

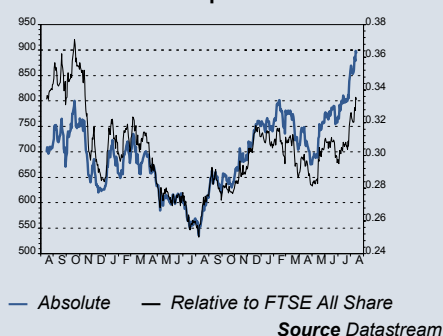
24 August 2005

Equity Research

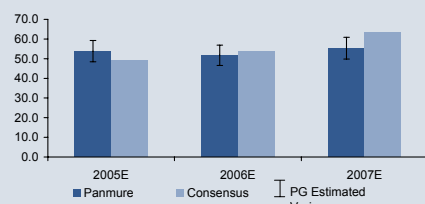
Key Data

Price	880p (cum-div)
Price Target	817p
Market Cap	£2,551m
All Share	2,677
Sector	Speciality Finance
Stock codes	SDR.L / SDR.LN
Next Event	Q3 trading update - Nov 2005
Gearing	Cash

Absolute & relative performance



Panmure Gordon EPS rel to consensus



Source Reuters, Panmure Gordon

SCHRODERS

SELL

Focus shifts from margins to AUM growth

Following substantial revenue and pre-tax margin expansion, the outlook is now for broadly stable rather than rising returns on assets managed. Organic and/or acquired asset growth will drive future earnings growth.

- **Returns on AUM: As good as they get?** The Asset Management division's revenue margin on average funds increased from 48bp in 2004 to 53bp in H105, while the pre-tax margin rose from 27% to 31% (and as high as 35% in Q205). The outlook is for broadly stable rather than rising margins from here, in our view.
- **Private Equity profits declining.** Schrodgers' "maturing and declining" Private Equity asset pool and the approaching exhaustion of unrealised carried interests imply a reduced Private Equity contribution to group profits.
- **Focus shifts to AUM growth.** With returns on AUM stabilising and Private Equity profits in decline, the responsibility has shifted to AUM growth – organic and/or through acquisitions – to drive future earnings growth.
- **Valuation.** Recent strong share price performance has fully discounted the step-up in reported profits (part IFRS, part fundamental). Based on a DCF analysis, we consider 817p a current fair value for the voting shares and hence retain our Sell recommendation.

Year end	Revenue	PBTA	Adj EPS	P/E	EV/NOPAT	Yield
December	(£m)	(£m)	(p)	(x)	(x)	(%)
2004A	543.4	211.6	40.8	21.6	25.3	2.3
2005E	625.3	226.1	54.1	14.8	18.7	2.4
2006E	675.6	206.1	52.1	15.4	18.1	2.5
2007E	729.6	220.7	55.8	14.3	16.4	2.6

Source Company data, Panmure Gordon

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INVESTMENT CASE

Strong share price performance since the Q1 update in May has been retrospectively justified by Q2 results ahead of expectations, a result of rising markets/revenues and reduced non-staff costs. The shares remain expensive, however, given the more moderate earnings growth outlook.

IFRS: RESTATED ASSET MANAGEMENT PROFITS 17% HIGHER

IFRS increased 2004 Asset Management & Private Banking profits by 17%

The interim results announcement included a full divisional breakdown under IFRS for the first time. Restated 2004 Asset Management & Private Banking operating profits were £121.2m, 17% above the £103.9m originally reported under UK GAAP. (As operating profits exclude investment gains, these figures are comparable and not impacted by the reclassification of such gains in restated divisional pre-tax profits.) Since this uplift primarily reflects a significantly reduced P&L account pension charge under IAS 19, we question whether this sizeable upward restatement in any way changes the fundamental value of the group's core asset management activities.

CORE BUSINESSES: PROFITS SURGE IN Q2

A strong Q2 made up for less impressive Q1 results following the reclassification of investment gains

Restatement aside, the second quarter saw a substantial increase in asset management profits. The newly separated Asset Management division saw its profits rise from £34.3m in Q1 to £45.4m in Q2, an increase of 32%. Its profit margin on revenues (pre-central costs) rose from 27.8% to 34.9%. Adding in Private Banking to recreate the old Asset Management segment, the profit increase was still 27%. Clearly, rising markets helped the revenue element, but the real leverage was on the cost side. Although Q205 Asset Management expenses were up 12% on Q204, they were down 5% on Q105 and down 9% on Q404.

MARGINS & RETURNS: AS GOOD AS THEY GET?

