-169.2
-Other operating expenses	-62.0	-62.4	-63.2	-64.0
Operating expenses	-203.8	-215.9	-219.7	-233.1
EBIT	79.0	94.6	121.3	140.8
Net finance income	-17.1	-16.8	-14.7	-14.0
Underlying profit	61.9	77.8	106.6	126.8
Tax	-17.6	-22.2	-30.4	-36.1
Net profit	44.3	55.6	76.5	90.6
Diluted shares in issue	605.2	605.2	684.8	684.8
Diluted EPS	7.3	9.3	11.2	13.3
Opening AUM	101.8	109.6	117.2	125.6
Flows	1.3	2.2	2.6	2.9
Returns	6.5	5.4	5.8	6.2
Closing AUM	109.6	117.2	125.6	134.8
Avg AUM	105.8	113.5	121.5	130.2
Net revs/avg AUM	0.27%	0.27%	0.28%	0.29%
Op profit margin	28%	30%	36%	38%

Source: HSBC estimates. *Pro forma – assumes Thames River Capital ownership for the full year in 2010.

F&C Asset Management: Forecast summary

Year to December (GBPm)	2007	2008	2009	2010e	2011e	2012e	2013e
Income & Expenses							
Management fees	246.4	236.3	219.1	249.3	298.4	327.7	359.2
Performance fees	20.8	7.9	18.7	35.7	32.7	35.1	38.2
Fee income	267.2	244.2	237.8	285.1	331.1	362.9	397.4
Other operating income	10.6	1.1	4.1	0.8	0.8	0.8	0.8
Total revenues	277.8	245.3	241.9	285.9	331.9	363.7	398.2
Fee & commission expenses	-13.3	-15.4	-16.8	-19.1	-22.9	-25.1	-27.5
Net revenues	264.5	229.9	225.1	266.8	309.0	338.5	370.7
Net policyholder income	1.1	1.8	1.4	1.0	1.0	1.0	1.0
Total income	265.6	231.7	226.5	267.8	310.0	339.5	371.7
Operating expenses	-183.8	-172.3	-166.6	-194.5	-215.4	-218.2	-230.8
Core operating profit	81.8	59.4	59.9	73.2	94.6	121.3	140.8
Net finance income	-3.5	-3.7	-18.8	-17.1	-16.8	-14.7	-14.0
Associates	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Core PBT	78.9	55.7	41.1	56.1	77.8	106.6	126.8
Reinvestment plan costs	-6.4	-10.6	0.0	0.0	0.0	0.0	0.0
Pre-exceptional/impairment PBT	72.5	45.1	41.1	56.1	77.8	106.6	126.8
Exceptionals	-4.2	-15.2	17.4	0.0	0.0	0.0	0.0
Pre-impairment PBT	68.3	29.9	58.5	56.1	77.8	106.6	126.8
Contract amortisation/impairment	-42.4	-97.2	-49.8	-50.0	-50.0	-50.0	-50.0
Profit before tax	25.9	-67.3	8.7	6.1	27.8	56.6	76.8
Tax	-7.2	16.7	10.0	-2.2	-8.3	-16.4	-22.0
Minorities	-1.6	-1.9	-2.8	0.0	0.0	0.0	0.0
Net profit after tax	17.1	-52.5	15.9	3.9	19.5	40.3	54.8
Dividends	-43.5	-29.6	-29.5	-30.1	-29.7	-30.1	-31.0
Retained earnings	-26.4	-82.1	-13.6	-26.2	-10.2	10.2	23.8
AUM Flows							
Opening AUM	104.1	103.6	98.6	97.8	109.6	117.2	125.6
Flows	-9.0	-7.4	-6.0	5.3	2.2	2.6	2.9
Returns	8.5	2.4	5.2	6.5	5.4	5.8	6.2
Closing AUM	103.6	98.6	97.8	109.6	117.2	125.6	134.8
Average AUM	103.9	101.1	98.2	103.7	113.4	121.4	130.2
Flows/opening AUM	-9%	-7%	-6%	5%	2%	2%	2%
Returns/opening AUM	8%	2%	5%	7%	5%	5%	5%
AUM Balances							
Insurance funds	58.9	57.0	57.2	58.7	60.2	62.2	64.7
Institutional clients	27.3	28.6	27.7	31.0	34.4	37.9	41.3
Retail	17.4	13.0	12.9	15.2	17.2	19.4	22.0
Thames River	0.0	0.0	0.0	4.7	5.4	6.1	6.8
Total	103.6	98.6	97.8	104.9	111.8	119.5	128.0
Ratios							
Management fees/avg AUM	0.24%	0.23%	0.22%	0.24%	0.26%	0.27%	0.28%
Performance fees/avg AUM	0.02%	0.01%	0.02%	0.03%	0.03%	0.03%	0.03%
Net revenues/avg AUM	0.25%	0.23%	0.23%	0.26%	0.27%	0.28%	0.28%
Expenses/avg AUM	-0.18%	-0.17%	-0.17%	-0.19%	-0.19%	-0.18%	-0.18%
Group operating profit/avg AUM	0.08%	0.06%	0.06%	0.07%	0.08%	0.10%	0.11%
Operating profit margin	31%	26%	26%	27%	31%	36%	38%
Per share data							
Adjusted EPS	10.4	7.6	5.8	8.0	10.9	14.9	17.7
Adjusted diluted EPS	10.0	7.5	5.7	7.3	9.3	11.2	13.3
DPS	6.0	6.0	6.0	6.0	6.0	6.0	6.0
NAV/share	142.7	124.0	116.0	105.3	103.4	105.3	110.0

