

8 March 2005

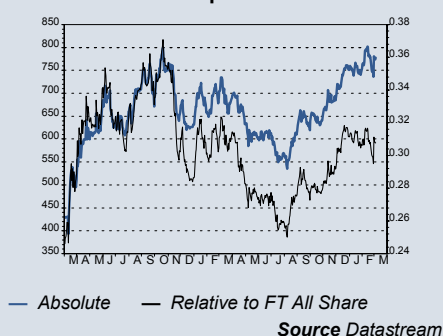
UK Equity Research

INITIATION OF COVERAGE

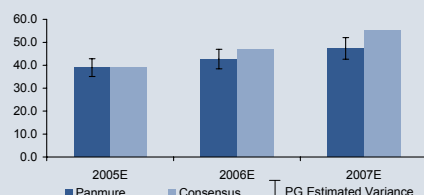
Key Data

Price	782.0p
Price Target	700.0p
Market Cap	£2,267m
FT All Share	2,527
Sector	Financials
Stock codes	SDR.L / SDR.LN
Next Event	Q1 results – 17 May
Gearing	Cash

Absolute & relative performance



Panmure forecasts EPS rel to consensus



Source Reuters, Lazard

SCHRODERS

SELL

Still an investment bank?

Schroders' segmental reporting underemphasizes the significance of its investment activities in relation to its capital, returns on capital and hence value.

- **More than fund management.** Reallocating central costs and balance sheet driven investment profits, asset management activities contributed only half of the group's pre-exceptional profits in 2004 (as compared with the 80% implied by the company's segmental analysis).
- **Valuation discounting rapid earnings growth.** Including investment activities, we forecast a return on group capital of 9.5% this year, rising to only 10.5% by 2007. At 2x book value, the current valuation discounts sustainable earnings growth of approaching 17% per annum, well ahead of our forecasts and consensus estimates.
- **Costs are rising.** Moreover, although the asset management activities are now positioned for good longer-term growth, rising costs and the potential for reduced performance fees and investment gains could hinder near-term earnings growth.
- **Sell recommendation.** Based on our valuation of asset management and investment activities separately, we derive a fair value for the group's voting shares of around 700p. We therefore initiate coverage with a Sell recommendation and a 700p target. For asset management exposure, we see better value in AMVESCAP.

Year end December	Net revenues (£m)	PBTA (£m)	EPS (p)	P/E (x)	EV/NOPAT (%)	Yield (%)
2004A	515.8	150.5	39.6	19.7	24.5	2.6
2005E	552.6	154.0	38.9	20.1	21.2	2.7
2006E	592.2	168.9	42.7	18.3	18.3	2.8
2007E	637.7	187.3	47.4	16.5	15.7	2.9

Source Company Data, Lazard

Research Analysts

Tony Cummings

+44 (0)20 7187 2403

tony.cummings@lazard.com

INVESTMENT CASE

Schroders is more of an investment company than its divisional analysis would have us believe. According to our analysis, investment activities accounted for half of the group's pre-exceptional profits in 2004 (63% including exceptional investment gains).

Not just a fund manager. Investments in third party hedge funds, in-house products and mainly Permira private equity funds and partnerships are now a significant part of the group's activities. Investments in these products, even after last year's distribution from Internet Finance Partners, amounted to £360m, a third of the group's end-2004 net assets.

Implications for valuation. We forecast a group-wide ROE of 9.5% this year, rising to 10.5% in 2007E. Since the shares currently trade on more than 2x end-2004 book value, a 9% cost of capital implies the shares are discounting book value growth of around 8.5% into perpetuity which, given our dividend payout assumption, implies annual earnings growth of around 17%. Such expectations seem to be factored into the group's earnings multiples. Based on our estimates, the voting shares trade on more than 20x 2005E earnings. Management needs to redeploy low-yielding surplus capital quickly in order to justify this rating, in our view.

Near-term headwinds. Although the longer-term outlook for asset management is positive, due to recovering investment performance, strong retail sales and rising revenue margins, the near-term outlook is unclear. Rising costs and the potential for reduced performance fees and investment gains could hinder near-term earnings growth. (Our forecasts are 9% below consensus for 2006 and 14% below for 2007.)

No longer a cost-cutting story. Last year, asset management staff costs grew by 18% (headcount increased by 6%), reflecting higher variable remuneration. Higher staff costs were partly offset by other administrative expenses being down 13% and a halving of the division's depreciation charge. Since some of the reduction in non-staff costs last year reflected the benefits of efficiency gains unlikely to be repeated this year, the outlook is for only moderate improvements in the asset management operating margin.

Initiating coverage with a Sell recommendation. Taking into account the group's aggregate price:book and earnings multiple ratings, and our fair value estimates for the asset management and investment activities considered separately, we target 700p for the voting shares over the next 12 months. We therefore initiate coverage with a Sell recommendation. For asset management exposure, we see better value in AMVESCAP.

CATALYSTS

- Schroders will release a Q1 trading update on 17 May and interim results on 16 August.
- The company will re-release its 2004 financial results under IFRS during Q2, possibly at around the time of the AGM on 19 April.
- The shares will be marked ex the 14p final dividend on 23 March.

RISKS

The principal risks to our cautious stance on Schroders include generic risks – better than forecast market returns and/or investment performance, and greater than estimated net fund inflows. Specific risks include the potential for earnings enhancing acquisitions and lower than forecast cost growth.

Markets and investment performance. We have assumed an 8% investment return – essentially equity and bond market returns plus any Schroders specific outperformance. Materially higher returns would result in higher than forecast assets under management and revenues, assuming unchanged margins.

Performance fees. The revenue margin assumption driving our 2005 asset management revenue estimate incorporates a lower performance fee contribution than last year. Stronger than expected investment performance could result in higher performance fees, and hence higher than forecast revenues.

Institutional mandates. Our forecasts and investment stance assume continued net outflows reflecting net institutional redemptions in excess of net retail/private banking inflows.

Revenue margins. Better than we have forecast outcomes for performance fees and retail institutional mix would result in materially higher revenues being earned on forecast assets under management (AUM).

Costs. Our forecasts assume continued asset management cost growth this year, which has the effect of depressing earnings growth. Better than forecast cost performance could lead to substantially higher earnings than forecast.

Deployment of surplus capital. With liquid funds of ~£350m as at end December, and with "surplus capital" stated at £759m, Schroders is well placed to make earnings enhancing acquisitions.

OUR CENTRAL CASE

Schroders' segmental reporting over-emphasises the relative importance of its asset management business, understating the significance of investment activities. Although asset management is positioned to deliver good long-term growth, rising costs, lower performance fees and reduced non-operating income could dampen near-term profit growth.

NOT JUST A FUND MANAGER

Asset management & investments

The company's segmental reporting focuses attention on its asset management activities, and under-emphasises the significance of its investment activities:

- In reporting a "Group net income/(costs)" business line, Schroders nets sizeable group interest and investment income against equally sizeable central costs. We argue that central costs should be charged to asset management.
- Reported profits for asset management includes significant net interest income and gains or losses on current asset investments. Last year, these two items accounted for almost 14% of the division's PBT before central costs. After central costs, these investment items accounted for 18% of asset management profits.

In the tables below we show the company's three-segment analysis of last year's profit and loss account, and our representation of these figures in two divisions.

2004 profits and NAV by division – company presentation (£m)

Year to December 2004	Asset Management	Private Equity	Group	Total
Net revenues	491.0	23.3	1.5	515.8
Administrative expenses	-383.0	-3.0	-29.2	-415.2
Depreciation	-4.1	0.0	-0.5	-4.6
Operating profit	103.9	20.3	-28.2	96.0
Interest/investment income	7.6	1.3	18.7	27.6
Associates	0.2	5.8	0.0	6.0
Core PBT	111.7	27.4	-9.5	129.6
Investment disposal gains	0.0	0.0	0.0	0.0
Other non-operating income/expenses	9.1	8.4	3.4	20.9
Pre-exceptional PBT	120.8	35.8	-6.1	150.5
Discontinued ops	0.0	0.0	0.0	0.0
Exceptional items	2.6	47.8	0.0	50.4
Goodwill amortisation	-9.9	0.0	0.0	-9.9
Profit before tax	113.5	83.6	-6.1	191.0
Shareholders funds	496.8	175.8	441.5	1114.1

Source Company, Lazard

The company's three segment divisional analysis focuses attention on asset management and understates the size of investment activities

Reallocating central costs and balance sheet driven investment profits, we offer an alternative divisional presentation

In representing these figures, we make the following reallocations:

- We charge £29.7m of "group costs" to the asset management division (which seems reasonable since the group's non-asset management activities are essentially outsourced to Permira or third party hedge funds).
- We aggregate "group" investment activities – liquid funds, third party hedge funds and investment in in-house funds – with the private equity segment to form a single "investment activities" unit.