Asset Management saw its pre-tax profit margin increase from 28% to 35%

Although improved profitability at Private Banking could drive further improvements in the reported profit margin for a combined Asset Management & Private Banking unit, it might prove difficult to improve the pre-tax margin of the standalone Asset Management division above the Q2 35%. At the same time, there appears only limited scope to further increase the combined Asset Management & Private Banking gross margin on AUM – which rose from 48bp in 2004 to 53bp in H1 2005 (and which was below 40bp in 2001). As a result, Asset Management & Private Banking profit growth looks likely to be more dependent on AUM growth and less on improving returns on AUM.

FLows: RETAIL PAUSES FOR BREATH

Flat Retail sales in Q2 following 'soft closure' of funds

Net fund sales during the first half of 2005 were flat, reflecting £2bn of Retail and Private Banking inflows, offset by £2bn of Institutional outflows, a similar pattern to that seen over the past few years. Somewhat surprising were the differences between the Q1 and Q2 flows. After £1.6bn of net inflows during Q1, Retail was flat in Q2. After showing reduced outflows of only £0.5bn in Q1, institutional outflows deteriorated to £1.5bn in Q2. All in, £1.2bn of net inflows in Q1 was lost in Q2 outflows. Flat Q2 Retail flows were due to a combination of some turnover in sub-advisory relationships and fund manager changes, which prompted Schroders to 'soft close' some of its funds. According to management, Retail sales could remain subdued until new fund managers bed down.

PRIVATE EQUITY: "A MATURING AND DECLINING ASSET POOL"

Private Equity profits are set to decline

End-June Private Equity net assets of £171m included a first-time estimate of the value of carried interests at £28m. In the interim report, Schroders valued its

carried interests on 1 January 2005 at £43.2m (since Schroders chose to adopt IAS 39 from 1 January onwards, the comparative end-December NAV does not include any value for carried interests). The £18m of Private Equity profit recorded during H1 therefore appears to have been mainly due to the realisation of carried interests.

The adoption of IAS 39 precludes Schroders from recognising mark-to-market gains on its 6% stake in SVG Capital (a quoted investment trust) through its profit and loss account, which effectively renders the £47m balance sheet value of this investment at end-June as nil-yielding (under the old rules, Schroders would have booked a £5.9m gain on the SVG stake during H1). With carried interests declining, Private Equity profits will be more dependent on realisations, it would appear.

NEXT STEPS: APPLYING THE BALANCE SHEET

With returns on assets under management set to stabilise and Private Equity assets and profits unwinding, we expect management to (at last) apply the group's substantial financial resource. Schroders seems to be targeting a combination of acquisitions and organic revenue investments, potentially in US mutual funds, fixed income and private banking. News on the deployment of some or all of around £450m of highly liquid surplus capital (and a further £350m of less liquid but still non-core capital) will be the key determinant of medium-term share price performance, in our view.

VALUATION: UP WITH EVENTS

Since the recent strong share price performance was driven by partially disclosed Q1 results now revealed to have been inflated by investment gains (and an accounting step-up due to IFRS), a strong Q2 was called for to justify the price increase.

Excluding more than £800m of 'surplus capital' and based on our higher IFRS forecasts, the core Asset Management & Private Banking businesses trade on EV/NOPAT multiples of 18.7x 2005E and 18.1x 2006E, which seem up with events. Based on DCF analysis, we now consider 817p a fair value for the voting shares (up from 700p based on our pre-interim UK GAAP estimates) and as such we retain our Sell recommendation.

Top-line AUM growth will replace margin expansion as the key earnings growth driver

Strong recent share price performance has fully discounted the step-up in profitability

CATALYSTS

- Acquisition and/or strategic investment news flow.
- Q3 Trading Update in mid-November.

RESULTS ANALYSIS

Better-than-expected Q2 profits offset disappointing Q2 Retail sales and cautionary margin outlook comments

Interpretation complicated by IFRS, welcome new disclosures and the reclassification of investment gains

The first half results were better than we expected, driven by a substantial increase in second quarter profitability from Asset Management, excluding Private Banking, and aided by a significant IFRS uplift. Offsetting profits growth were flat Q2 net retail sales and outlook comments hinting at stable rather than rising margins from now on.

NEW DISCLOSURE AND PROFIT RECLASSIFICATIONS

Interpreting the first half financial results was complicated by first-time full disclosure (ie at the divisional level) under IFRS, the reclassification of some investment gains (or losses) from Asset Management to the Group segment, the creation of an entirely new reporting segment in Private Banking (previously included in Asset Management) and a sizeable one-off gain following the termination of the group's outsourcing contract with JP Morgan Chase.