Source: Company data, HSBC estimates

F&C Asset Management: AUM and fund flow forecasts

Year to December (GBPm)	2007	2008	2009	2010e	2011e	2012e	2013e
Insurance funds							
Opening AUM	59.0	58.9	57.0	57.2	58.7	60.2	62.2
Flows	-5.0	-4.4	-2.2	-1.4	-0.8	-0.4	0.0
Returns	4.9	2.5	2.4	2.9	2.3	2.4	2.5
Closing AUM	58.9	57.0	57.2	58.7	60.2	62.2	64.7
Average AUM	59.0	58.0	57.1	57.9	59.4	61.2	63.5
Flows/opening AUM	-9%	-8%	-4%	-2%	-1%	-1%	0%
Returns/opening AUM	8%	4%	4%	5%	4%	4%	4%
Institutional clients							
Opening AUM	28.1	27.3	28.6	27.7	31.0	34.4	37.9
Flows	-2.9	-5.2	-2.3	1.7	1.9	1.7	1.5
Returns	2.1	6.5	1.4	1.7	1.6	1.7	1.9
Closing AUM	27.3	28.6	27.7	31.0	34.4	37.9	41.3
Average AUM	27.7	28.0	28.2	29.4	32.7	36.2	39.6
Flows/opening AUM	-10%	-19%	-8%	6%	6%	5%	4%
Returns/opening AUM	7%	24%	5%	6%	5%	5%	5%
Retail							
Opening AUM	17.0	17.4	13.0	12.9	15.2	17.2	19.4
Flows	-1.1	2.2	-1.4	0.6	0.8	0.9	1.0
Returns	1.5	-6.6	1.3	1.7	1.2	1.4	1.6
Closing AUM	17.4	13.0	12.9	15.2	17.2	19.4	22.0
Average AUM	17.2	15.2	13.0	14.1	16.2	18.3	20.7
Flows/opening AUM	-7%	13%	-11%	5%	5%	5%	5%
Returns/opening AUM	9%	-38%	10%	13%	8%	8%	8%
Thames River							
Opening AUM				4.0	4.7	5.4	6.1
Flows				0.4	0.4	0.4	0.4
Returns				0.3	0.3	0.3	0.3
Closing AUM				4.7	5.4	6.1	6.8
Average AUM				2.2	5.1	5.8	6.5
Flows/opening AUM				10%	9%	7%	7%
Returns/opening AUM				8%	6%	6%	5%
TOTAL							
Opening AUM	104.1	103.6	98.6	97.8	109.6	117.2	125.6
Flows	-9.0	-7.4	-6.0	5.3	2.2	2.6	2.9
Returns	8.5	2.4	5.2	6.5	5.4	5.8	6.2
Closing AUM	103.6	98.6	97.8	109.6	117.2	125.6	134.8
Average AUM	103.9	101.1	98.2	103.7	113.4	121.4	130.2
Flows/opening AUM	-9%	-7%	-6%	5%	2%	2%	2%
Returns/opening AUM	8%	2%	5%	7%	5%	5%	5%

Source: Company data, HSBC estimates

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Tony Cummings.

Important disclosures

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HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

Rating distribution for long-term investment opportunities

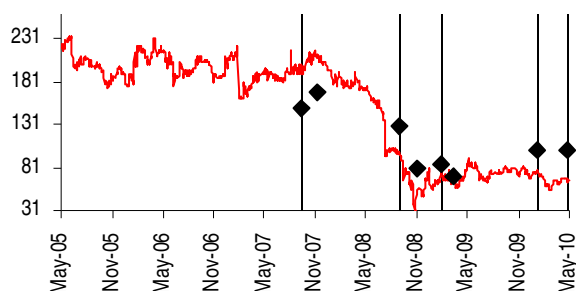
As of 04 May 2010, the distribution of all ratings published is as follows:

Overweight (Buy)	48%	(12% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(11% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(10% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

F&C Asset Management (FCAM.L) Share Price performance GBP Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Underweight	12 September 2007
Underweight	Overweight (V)	01 September 2008
Overweight (V)	Neutral (V)	29 January 2009
Neutral (V)	Overweight (V)	13 January 2010
Overweight (V)	Restricted	28 April 2010
Restricted	Overweight (V)	30 April 2010
Target Price	Value	Date
Price 1	150	12 September 2007
Price 2	170	13 November 2007
Price 3	130	01 September 2008
Price 4	80	06 November 2008
Price 5	85	29 January 2009
Price 6	70	12 March 2009
Price 7	100	13 January 2010
Price 8	Restricted	28 April 2010
Price 9	100	30 April 2010

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
F&C Asset Management	FCAM.L	66	04-May-2010	1, 5

Source: HSBC

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 31 March 2010 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
- 5 As of 31 March 2010, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
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- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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Additional disclosures

- 1 This report is dated as at 05 May 2010.
- 2 All market data included in this report are dated as at close 04 May 2010, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

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