2004 profits and NAV by division – alternative presentation (£m)

Year to December 2004	Asset Management	Investment Activities	Total
Net revenues	491.0	24.8	515.8
Divisional expenses	-387.1	-3.0	-390.1
Group costs	-29.7		-29.7
Operating profit	74.2	21.8	96.0
Interest/investment income	7.6	20.0	27.6
Associates	0.2	5.8	6.0
Core PBT	82.0	47.6	129.6
Investment disposal gains	0.0	0.0	0.0
Other non-operating income/expenses	9.1	11.8	20.9
Pre-exceptional PBT	91.1	59.4	150.5
Shareholders funds	496.8	617.3	1114.1

Source Company, Lazard

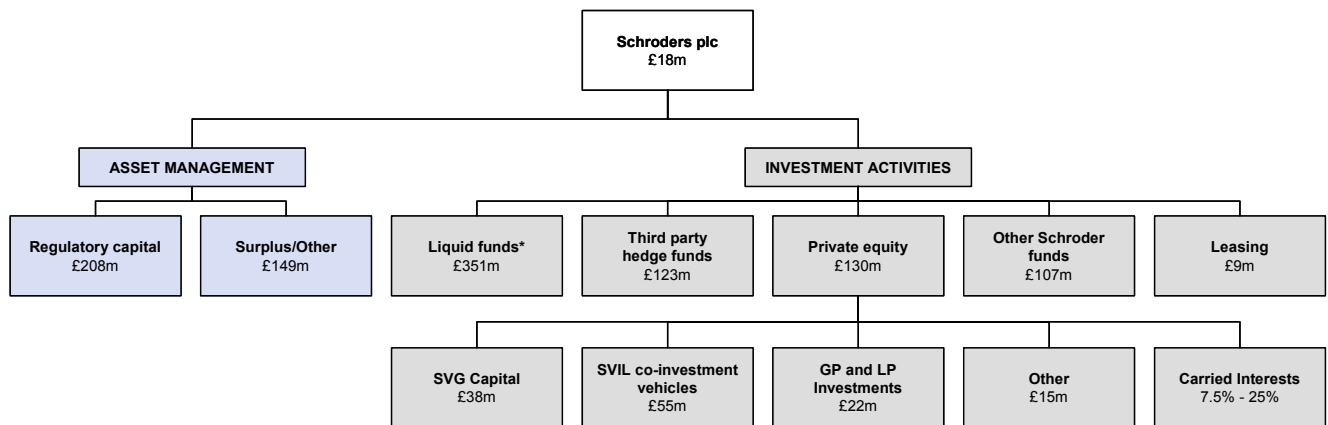
Are investments in Schroders' in-house products really "surplus capital" or are they generating sizeable investment gains for the asset management division?

Note: In its capital allocation presentation (see below), Schroders' includes investments in its own products as "surplus" rather than as asset management capital. In the segmental breakdown, this capital is allocated to asset management, since gains on these current assets investments are attributed to the asset management division. We could argue that these gains should be recognised in our Investment Activities segment rather than in our Asset Management presentation; this would be more consistent with the company's own analysis of capital allocation.

Capital allocation

The chart and table below set out Schroders' capital allocation at end 2004, and how that allocation changed during 2004.

End 2004 capital allocation



* Includes IFP £35m but excludes £39m 2004 final dividend

Source Company, Lazard

The group's liquidity has been increasingly invested in non-cash in-house and third party investments

The main changes during last year were a £108m increase in investments in third party hedge funds, Schroder funds and private equity (after the realisation of £34m from Internet Finance Partners), a decrease in liquid funds of £69m, and the ongoing withdrawal from big ticket leasing.

Capital allocation & liquidity

As at end December	2003A	2004A	Ch (£m)	Ch (%)
Liquid funds	420	351	-69	-16
Third party hedge funds	15	123	108	720
Schroder funds	58	107	49	84
Private equity	119	130	11	9
Leasing	32	9	-23	-72
Total investment activities	644	720	76	12
Asset management regulatory capital	212	208	-4	-2
Asset management surplus capital	130	149	19	15
Total asset management	342	357	15	4
Central capital	18	11	-7	-39
	1004	1088	84	8
Goodwill	25	15	-10	-40
Group	1029	1103	74	7

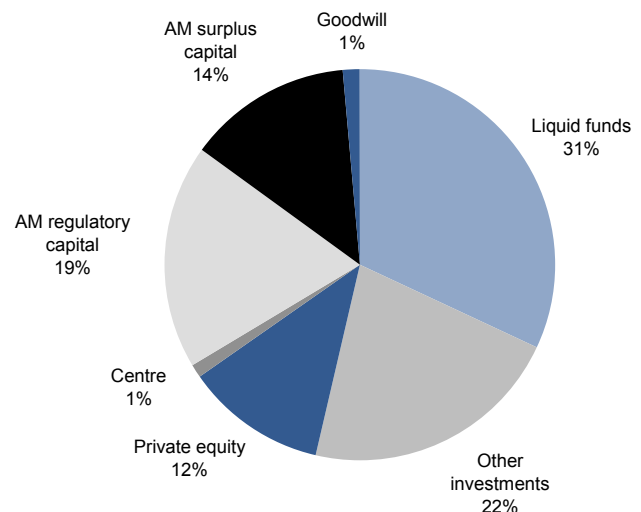
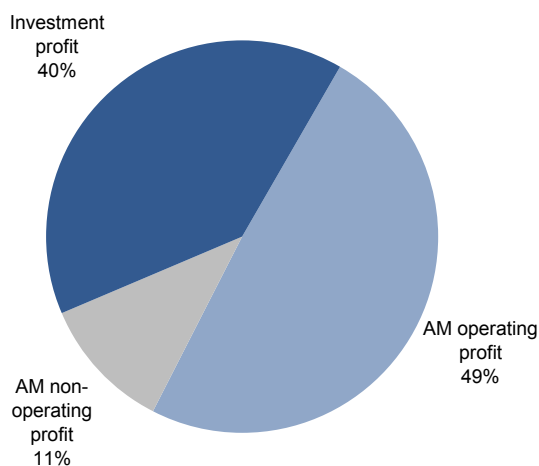
Source Company

Half of profits from asset management, half from investment activities

The balance sheet wins – 51% to 49%

The charts below summarise our presentation of the group's sources of profit in 2004 alongside the company's end-2004 capital allocation.

2004 pre-exceptional PBT* and NAV mix



* Asset management profits less central costs

Source Company, Lazard

In support of our argument that the asset management division is smaller than it first appears, we highlight the following:

- Asset management operating profit (our basis, net of central costs) accounted for 49% of 2004's pre-exceptional PBT;
- Net interest on asset management capital (regulatory plus surplus) and gains on current asset investments accounted for 11% of last year's PBT;
- 40% of profits were due to non-asset management investment activities (net interest and investment income/profits); including asset management net interest and gains on current asset investments and the balance sheet driven profit the contribution rises to 51%;
- Asset management capital (regulatory plus surplus) amounted to only a third of end-2004 shareholders' funds; non-cash investments amounted to 34% of year-end NAV.