New and improved disclosure

The H105 results included a full divisional breakdown at the interim stage for the first time, a welcome increase in disclosure. The results also included full-year 2004 results, restated under IFRS, at the divisional level (the group's formal IFRS restatement on 15 June provided a less than ideal group-wide analysis only).

Furthermore, the post-results meeting presentation included restated quarterly results (restated for both IFRS and profit reclassification) going back to Q104 and a full divisional capital allocation analysis for the first time.

Finally, a welcome reclassification of investment gains

The interims also included the reclassification of profits earned on seed capital investments to the Group Net Income segment. Previously these earnings were booked as Asset Management division profits, despite the capital being described as "surplus". Divisional earnings restated for these changes were also provided for 2004, including H104.

FIRST HALF HEADLINE RESULTS

The table below summarises the 2005 interim results.

Headline results – under IFRS & with reclassified investment gains (£m)

Year to December	H104	H204	2004	H105	H1/H1 (%)	H1/H2 (%)
Asset Management income	206.8	234.0	440.8	253.7	23	8
Asset Management costs	-151.5	-169.5	-321	-174.0	15	3
Asset Management profit	55.3	64.5	119.8	79.7	44	24
Private Banking profit	2.0	2.6	4.6	1.9	-5	-27
AM&PB profit	57.3	67.1	124.4	81.6	42	22
Private Equity	13.9	22.1	36	18.0	29	-19
Group net income/(costs)	1.4	2.0	3.4	3.5	150	75
Pre-exceptional PBT	72.6	91.2	163.8	103.1	42	13
Exceptional items		47.8	47.8	20.4		
Profit before tax	72.6	139.0	211.6	123.5	70	-11
Shareholders' funds	1,044.9	1,136.0	1,136.0	1,243.8	19	9
Diluted EPS (p)	19.4	33.7	53.1	30.6	58	-9
DPS (p)	6.5	13.5	20.0	7.0	8	-

Source Company

Asset Management division revenues and costs increased by 23% and 15% respectively, driving reported Asset Management profit up 44% to £79.7m. Private Banking revenues and costs grew by 13% and 14% respectively, leaving

the division's profits down 5% at £1.9m. In aggregate, Asset Management and Private Banking saw pre-exceptional profits increase by 42% to £81.6m.

CORE ASSET MANAGEMENT/ PRIVATE BANKING ACTIVITIES

We have aggregated the newly-separated Asset Management and Private Banking divisions into a single division (AM&PB) for the purposes of comparative analysis (and forecasting and valuation).

Reported results

The reported AM&PB H105 results under IFRS are set out below, together with restated IFRS comparatives and the previous UK GAAP results.

Reported Asset Management & Private Banking results (£m)

Year to December	UK GAAP			IFRS			
	H104	H204	2004	H104	H204	2004	H105
Net revenues	229.5	261.5	491.0	235.8	265.1	500.9	286.3
Administrative expenses	-181.0	-202.0	-383.0	-174.4	-193.4	-367.8	-201.0
Depreciation	-2.0	-2.1	-4.1	-5.5	-6.4	-11.9	-5.4
Operating profit	46.5	57.4	103.9	55.9	65.3	121.2	79.9
Interest/investment income	3.1	4.5	7.6	1.2	1.8	3.0	1.6
Associates	0.0	0.2	0.2	0.2	0.0	0.2	0.1
Core PBT	49.6	62.1	111.7	57.3	67.1	124.4	81.6
Non-operating income	2.4	6.7	9.1				
Pre-exceptional PBT	52.0	68.8	120.8	57.3	67.1	124.4	81.6
Exceptional items	2.7	-0.1	2.6	0.0	0.0	0.0	20.4
Goodwill amortisation	-5.0	-4.9	-9.9	0.0	0.0	0.0	0.0
Profit before tax	49.7	63.8	113.5	57.3	67.1	124.4	102.0
Opening AUM (£bn)	98.3	100.0	98.3	105.6	100.0	98.3	105.6
Investment return	2.4	6.9	9.3	2.4	-0.4	2.0	6.5
Net flow	-1.3	-1.3	-2.6	-1.3	-1.3	-2.6	0.0
Other	0.6	0.0	0.6	0.6	0.0	0.6	0.0
Closing AUM	100.0	105.6	105.6	100.0	105.6	105.6	112.1
Average AUM	99.2	102.8	102.0	99.2	102.8	102.0	108.9
Revenue/avg AUM (bp)	46.4	50.9	48.2	47.6	51.6	49.1	52.6
Admin expenses/avg AUM (bp)	-36.5	-39.3	-37.6	-35.2	-37.6	-36.1	-36.9
Costs/avg AUM (bp)	-36.9	-39.7	-38.0	-36.3	-37.9	-37.2	-37.9
Operating profit/avg AUM (bp)	9.4	11.2	10.2	11.3	12.7	11.9	14.7
Operating profit margin (%)	20.3	22.0	21.2	23.7	24.6	24.2	27.9

Source Company

IFRS impact

Before discussing the H105 results, it is worth noting the magnitude of the IFRS upward restatement of the division's profits. H104 Asset Management & Private Banking (AM&PB) operating profits (ie clean of any investment gains) have increased by 20% from £46.5m to £55.9m. Full-year 2004 operating profits have been restated upwards by 17% from £103.9m to £121.2m. These revisions are significantly higher than indicated in previous, group-wide IFRS transition presentations.

The key features of the reported AM&PB results were:

- Under IFRS, H1 AM&PB revenues were 21% up on H104 and 8% up on H204. This compares with average AUM up by around 10% and 6% respectively, indicating that around one-half of the division's revenue growth was driven by average AUM growth with one-half due to revenue margin expansion. Whereas the margin rose by 4bp from 48bp to 52 bp between H1 and H2 last year (aided by strong H2 performance fees, the increase from H204 to H105 was only 1bp).

- With first half 2005 AM&PB costs up 15% (3% sequentially), well below revenue growth, operating profits increased by 42% (22% sequentially).

Adjusting for central costs

An analysis of reported Asset Management & Private Banking results takes no account of central costs.

H105 profits by division – company presentation (£m)

Year to June 2005	AM&PB	Private Equity	Group net income/(costs)	Total
Net revenues	286.3	9.8	9.0	305.1
Administrative expenses	-201.0	-1.4	-16.0	-218.4
Depreciation	-5.4	0.0	0.0	-5.4
Operating profit	79.9	8.4	-7.0	81.3
Interest/investment income	1.6	0.7	10.5	12.8
Associates	0.1	8.9	0.0	9.0
Pre-exceptional PBT	81.6	18.0	3.5	103.1

Source Company, Panmure Gordon

H105 profits by division – alternative presentation (£m)

Year to June 2005	AM&PB	Investment Activities	Total
Net revenues	286.3	18.8	305.1
Divisional expenses	-206.4	-1.4	-207.8
Group costs	-16.0		-16.0
Operating profit	63.9	17.4	81.3
Interest/investment income	1.6	11.2	12.8
Associates	0.1	8.9	9.0
Pre-exceptional PBT	65.6	37.5	103.1

Source Company, Panmure Gordon

“True” Asset Management & Private Banking profit record

The table below sets out Asset Management & Private Banking profits net of group/central costs under UK GAAP and IFRS.

“True” Asset Management & Private Banking results* (£m)

Year to December	UK GAAP			IFRS			
	H104	H204	2004	H104	H204	2004	H105
Net revenues	229.5	261.5	491.0	235.8	265.1	500.9	286.3
Divisional expenses	-183.0	-204.1	-387.1	-179.9	-199.8	-379.7	-206.4
Group costs	0.0	0.0	-29.7	-10.1	-15.5	-26.1	-16.0
Operating profit	46.5	57.4	74.2	45.8	49.8	95.1	63.9
Interest/investment income	3.1	4.5	7.6	1.2	1.8	3.0	1.6
Associates	0.0	0.2	0.2	0.2	0.0	0.2	0.1
Core PBT	49.6	62.1	82.0	47.2	51.6	98.3	65.6
Non-operating income	2.4	6.7	9.1				
Pre-exceptional PBT	52.0	68.8	91.1	47.2	51.6	98.3	65.6
Opening AUM (£bn)	98.3	100.0	98.3	105.6	100.0	98.3	105.6
Investment return	2.4	6.9	9.3	2.4	-0.4	2.0	6.5
Net flow	-1.3	-1.3	-2.6	-1.3	-1.3	-2.6	0.0
Other	0.6	0.0	0.6	0.6	0.0	0.6	0.0
Closing AUM	100.0	105.6	105.6	100.0	105.6	105.6	112.1
Average AUM (£bn)	99.2	102.8	102.0	99.2	102.8	102.0	108.9
Revenue/avg AUM (bp)	46.3	50.9	48.2	47.6	51.6	49.1	52.6
Costs/avg AUM (bp)	-36.9	-39.7	-40.9	-38.3	-41.9	-39.8	-40.9
Operating profit/avg AUM (bp)	9.4	11.2	7.3	9.2	9.7	9.3	11.7
Operating profit margin (%)	20.3	22.0	15.1	19.4	18.8	19.0	22.3

*Charged for central costs

Source Company

The table below presents restated historic quarterly results prepared under IFRS and following the reclassification of investment gains.