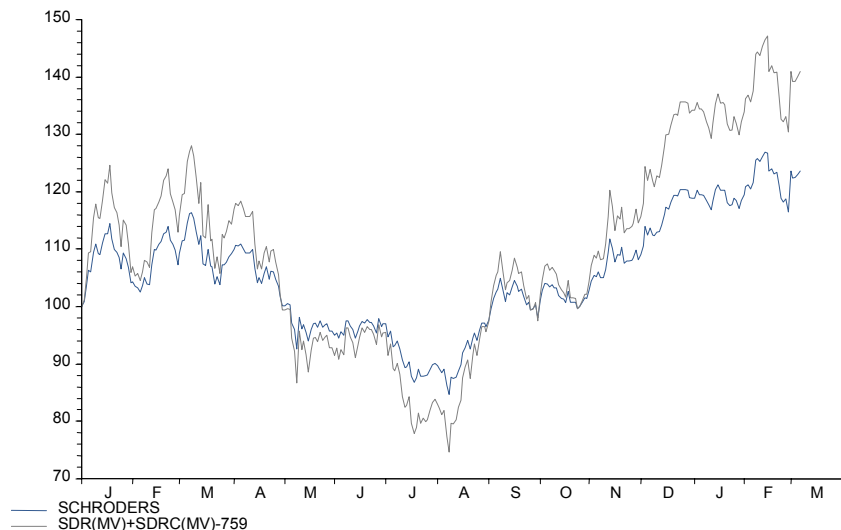
A 10% rise in the shares from the current level would equate to a 15% increase in asset management enterprise value

VALUATION IMPLICATIONS

Asset management EV leverage

The chart below shows that Schroders' asset management enterprise value has significantly outperformed the group's market value (as reflected by the price of the voting shares): since early August last year the implied asset management EV has increased by around 80%, as compared to an increase in the voting shares of around 40%.

Market value and asset management enterprise value



Source Datastream

This reflects the fact that, last August, surplus capital accounted for around half the group's market value, and hence the enterprise value of the asset management business was twice geared to an increase in the company's share price. That the Schroders group is valued in relation to its asset management activities, rather than in relation to asset management and investment activities, tends to result in overshooting as far as the ex-investment valuation of the asset management enterprise is concerned.

Whole group valuation

Trading on twice end-2004 book value, but generating an ROE of only 10.5% by 2007E

We forecast a group-wide ROE of 9.5% this year, rising to 10.5% in 2007E, assuming surplus capital deployed as at present. The group's market value, £2,267m, is currently twice the group's end-2004 book value.

Given a 9% cost of capital, say, the price is therefore discounting book value growth of around 8.5% into perpetuity which, given our ~50% dividend payout assumption, implies 17% earnings growth.

The group's valuation discounts well above consensus earnings growth

Growth of this order seems to be factored into the group PER multiples, below. Schroders needs to successfully redeploy its low-yielding surplus capital quickly in order to justify these multiples.

Whole group PER valuations

Year to December	2005E	2006E	2007E
EPS (p)	38.9	42.7	47.4
Schroders PER (x)	20.1	18.3	16.5
Schroders NV PER (x)	18.3	16.6	15.0

Source Lazard

Positive long-term prospects for asset management...

ASSET MANAGEMENT PROSPECTS – NEAR-TERM CONCERNS

The longer-term outlook for the company's asset management division is positive:

- Good investment performance: 47% of institutional AUM performed above benchmark in 2004, relative to 21% below benchmark; 23% of rateable retail AUM was above benchmark, relative to only 9% below.
- Strong retail AUM growth: gross sales of retail products amounted to £15.3bn, with net sales of £5.9bn, both up 40% on 2003.
- Gross returns are rising: the shift in mix from lower fee institutional assets to higher fee retail assets is increasing Schroders' revenue return on average AUM. Based on our average AUM calculations (and excluding non-operating income) the division's net revenue return has risen from 44.8bps in 2002 to 48.2bps in 2004.

...but the near-term outlook is less clear

However, there are near-term headwinds.

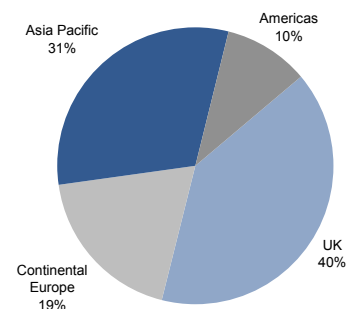
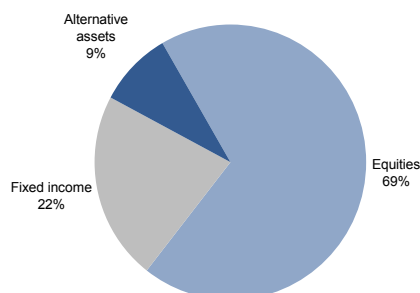
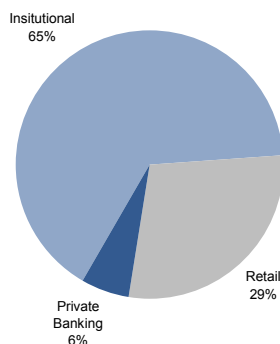
- **More UK and US institutional outflows to come.** With some £15bn worth of multi-asset institutional mandates remaining (of which ~£5bn are traditional UK balanced mandates), the outlook is for further net institutional redemptions as the structural shift from multi-asset/balanced to specialist mandates continues to take its toll. Last year saw £16.9bn of institutional outflows (£13.5bn in 2003) as compared with gross inflows of £8.5bn (£9.2bn in 2003).
- **Performance fees.** Last year's revenues included £24m in performance fees, more than double the ~£11.5m earned in 2003, of which £14m was recorded in Q4. Sequential quarterly and half-yearly revenue (and profit) could therefore compare poorly for much of 2005.
- **Non-operating income.** In a similar vein, last year's asset management division gains on current asset investments at £9m (£5.2m in 2003, and losses in 2002) represented a return of more than 10% on average in-house fund investments during the year, which could be difficult to match in the current year.
- **Cost growth.** Last year staff costs grew by 18%, but were partly offset by other administrative expenses being down 13% and a halving of the division's depreciation charge. Since some of the reduction in non-staff costs last year reflected the benefits of efficiency gains unlikely to be repeated this year, the outlook is for higher total cost growth.

Assets under management

Diversified AUM base by client and asset class

The charts below set out the group's end-2004 AUM by main client type, asset class and geographic location of investments.

End-2004 assets under management by client type, asset class and location



Source Company

The table below shows the evolution of the asset mix over the last three years:

Assets under management by client type, asset class and location (£bn)						
At end December	2002A	Mix (%)	2003A	Mix (%)	2004A	Mix (%)
Client type						
Institutional	65.5	76	71.4	72	69.1	65
Retail	15.5	18	22.1	22	30.2	29
Private Banking	5.2	6	5.4	5	6.3	6
	86.2		98.9		105.6	
Asset class						
Equities	59.5	69	67.3	68	72.9	69
Fixed income	20.7	24	24.7	25	23.2	22
Alternative assets	6.0	7	6.9	7	9.5	9
	86.2		98.9		105.6	
Investment of assets						
UK	41.4	48	43.5	44	42.2	43
Continental Europe	12.9	15	15.8	16	20.1	21
Asia Pacific	23.3	27	28.7	29	24.4	25
Americas	8.6	10	10.9	11	10.6	11
	86.2		98.9		105.6	

Source Company

The significant changes have been:

- The shift from institutional to retail: institutional AUM declining from 76% at end 2002 to 65% at end 2004, whilst retail increased from 18% to 29% of total AUM over the same period.
- The shift from UK to Continental Europe. The loss of UK balanced institutional mandates and increased European retail sales has resulted in the UK proportion of AUM falling from 48% to 43% over the past three years, with Europe rising from 15% to 21%.

The mix by asset class has remained broadly stable, with equities continuing to account for around 70% of the mix.

Sales & redemptions

Fund flows by main client type are set out below:

- As evident from the changing mix of year-end AUM, the past two years have seen a trade-off between institutional outflows and retail inflows.
- Over the two years, £21.4bn worth of positive investment returns have more than offset £2.3bn of net fund outflows, and accounted for the majority of the 23% increase in AUM over the period, from £86.2bn to end-2004's £105.6bn.

Fund flows by client type (£bn)

Year to end December	2003A	2004A	Ch (£bn)	Ch (%)
Institutional				
Opening AUM	66.0	71.4	5.4	8
Investment return	9.8	6.9		
Gross sales	9.2	8.5		
Losses/redemptions	-13.5	-16.9		
Net inflow	-4.3	-8.4		
Other	-0.1	-0.8		
Closing AUM	71.4	69.1	-2.3	-3
Average AUM	68.7	70.3	1.6	2
Retail				
Opening AUM	15.3	22.1	6.8	44
Investment return	2.3	1.9		
Gross sales	11.1	15.3		
Losses/redemptions	-6.9	-9.4		
Net inflow	4.2	5.9		
Other	0.3	0.3		
Closing AUM	22.1	30.2	8.1	37
Average AUM	18.7	26.2	7.5	40
Private banking				
Opening AUM	4.9	5.4	0.5	10
Investment return	0.5	0.0		
Gross sales	1.1	2.1		
Losses/redemptions	-1.5	-1.4		
Net inflow	-0.4	0.7		
Other	0.4	0.2		
Closing AUM	5.4	6.3	0.9	17
Average AUM	5.2	5.9	0.7	14
Total				
Opening AUM	86.2	98.9	12.7	15
Investment return	12.6	8.8		
Gross sales	21.4	25.9		
Losses/redemptions	-21.9	-27.7		
Net inflow	-0.5	-1.8		
Other	0.6	-0.3		
Closing AUM	98.9	105.6	6.7	7
Average AUM	92.6	102.3	9.7	10

Source Company

Revenues and gross margins

The table below sets out net revenues in relation to average AUM by institutional, retail and private banking client assets. These returns are based on operating revenues excluding net interest and current asset investment gains, but including performance fees.

- Institutional net revenue margins have remained relatively stable over the past two years, at 31bps.
- Retail margins look to have declined by a couple of basis points, averaging 83bps in 2004 compared with 83bps in 2003
- Private banking returns appear to have risen by around 4bps during 2004, averaging around 100bps.
- The shift in mix between these three margins has seen a 3bps increase in the aggregate return on average AUM, from 45bps to 48bps.

Asset management net revenues & gross margins (£m)

Year to December	2003A	2004A	Ch (£m)	Ch (%)
Revenues				
Institutional	212	219	7	3
Retail	156	213	57	37
Private Banking	50	59	9	18
	418	491	73	17
Average AUM				
Institutional	68.7	70.3	1.6	2
Retail	18.7	26.2	7.5	40
Private Banking	5.2	5.9	0.7	14
	92.6	102.3	9.7	10
Gross margins (%)				
Institutional	0.31	0.31	0.00	1
Retail	0.83	0.81	-0.02	-2
Private Banking	0.97	1.01	0.04	4
	0.45	0.48	0.03	6

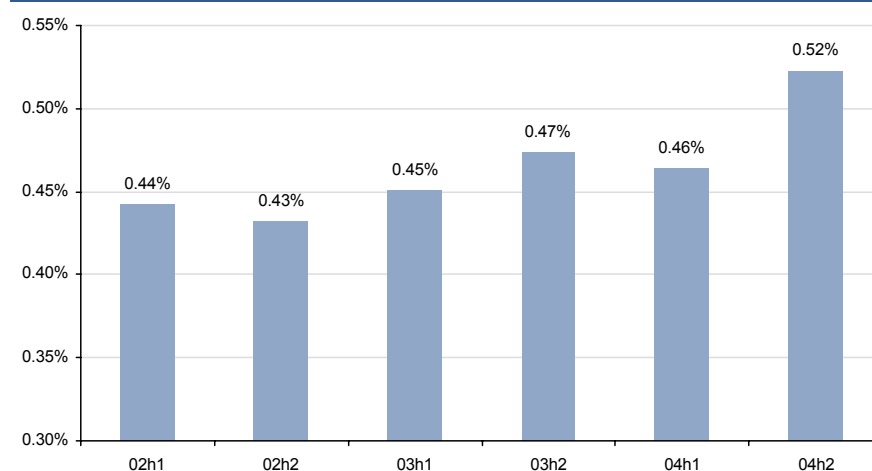
Source Company

Performance fees are mainly recorded in Q4 revenues

Seasonality and the performance fee effect

The annual returns set out above mask an element of seasonality due to performance fees. The chart below shows a significant spike in the annualised revenue return on AUM during H2 last year due to the inclusion of the best part of £24m of performance fees (~9% of second half asset management net revenues).

Net revenue returns on average AUM by half-year



Source Company

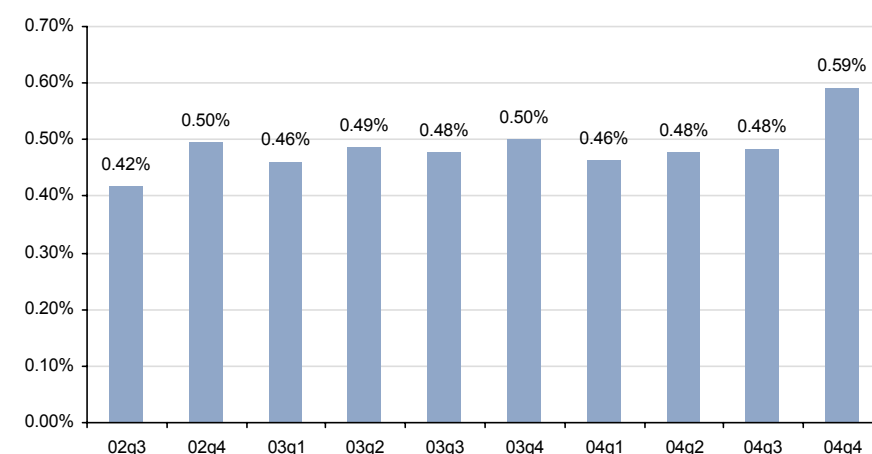
The performance fee impact is even more pronounced in quarterly revenues figures; management has acknowledged that £18m of last year's £24m of performance fees were reflected in fourth quarter revenues.

Unfortunately, the group's Q1 and Q3 trading updates include only gross asset management revenues (i.e. including net interest and investment gains) and so the quarterly chart below is not directly comparable with the semi-annual one above. Nevertheless, it highlights a 2004 Q4 revenue margin spike. Looking forward, there are the following potential implications:

- unless the market is aware of this seasonality, there is scope for some disappointment when Q1 and H1 results are reported;

- Since the majority of performance fees are earned in Q4, it is likely to become the most sensitive quarter of the year as far as the full year outcome is concerned.

Quarterly revenue margin* – the performance fee effect



* gross revenues including investment income

Source Company

Staff costs grew by 18% last year; headcount increased by 6%

Costs rising

The table below shows the trade-off last year between rising asset management staff costs and declining asset management non-staff costs. It also shows that although non-staff asset management costs fell by £18m, group/central non-staff costs rose by ~£4m.

Year to December (£m)

	2003A	2004A	Ch (£m)	Ch (%)
Asset Management				
Staff	223.2	263.4	40.2	18
Other	137.4	119.6	-17.8	-13
Depreciation	8.1	4.1	-4	-49
Surplus space provisions				
	368.7	387.1	18.4	5
Private equity				
Staff				
Other	2.2	3.0	0.8	36
Depreciation				
Surplus space provisions				
	2.20	3.0	0.8	36
Group/centre				
Staff	21.2	21.5	0.3	1
Other	1.4	5.0	3.6	257
Depreciation	0.2	0.5	0.3	150
Surplus space provisions	2.2	2.7	0.5	23
	25.0	29.7	4.7	19
Total				
Staff	244.4	284.9	40.5	17
Other	141	127.6	-13.4	-10
Depreciation	8.3	4.6	-3.7	-45
Surplus space provisions	2.2	2.7	0.5	23
	395.9	419.8	23.9	6

Source Company

The outlook is for higher cost growth, not least because management flagged this at the 2004 final results conference call:

2004 H2 saw a substantial increase in non-operating income

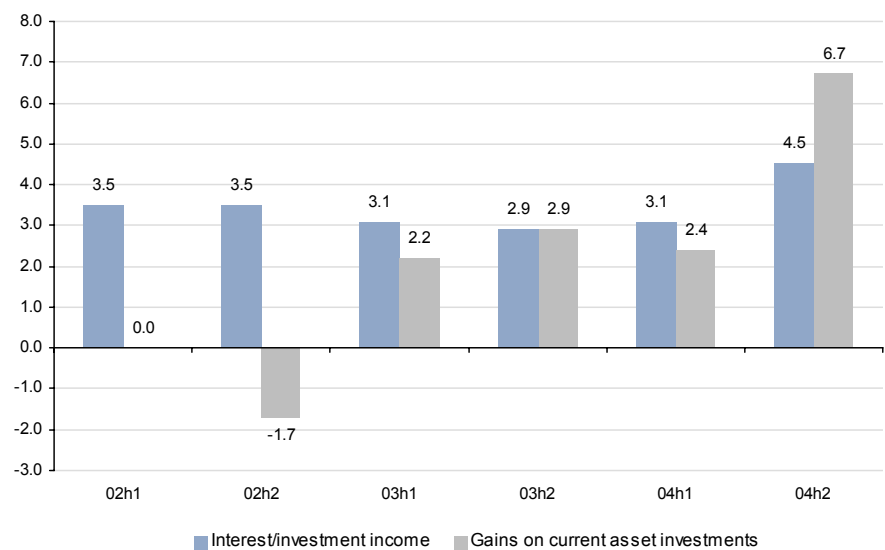
- The recovery in markets and long-only investment returns has and will continue to increase the cost of staff recruitment and retention;
- The reduction in non-staff asset management costs last year partly reflects the benefits of outsourcing and streamlining and, as such, reductions of this magnitude are unlikely to be repeated.

Non-operating asset management income

After charging central costs to asset management, non-operating income accounted for 18% of last year's asset management profit. Even on the company's definition, pre-central costs, non-operating income amounted to 14% of profits.

The chart below shows the progression of asset management non-operating income half-yearly over the past three years.

Non-operating asset management income (£m)



Source Company

As might be expected, net interest income reflects the movement in interest rates and the absolute level of asset management capital (regulatory plus surplus). However, gains or losses on current asset investments (investments in Schroder unit trusts, mainly) have been more volatile, culminating in a significant spike in H2 last year.

The net result – headwinds in 2005?

Near-term pressures on earnings growth

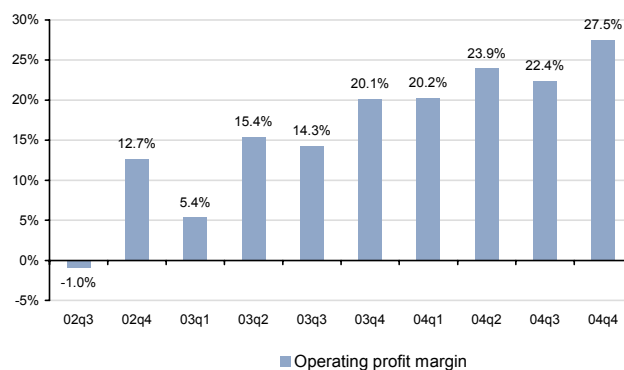
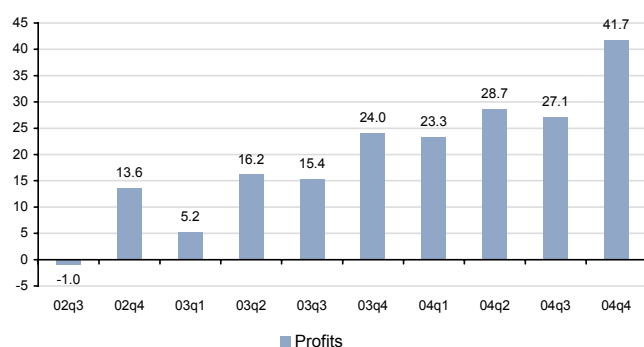
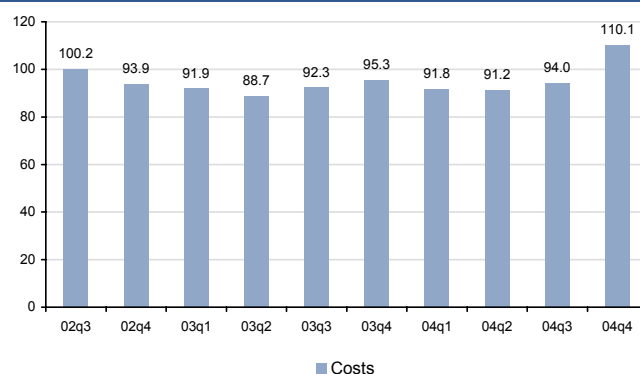
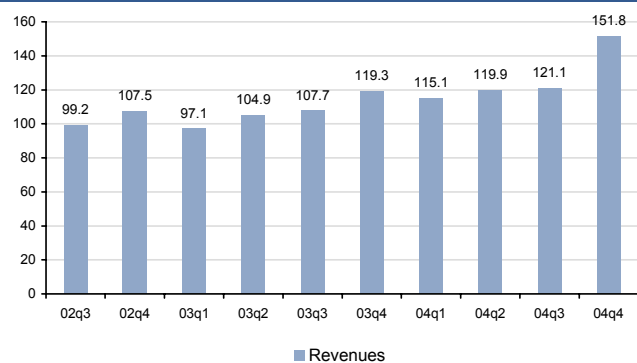
Last year's growth in AUM and the shift in its mix will have given 2005 a good start as far as run-rate revenues are concerned. However, three factors could conspire to hold back asset management profit growth:

- Reduced performance fees;
- Higher costs;
- Lower non-operating income.

The combined effect could be a flat or even reduced gross revenue return on AUM this year, and a flat or only moderately reduced costs to AUM ratio. If AUM continues to grow, this still leads to profit growth and perhaps a further improvement in the asset management operating profit margin. However, it leaves the company more than usually exposed to a market setback.

The four charts below attempt to summarise the potential for a squeeze on asset management margins over the near-term.

Asset management income & expenses, profits & margins (£m)



Source Company

FORECAST SUMMARY

Asset Management (net of group central costs, £m)

Year to December	2002A	2003A	2004A	2005E	2006E	2007E
Net revenues	439.0	417.7	491.0	527.8	567.3	612.8
Divisional expenses	-407.8	-368.2	-387.1	-413.1	-436.9	-463.0
Group costs	-25.1	-24.8	-29.7	-30.6	-31.5	-32.4
Operating profit	6.1	24.7	74.2	84.1	99.0	117.3
Interest/investment income	7.0	6.0	7.6	10.7	10.7	10.7
Associates	0.0	0.2	0.2			
Core PBT	13.1	30.9	82.0	94.8	109.7	128.0
Investment disposal gains	0.9					
Other non-operating income	-1.7	5.1	9.1	8.0	8.0	8.0
Pre-exceptional PBT	12.3	36.0	91.1	102.8	117.7	136.0
Opening AUM (£bn)	110.0	86.2	98.3	105.6	112.0	119.5
Investment return	-19.5	12.6	9.3	8.4	9.0	9.6
Net flow	-2.2	-0.5	-2.6	-2.0	-1.5	-1.0
Other	-2.1	0.0	0.6			
Closing AM	86.2	98.3	105.6	112.0	119.5	128.1
Average AUM (£bn)	98.1	92.3	102.0	108.8	115.8	123.8
Revenue/AvgAUM (bps)	44.8	45.3	48.2	48.5	49.0	49.5
Costs/AvgAUM (bps)	-44.1	-42.6	-40.9	-40.8	-40.5	-40.0
Operating profit/AvgAUM (bps)	0.6	2.7	7.3	7.7	8.5	9.5
Operating profit margin (%)	1.4	5.9	15.1	15.9	17.4	19.1

Investment Activities (group and private equity, £m)

Year to December	2002A	2003A	2004A	2005E	2006E	2007E
Net revenues	32.2	9.8	24.8	24.8	24.9	24.9
Administrative expenses	-1.0	-2.2	-3.0	-3.0	-3.0	-3.0
Operating profit	31.2	7.6	21.8	21.8	21.9	21.9
Interest/investment income	14.7	18.0	20.0	18.3	18.3	18.3
Associates	7.7	2.3	5.8	3.5	3.5	3.5
Core PBT	53.6	27.9	47.6	43.7	43.7	43.8
Other non-operating income	-6.7	10.1	11.8	7.5	7.5	7.5
Pre-exceptional PBT	46.9	38.0	59.4	51.2	51.2	51.3

Source Lazard

Our key assumptions are 8% investment returns and continued institutional redemptions offset by net retail inflows

ANALYSIS OF FORECASTS

We model Schroders on a two-segment basis – asset management and investment activities. The key drivers are investment returns (equity and fixed income market returns for asset management and some investment gains, interest rates for liquid assets), net fund flows, and revenue and cost margins on AUM.