Asset Management & Private Banking – quarterly progression (IFRS and investment gains reclassified) (£m)

Year to December	Q104	Q204	H104	Q304	Q404	H204	Q105	Q205	H105
Asset Management income	99.9	106.9	206.8	103.9	130.1	234.0	123.5	130.2	253.7
Asset Management costs	-76.1	-75.4	-151.5	-76.4	-93.1	-169.5	-89.2	-84.5	-173.7
Asset Management profit	23.8	31.5	55.3	27.5	37.0	64.5	34.3	45.4	79.7
AM profit margin (%)	24	29	27	26	28	28	28	35	31
Private Banking profit	0.4	1.6	2.0	2.5	0.1	2.6	1.7	0.2	1.9
AM&PB	24.2	33.1	57.3	30.0	37.1	67.1	36.0	45.6	81.6
Opening AUM (£bn)	98.3	100.4	98.3	100.0	99.8	100.0	105.6	108.9	105.6
Investment return	2.9	-0.5	2.4	1.1	5.8	6.9	2.1	4.4	6.5
Net flow	-1.4	0.1	-1.3	-1.3	0.0	-1.3	1.2	-1.2	0.0
Other	0.6	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Closing AM	100.4	100.0	100.0	99.8	105.6	105.6	108.9	112.1	112.1
Average AUM	99.4	100.2	99.2	99.9	102.7	102.8	107.3	110.5	108.9

Source Company

The table shows that the strength in first-half AM&PB profits was driven by a particularly strong Q2, with profits up 38% on Q204 and up 27% on Q105. It also shows an increase in the standalone Asset Management (ie excluding Private Banking) profit margin from 29% in Q204 and 28% in Q105 to 35% in Q205.

We also note that Q105 AM&PB profit was restated down from the £41.4m reported at the group's Q1 trading update on 17 May to £36.0m, a reduction of 13%. In other words, previously reported AM&PB profits 'overstated' the new definition by some 15%.

Assets under management and asset flows

AUM increased by 6% during H105 with all of the increase due to markets since aggregate net flows were flat.

2005 H1 AUM and asset flows (£bn)

	Institutional	Retail	Private Banking	Total
31 December 2004	69.1	30.2	6.3	105.6
Investment return	4.6	1.7	0.2	6.5
Net inflows	-2.0	1.6	0.4	0.0
30 June 2005	71.7	33.5	6.9	112.1

Source Company

Over the full six months, £2.0bn of institutional outflows was matched by £1.6bn of retail inflows and £0.4bn of Private Banking inflows.

As shown below, institutional outflows picked up a little during the second quarter, while retail flows were flat, leading to an overall net outflow of £1.2bn.

Asset flows - Retail inflows pause for breath (£bn)

	Q103	Q203	Q303	Q403	Q104	Q204	Q304	Q404	Q105	Q205
Retail	1.2	1.7	0.9	0.4	2.0	0.9	1.2	1.8	1.6	0.0
Private Banking	-0.3	0.1	-0.3	0.1	0.2	0.1	0.2	0.2	0.1	0.3
Institutional	-0.5	-0.2	-1.8	0.0	-3.6	-0.9	-2.7	-1.2	-0.5	-1.5
Total	0.4	1.6	-1.2	0.5	-1.4	0.1	-1.3	0.8	1.2	-1.2

Source Company

The tail-off in Retail flows during Q2 was explained as being due to a combination of:

- Some turnover in sub-advisory relationships during the quarter and some shifts in client asset allocation.
- The 'soft closure' of some funds to new client monies following recent and forthcoming fund manager changes. Zafar Ahmadullah and Adriaan de Mol van Otterloo are leaving Schroders later this year. They will be replaced by Gary Clarke from Gartmore and Leon Howard-Spink from Jupiter, who are due to arrive in September and November respectively.

According to management, sales of European equity funds could remain subdued until the new fund managers bed down.

BALANCE SHEET AND SURPLUS CAPITAL

Equity shareholders' funds increased by 8% or £100m during H105 and amounted to £1,244m at the end of June. The increase reflects retained earnings, marked-to-market gains on the group's stake in SVG Capital (which under IFRS are no longer recognised in the P&L account until realised) and the recognition of carried interests in private equity funds from 1 January 2005 onwards (and afforded a fair value of £28m at end-June 2005).

The table below sets out the allocation of this capital by division and the deployment of capital by division.