Asset management

Assets under management. We assume an 8% investment return in each of the years 2005-2007. For 2005, we assume further net outflows of £2bn, reflecting positive retail and private banking flows offset by continued institutional outflows. For 2006, and 2007, we forecast reduced net outflows of £1.5bn and £1bn respectively, reflecting the run-off of the group's remaining UK balanced and other multi-asset institutional mandates.

Revenue margins. We forecast rising base fee margins on average AUM reflecting a continued shift in the mix towards retail. We have assumed only a 3bps rise in 2005 (5bps in 2006 and 2007) to smooth the impact of strong performance fees in 2004.

Costs. We model costs in relation to AUM and forecast reductions in this ratio in each of the three forecast years, albeit only a 1bps reduction in 2005. This seems to be consistent with management guidance for cost growth. These forecasts result in continued improvements in the group's operating profit margin (company basis, pre-central costs) from 21.2% in 2004 to 24.4% by 2007.

Non-operating income. We assume a 3% net return on opening asset management division capital (regulatory plus surplus), which results in the division's net interest income rising from £7.6m in 2004 to £10.7m in 2005 and beyond. For gains on current asset investments we assume the same ~8% investment return as in our assets under management estimates, giving £8m p.a.

Investment activities

General investments. We assume a blended 2.8% return on opening "general investments" (liquid funds, third party hedge funds, Schroder funds and leasing assets) including a 4.5% return on liquid funds (£351m, including IFP proceeds and excluding the final dividend).

Private equity. Our forecasts are based on an assumed 13% after-tax return on average private equity invested capital.

Group items

Tax. We assume a blended tax rate of 25% going forward, reflecting geographical earnings mix.

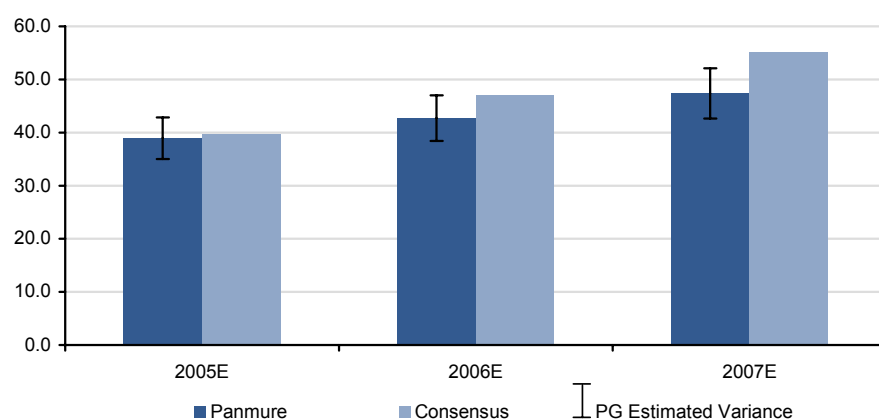
EPS. The above assumptions deliver EPS down 2% in 2005E, followed by increases of 10% and 11% in 2006E and 2007E.

DPS. We have prudently assumed a 1p increase in the annual dividend in each of our forecast years.

Cash flows. Our forecasts imply gross operating cash flows of £140m in 2005E, which after forecast capital expenditure and tax leaves equity cash flow of £94m.

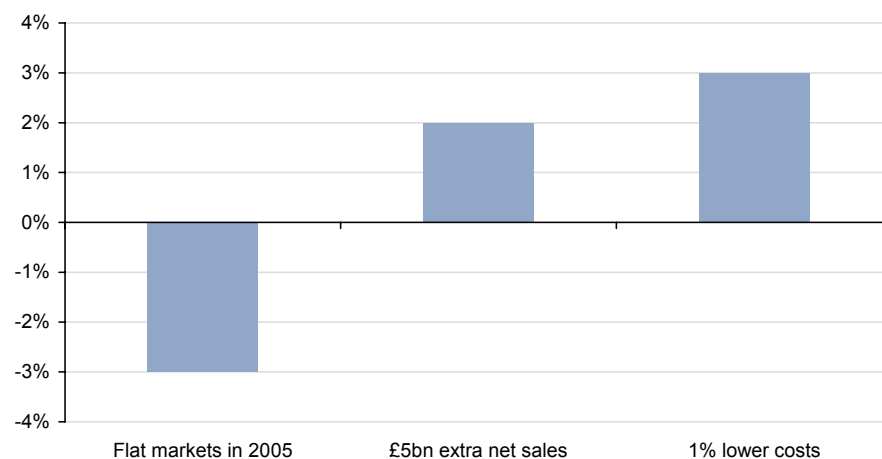
Our base case forecast is only a little below consensus for the current year, 9% below in 2006 and 14% below in 2007.

Panmure Gordon relative to consensus forecasts (EPS)



Source Reuters, Lazard

Sensitivities for Panmure Gordon 2005E forecasts



Source Lazard

Investment returns, net fund flows and operating profit margins are key sensitivities.

Based on our sum of the asset management and investment parts, the shares are around 12% overvalued

VALUATION

We value Schroders as the sum of its asset management and investment components. Based on our analysis, we believe that both voting and non-voting shares are around 12% overvalued.

Two valuations

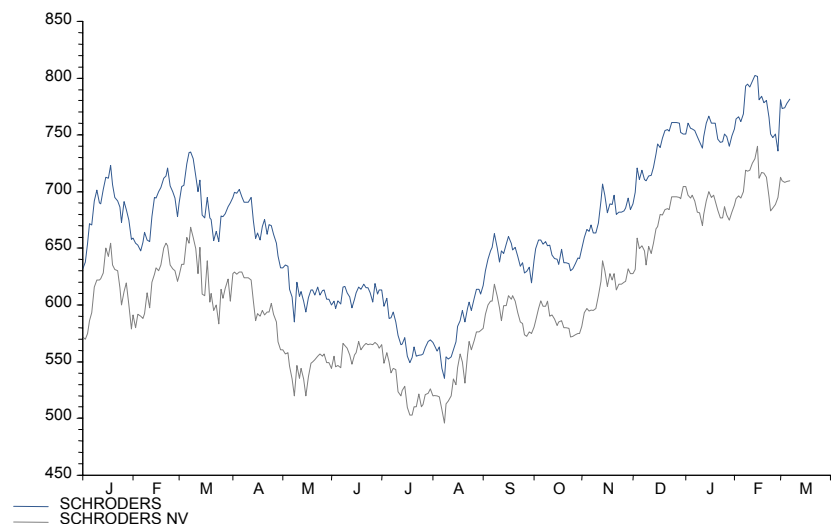
Capital structure and market value

	Shares (m)	Price (p)	Market value (£m)
-Voting shares	226.0	782.0	1,767
-Non-voting shares	70.3	711.0	500
Total	296.29		2,267

Source Company, Lazard

Schroders has two classes of shares – voting and non-voting. Apart from the vote, non-voting shares have the same entitlements to dividends, earnings and assets as the voters. We value the Schroders group in aggregate and apportion this value over the two classes in relation to their current trading relationship.

Dual capital structure – two valuations



Source Datastream

Sum of the asset management and investment parts

The table below sets out our sum of the parts valuation. The key assumptions are as follows:

- We value genuine surplus capital (i.e. liquid funds plus asset management surplus capital) at 70% of par to reflect returns below cost of capital.
- Third party hedge funds and investment in in-house products are valued at a 15% discount to NAV to reflect lack of visibility as to the actual investments themselves and assumed returns below cost of capital.
- Private equity investments are in aggregate valued at 1.8x book value, primarily because of the £100m of value we afford to the group's carried interests which have no book value. Note that, since the SGV Capital investment is a marked-to-market (~6%) holding in a quoted investment company, valuing this at book value effectively incorporates a 45% premium to underlying NAV.
- In aggregate, therefore, we value "investment activities" at a 6% discount to end-2004 book value, which seems fair given our estimated 2005 aggregate return

on capital of 4.3%, and which implies a multiple on investment earnings of almost 22x.

- We value the asset management enterprise (operating profit plus earnings on regulatory capital) at 18x estimated 2005E earnings (net of central costs). (Gains on current asset investments included within our divisional presentation of the asset management division are reflected in the valuation of in-house products within investment activities).

Implied asset management enterprise value and EV: estimated profit after tax (£m)

	End-2004 NAV	Value:NAV (x)	Value	Est. 2005 interest/ inv. income	Est. 2005 Operating profit	Est. 2005 net profit (25% tax)	PER (x)	2005E ROE (%)
Liquid funds*	351	0.70	246	15.8				
Third party hedge funds	123	0.85	105					
Schroder funds	107	0.85	91					
Leasing	9	1.00	9	0.7				
Total general investments	590	0.76	450	16.5		12.4	36.3	2.1
SGV Capital	38	1.00	38	1.3				
SVIL co-investment vehicles	55	1.00	55					
General & Limited Partnerships	22	1.00	22					
Other	15	1.00	15					
Carried interests			100					
Total private equity	130	1.77	230	1.3	23.8	18.8	12.2	14.5
Investment activities	720	0.94	680	17.8	23.8	31.2	21.8	4.3
Asset management	208	5.9	1,220	6.2	84.1	67.8	18.0	32.6
Asset management surplus capital	149	0.7	104	4.5		3.4	30.6	2.3
Asset management	357	4.0	1,324	10.7	84.1	71.1	18.6	19.9
Central capital	11	1.0	11	0.5	1.5	1.5		
Goodwill	15							
Group	1103	2.0	2,016	29.1	109.5	103.9	21.7	9.5

* Includes Internet Finance Partners distribution, but excludes final dividend

Source Company, Lazard

In total, we value the group at £2,016m, which represents an 11% discount to the group's market value (note that valuing asset management on 22x eliminates the discount; affording zero value to carried interests increased the discount to 15%).

Our aggregate fair value translates into the following per share values assuming a 71p spread between the voters and non-voters.

Fair market value apportioned between voting and non-voting shares

	Fair value (p)	Current value	Upside/(downside) (%)
Per voting share	697	782	-11
Per non-voting share	626	711	-12

Source Lazard

THE NUMBERS

Profit & loss (£m)

Year to December	2002A	2003A	2004A	2005E	2006E	2007E
Net revenues	471.2	427.5	515.8	552.6	592.2	637.7
Administrative expenses	-421.2	-387.2	-415.2	-441.2	-465.8	-492.9
Depreciation	-30.5	-8.2	-4.6	-5.5	-5.5	-5.5
Operating profit	19.5	32.1	96.0	106.0	120.9	139.3
Interest/investment income	21.7	24.0	27.6	29.1	29.1	29.1
Associates	7.7	2.5	6.0	3.5	3.5	3.5
Core PBT	48.9	58.6	129.6	138.5	153.4	171.8
Investment disposal gains	0.9					
Other non-operating income	-8.4	15.2	20.9	15.5	15.5	15.5
Pre-exceptional PBT	41.4	73.8	150.5	154.0	168.9	187.3
Discontinued ops	-5.6	-0.3				
Exceptional items	-6.3	2.4	50.4			
Goodwill amortisation	-10.6	-10.3	-9.9			
Profit before tax	18.9	65.6	191.0	154.0	168.9	187.3
Taxation	7.7	-16.4	-41.4	-38.5	-42.2	-46.8
Minorities	-0.5	0.0	-15.6			
Attributable profit	26.1	49.2	134.0	115.5	126.7	140.5
Dividends	-53.3	-53.7	-57.8	-62.2	-65.2	-68.1
Retained profit	-27.2	-4.5	76.2	53.3	61.5	72.4
Period-end shares	295.7	296.3	296.3	296.3	296.3	296.3
Average shares	298.2	296.6	296.6	296.6	296.6	296.6
EPS (p)	8.8	16.6	45.2	38.9	42.7	47.4
Adjusted EPS (p)	12.3	20.1	39.6	38.9	42.7	47.4
DPS (p)	18.0	18.0	20.0	21.0	22.0	23.0
NAV (p)	347.6	350.9	372.2	390.1	410.9	435.3

Summary cash flows

Operating profit	41.2	56.1	123.6	135.0	149.9	168.3
Depreciation	30.5	8.2	4.6	5.5	5.5	5.5
Gross cash flow	71.1	64.3	128.2	140.5	155.4	173.8
Capex	13.8	-14.9	-5.0	-5.0	-5.0	-5.0
Operating cash flow	85.5	49.4	123.2	135.5	150.4	168.8
Tax	-4.6	-9.2	-16.4	-41.4	-38.5	-42.2
Equity cash flow	80.9	40.2	106.8	94.1	119.1	126.6
Equity dividends	-53.5	-53.4	-53.7	-57.8	-62.2	-65.2
Net Cash flow	27.4	-13.2	53.1	36.3	49.7	61.4

Summary balance sheets

Avg AUM	98.1	92.3	102.0	108.8	115.8	123.8
Assets under management	86.2	98.3	105.6	112.0	119.5	128.1
Equity	1087	1028	1040	1103	1156	1218
Intangible assets	35	25	15	15	15	15
Tangible equity	1052	1003	1025	1088	1141	1203

Source Company, Lazard

DIVISIONS

Asset management (£m)

Year to December	2002A	2003A	2004A	2005E	2006E	2007E
Net revenues	439.0	417.7	491.0	527.8	567.3	612.8
Administrative expenses	-395.1	-360.2	-383.0	-408.1	-431.9	-458.0
Depreciation	-12.7	-8.0	-4.1	-5.0	-5.0	-5.0
Operating profit	31.2	49.5	103.9	114.7	130.5	149.7
Interest/investment income	7.0	6.0	7.6	10.7	10.7	10.7
Associates	0.0	0.2	0.2			
Core PBT	38.2	55.7	111.7	125.4	141.2	160.5
Investment disposal gains	0.9					
Other non-operating income	-1.7	5.1	9.1	8.0	8.0	8.0
Pre-exceptional PBT	37.4	60.8	120.8	133.4	149.2	168.5
Discontinued ops	-6.4	-0.3				
Exceptional items	-6.3	2.4	2.6			
Goodwill amortisation	-10.6	-10.3	-9.9			
Profit before tax	14.1	52.6	113.5	133.4	149.2	168.5
Opening AUM (£bn)	110.0	86.2	98.3	105.6	112.0	119.5
Investment return	-19.5	12.6	9.3	8.4	9.0	9.6
Net flow	-2.2	-0.5	-2.6	-2.0	-1.5	-1.0
Other	-2.1	0.0	0.6			
Closing AM	86.2	98.3	105.6	112.0	119.5	128.1
Average AUM (£bn)	98.1	92.3	102.0	108.8	115.8	123.8
Revenue/AvgAUM (bps)	44.8	45.3	48.2	48.5	49.0	49.5
Admin expenses/AvgAUM (bps)	-40.3	-39.0	-37.6	-37.5	-37.3	-37.0
Costs/AvgAUM (bps)	-41.6	-39.9	-38.0	-38.0	-37.7	-37.4
Operating profit/AvgAUM (bps)	3.2	5.4	10.2	10.5	11.3	12.1
Operating profit margin (%)	7.1	11.9	21.2	21.7	23.0	24.4
Shareholders funds	440.6	440.2	496.8			
Average equity	459.2	440.4	468.5			
Pre-exc ROE (25% tax) (%)	6.1	10.4	19.3			
Quarterly-style disclosure						
Revenues	445.2	429.0	507.9	546.5	586.0	631.5
Costs	-407.8	-368.2	-387.1	-413.1	-436.9	-463.0
Profits	37.4	60.8	120.8	133.4	149.2	168.5