- According to this analysis, Schroders held capital surplus to its regulatory and other operating requirement amounting to £834m. Deducting the estimated value of carried interests, this equates to realisable surplus capital of £807m.
- Broken out of Asset Management for the first time, the group's Private Banking activities absorb a disproportionately large amount of capital (£163m), given their current profit contribution (a pre-exceptional £1.9m in H105).

End-June 2005 capital allocation by division (£m)

	Asset	Private		Private			
End-June 2005	Mgmt	Banking	AM&PB	Equity	Group	TOTAL	%
Regulatory	134.2	103.5	237.7			237.7	19
Other operating	70.4	55.8	126.2		21.0	147.2	12
Goodwill	20.9	3.6	24.5			24.5	2
Liquid funds	47.4		47.4		372.3	419.7	34
Hedge funds					126.0	126	10
Schroder funds					109.8	109.8	9
Private equity				170.9		170.9	14
Leasing					8.0	8.0	1
TOTAL	272.9	162.9	435.8	170.9	637.1	1,243.8	100
O/w 'surplus'	47.4		47.4	170.9	616.1	834.4	67

Source Company

- The make-up of the group's Private Equity capital, split between actual investments and the estimated fair value of carried interests, is set out below.

Private Equity interests (£m)

	End-June 2005
SVG Capital	47
SVIL co-investment vehicles	34
GP & LP interests (Permira/other funds)	36
Internet Finance Partners	8
Other	18
Investments	143
Carried interests	28
Total	171

Source Company

VALUATION

Strong share price performance has fully reflected the step-up in core profitability

The group's share price performance, and in particular its asset management EV performance, has fully discounted the step-up in core profitability (part IFRS, part fundamental). Based on DCF analysis, we consider 817p a current fair value for the voting shares.

AM&PB ENTERPRISE VALUE PERFORMANCE

As shown below, Schroders' Asset Management & Private Banking enterprise value rose from less than £1.2bn prior to the Q1 trading update on 17 May to almost £1.8bn prior to the interim results last week, outperforming the FTSE All Share Index by more than 30% over the three-month period.

Asset Management & Private Banking EV and relative to All Share



Source Datastream

The pick-up in the share price following the Q1 update primarily reflected the revelation that Q1 Asset Management profits (including Private Banking) had increased by 60% from £25.8m in Q104 to £41.4m in Q105. It is interesting to note that, following restatement to exclude investment gains on 'surplus capital', this increase has been reduced to 49% from £24.2m to £36.0m.

NEW IFRS FORECASTS

We have upgraded our forecasts to reflect: 1) the step-up in profitability seen on the shift from UK GAAP to IFRS accounting; and 2) a much better-than-expected Q2 performance from Asset Management & Private Banking.

Revised estimates (£m)

Year to December	2005E			2006E			2007E		
	Old	New	Change	Old	New	Change	Old	New	Change
	UK GAAP	IFRS	(%)	UK GAAP	IFRS	(%)	UK GAAP	IFRS	(%)
AM&PB operating profit	114.7	162.8	42	130.5	168.6	29	149.7	183.8	23
AM&PB profit before tax	125.5	166.0	32	141.2	171.8	22	160.5	187.0	16
Group pre-exceptional PBT	154	205.7	34	168.9	206.1	22	187.3	220.7	18
EPS (p)	38.9	54.1	39	42.7	52.1	22	47.4	55.8	18
Net DPS (p)	21.0	21.0	0	22.0	22.0	0	23.0	23.0	0

Source Panmure Gordon

- The AM&PB operating profit changes are most comparable, in that they exclude the effects of the reclassification of investment gains which accompanied restatement under IFRS (although not part of IFRS itself).

- We estimate that around 17% of our AM&PB operating profit upgrade is due to the shift to IFRS, which implies fundamental, like-for-like upgrades of around 25% for 2005E, 12% for 2006E and 6% for 2007E.
- The 2005E upgrade also reflects the improvement in the division's return on average AUM.

VALUATION

EV/NOPAT multiples

In the table below, we subtract what we consider 'surplus capital' from the combined market capitalisation of the group's voting and non-voting share classes to derive an estimate of the enterprise value (EV) of the group's core Asset Management & Private Banking (AM&PB) businesses.

'Ex-cash' EV/NOPAT multiples for AM&PB divisions

Year to December	2004	2005E	2006E	2007E
AM&PB enterprise value	1,743.8	1,743.8	1,743.8	1,743.8
AM&PB revenues	500.9	585.0	634.8	688.2
AM&PB NOPAT	68.8	93.1	96.5	106.4
EV/revenues	3.5	3.0	2.7	2.5
EV/NOPAT	25.3	18.7	18.1	16.4

Source Panmure Gordon

Based on our updated IFRS forecasts, and assuming a 30% tax charge (the group charge is lower than 30% due to tax-free private equity profits) and charged for central costs, the core businesses currently trade on a 2005E EV/NOPAT of 18.7x, falling to 16.4x for 2007E (reflecting 7% pa core NOPAT growth over the two years).