Private equity (£m)

Net revenues	5.7	6.4	23.3	23.3	23.3	23.3
Administrative expenses	-1.0	-2.2	-3.0	-3.0	-3.0	-3.0
Operating profit	4.7	4.2	20.3	20.3	20.3	20.3
Interest/investment income	1.3	1.2	1.3	1.3	1.3	1.3
Associates	7.7	2.3	5.8	3.5	3.5	3.5
Core PBT	13.7	7.7	27.4	25.1	25.1	25.1
Investment disposal gains						
Other non-operating income	-0.8	9.1	8.4	7.5	7.5	7.5
Pre-exceptional PBT	12.9	16.8	35.8	32.6	32.6	32.6
Exceptional items			47.8			
Profit before tax	12.9	16.8	83.6	32.6	32.6	32.6
Shareholders funds	124.1	118.6	175.8			
Average equity	122.9	121.4	147.2			
Pre-exc. ROE (25% tax) (%)	7.9	10.4	18.2			

Source Lazard

Group net income/(costs)

Year to December	2001A	2002A	2003A	2004A	2005E	2006E	2007E
Net revenues	34.1	26.5	3.4	1.5	1.5	1.6	1.6
Administrative expenses	-28.6	-25.1	-24.8	-29.2	-30.1	-31.0	-31.9
Depreciation	-25.2	-17.8	-0.2	-0.5	-0.5	-0.5	-0.5
Operating profit	-19.7	-16.4	-21.6	-28.2	-29.0	-29.9	-30.8
Interest/investment income	18.3	13.4	16.8	18.7	17.0	17.0	17.0
Core PBT	-1.4	-3.0	-4.8	-9.5	-12.0	-12.9	-13.8
Other non-operating income	1.4	-5.9	1.0	3.4			
Pre-exceptional PBT	0.0	-8.9	-3.8	-6.1	-12.0	-12.9	-13.8
Discontinued ops	-10.0	0.8					
Profit before tax	-10.0	-8.1	-3.8	-6.1	-12.0	-12.9	-13.8
Shareholders funds	487.5	463.0	480.8	441.5			
Average equity	517.3	475.3	471.9	461.2			

Source Lazard

Distribution of investment ratings (as of 31st December 2004)

Overall Global Distribution (Banking Client*)		
Buy	Hold	Sell
49% (34%)	39% (14%)	13% (8%)

* Indicates the percentage of each category in the Overall Distribution that were Lazard banking clients in the previous 12 months

Rating: GUIDELINE (return targets may be modified by risk or liquidity issues)

Buy	Expected to produce a total return of 15% or better in the next 12 months
Hold	Fairly valued: total return in the next 12 months expected to be $\pm 10\%$
Sell	Stock is expected to decline by 10% or more in the next 12 months

All of the recommendations and views about the securities and companies in this report accurately reflect the personal views of the research analyst named on the cover of this report. No part of this research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research report.

This report has been prepared by Lazard Frères & Co. LLC ("LF&Co.") in New York, Limited or Lazard & Co., Limited (which includes Panmure Gordon, a division of Lazard & Co., Limited) ("LCL") in London, or one of their associated or affiliated companies or partnerships ("associates") (and together with their officers, directors, employees or representatives, "the Lazard Group"). The business line that prepared this report is noted on the cover. It may not be reproduced, redistributed or copied in whole or in part for any purpose.

From time to time, we offer investment banking and other services (IBS) to Schroders. We buy and sell these company securities from customers on a principal basis. Accordingly, we may at any time have a long or short position in any such securities. We may make a market in the securities of Schroders.

This report has been approved in the UK by LCL solely for the purposes of section 21 of the Financial Services and Markets Act 2000. In the UK, this report is directed at and is for distribution only to persons who (i) fall within Article 19(1) (persons who have professional experience in matters relating to investments) or Article 49(2)(a) to (d) (high net worth companies, unincorporated associations etc) of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2001 (as amended) or (ii) are intermediate customers or market counterparties of LCL (all such persons together being referred to as "relevant persons"). This report must not be acted on or relied upon by persons in the UK who are not relevant persons.

This report has been approved by, and is being distributed in the US or to US persons, by LF&Co., which accepts responsibility for its contents in the US. LCL is not a US registered broker-dealer. Transactions undertaken in the US in any security mentioned herein must be effected through LF&Co. or another US-registered broker-dealer, in conformity with SEC Rule 15a-6.

Neither this report nor any copy or part thereof may be distributed in any other jurisdictions where its distribution may be restricted by law and persons into whose possession this report comes should inform themselves about, and observe, any such restrictions. Distribution of this report in any such other jurisdictions may constitute a violation of UK or US securities laws, or the law of any such other jurisdictions.

This report does not constitute an offer or solicitation to buy or sell any securities referred to herein. It should not be so construed, nor should it or any part of it form the basis of, or be relied on in connection with, any contract or commitment whatsoever. The information in this report, or on which this report is based, has been obtained from sources that the Lazard Group believes to be reliable and accurate. However, it has not been independently verified and no representation or warranty, express or implied, is made as to the accuracy or completeness of any information obtained from third parties. The information or opinions are provided as at the date of this report and are subject to change without notice. The information and opinions provided in this report take no account of the investors' individual circumstances and should not be taken as specific advice on the merits of any investment decision. Investors should consider this report as only a single factor in making any investment decisions. Further information is available upon request. No member of the Lazard Group accepts any liability whatsoever for any direct or consequential loss howsoever arising, directly or indirectly, from any use of this report or its contents.

By accepting this report you agree to be bound by the foregoing limitations.

Lazard & Co., Limited
Member of the London Stock Exchange
Authorised and regulated by the Financial Services Authority

Lazard Frères & Co. LLC
Member NYSE and NASD

8 March 2005

UK Equity Research

COMPANY PROFILE

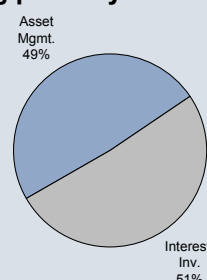
Business Profile

Schroders is a global asset management company with £105.6 billion under management as at 31 December 2004. The company's clients include corporations, insurance companies, local and public authorities, charities, pension funds, high net worth individuals and retail investors.

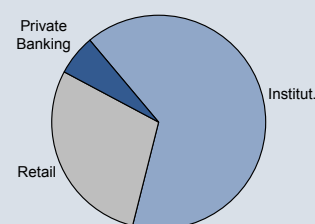
Recent News

Schroders announced final results for the year to December 2004 on 1 March. Asset management profit before tax and exceptional items doubled to £120.8m, while private equity profits before exceptionals increased from £16.8m to £35.8m. Group net costs amounted to £6.1m. In addition, exceptional gains of £47.8m were earned from the disposal of a private equity investment by one of Schroders' limited partnership interests. The full year dividend was raised by 8% to 20.0p.

Operating profit by activity* (%)



AUM by client type* (%)



*FY ending December 2004

Source: Company

Company Information

Company	Schroders
Address	31 Gresham Street, London EC2V 7QA
Tel no	+44 (0)20 7658 6000
Website	www.schroders.com
Chairman	Michael Miles
Chief Executive	Michael Dobson
Finance Director	Jonathan Asquith
IR Officer	Jo Godfrey

Major Shareholders (%)

Schroder family	44.10%
Fidelity	4.14%
Legal & General	3.25%

Financial Diary

Next Statement	AGM 19 April 2005
Next Results	Q1 17 May 2005
Next ex dividend	23 March 2005 (14p final)

Lazard & Co., Limited

50 Stratton Street, London W1J 8LL UK
+44 (0)20 7187 2000

Lazard Frères & Co LLC

30 Rockefeller Plaza, New York, NY 10020 US
+1 212 632 6000