DCF valuation (£m)

Steady-state AUM growth (%)	6													
Steady-state RoAUM (%)	0.080													
Discount rate (%)	9													
Terminal multiple	11.1													
	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	Terminal
Average AUM	110.4	119.8	129.8	137.6	145.9	154.7	163.9	173.8	184.2	195.2	207.0	219.4	232.5	233
Asset growth (%)	8	9	8	6	6	6	6	6	6	6	6	6	6	
Operating profit less tax	133.0	137.9	152.0											
NOPAT	93.1	96.5	106.4	110.1	116.7	123.7	131.1	139.0	147.4	156.2	165.6	175.5	186.0	2067.0
RoAUM (%)	0.082	0.081	0.082	0.080	0.080	0.080	0.080	0.080	0.080	0.080	0.080	0.080	0.080	
PV (free cash flow)	85	81	82	78	76	74	72	70	68	66	64	62	61	619
NPV (free cash flow)	1,558													
NPV/share	526													
	(£m)	(p)												
AM&PB enterprise	1,558	526												
Surplus capital	807	272												
TOTAL	2,365	789												

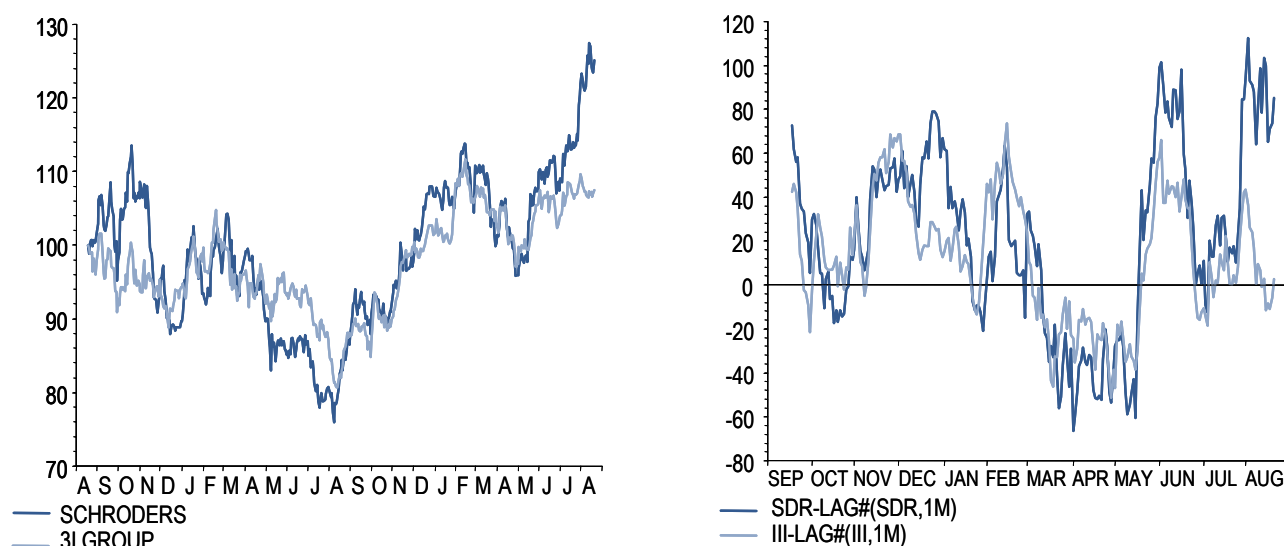
Source Panmure Gordon

The above DCF incorporates the AM&PB NOPAT forecasts used in our EV/NOPAT ratio analysis above. We have assumed a stabilisation of the core return on AUM from 2008 onwards at 8bp and cautiously assumed long-term AUM growth settling at 6% pa. The analysis yields a fair enterprise value estimate of £1,558 and a fair market value estimate of £2,433m (equivalent to 817p per voter, 737p per non-voter, given the current 80p spread).

TECHNICAL CORNER: THE 3I RELATIVE STRENGTH INDICATOR

In our note *Still Expensive*, 25 May 2005, we noted the high correlation (and co-linearity) between Schroders' and 3i's share prices. As shown below, this relationship appeared to break down during July.

Schroders and 3i Group – prices and monthly returns diverge in July



Source Datastream

Based on the longer-term relationship (which reflects the significance of private equity/investment profits to Schroders' overall returns), we might expect at least some convergence in relative performance. For an unchanged 3i price, this equates to a reduction in Schroders' voting shares of up to around 80p per share, from the current 880p to around 800p.

THE NUMBERS

We have updated and reformulated our forecasts to reflect IFRS, profit reclassifications and H105 results

Profit & loss (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	543.4	625.3	675.6	729.6
Administrative expenses	-396.2	-447.2	-492.1	-531.4
Depreciation	-12.4	-11.0	-11.0	-11.0
Operating profit	134.8	167.1	172.5	187.2
Interest/investment income	23.0	25.3	25.3	25.3
Associates	6.0	13.2	8.2	8.2
Pre-exceptional PBT	163.8	205.7	206.1	220.7
Exceptional items	47.8	20.4		
Profit before tax	211.6	226.1	206.1	220.7
Taxation	-41.4	-51.4	-51.5	-55.2
Minorities	-15.6			
Attributable profit	154.6	174.7	154.5	165.6
Dividends	-56.4	-62.2	-65.2	-68.1
Retained profit	98.2	112.4	89.4	97.4
Period-end shares	296.3	296.3	296.3	296.3
Average shares	296.6	296.6	296.6	296.6
EPS (p)	53.1	58.9	52.1	55.8
Adjusted EPS (p)	40.8	54.1	52.1	55.8
DPS (p)	20.0	21.0	22.0	23.0
NAV (p)	383.4	421.3	451.5	484.4

Source Panmure Gordon, company data

Summary cash flows (£m)

Year to December	2004	2005E	2006E	2007E
Operating profit	157.8	192.5	197.9	212.5
Depreciation	12.4	11	11	11
Gross cash flow	170.2	203.5	208.9	223.5
Capes	-5.0	-5.0	-5.0	-5.0
Operating cash flow	165.2	198.5	203.9	218.5
Tax	-16.4	-41.4	-51.4	-51.5
Equity cash flow	148.8	157.1	152.4	167.0
Equity dividends	-53.7	-56.4	-62.2	-65.2
Net cash flow	95.1	100.7	90.2	101.8

Source Panmure Gordon, company data

Summary balance sheets (£m)

Year to December	2004	2005E	2006E	2007E
Avg AUM	102.0	110.4	119.8	129.8
Assets under management	105.6	115.2	124.4	135.3
Equity	1,136.0	1,247.8	1,336.2	1,432.2
Intangible assets	35.8	28.4	21.0	13.6
Tangible equity	1,100.2	1,219.4	1,315.2	1,418.6

Source Panmure Gordon, company data

DIVISIONS – REPORTED BASIS

Asset Management & Private Banking (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	500.9	585.0	634.8	688.2
Administrative expenses	-367.8	-411.2	-455.1	-493.4
Depreciation	-11.9	-11.0	-11.0	-11.0
Operating profit	121.2	162.8	168.6	183.8
Interest/investment income	3.0	3.0	3.0	3.0
Associates	0.2			
Pre-exceptional PBT	124.4	166.0	171.8	187.0
Discontinued ops				
Exceptional items		20.4		
Profit before tax	124.4	186.4	171.8	187.0
Opening AUM (£bn)	98.3	105.6	115.2	124.4
Investment return	9.3	10.6	9.2	9.9
Net flow	-2.6	-1.0	0.0	1.0
Other	0.6			
Closing AUM	105.6	115.2	124.4	135.3
Average AUM (£bn)	102.0	110.4	119.8	129.8
Revenue/avg AUM (bp)	49.1	53.0	53.0	53.0
Admin expenses/avg AUM (bp)	-36.1	-37.3	-38.0	-38.0
Costs/avg AUM (bp)	-37.2	-38.2	-38.9	-38.8
Operating profit/avg AUM (bp)	11.9	14.8	14.1	14.2
Operating profit margin (%)	24.2	27.8	26.6	26.7
Shareholders funds	379.0	435.8	435.8	435.8
Pre-exceptional ROE (%)	23.0	26.7	27.6	30.0

Source Panmure Gordon, company data

Private Equity (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	31.7	21.3	21.3	21.3
Administrative expenses	-2.8	-3.0	-3.0	-3.0
Operating profit	28.9	18.3	18.3	18.3
Interest/investment income	1.3	1.3	1.3	1.3
Associates	5.8	13.0	8.0	8.0
Other income/expenses	0.0	-0.9	-1.3	-1.8
Pre-exceptional PBT	36.0	31.7	26.3	25.8
Exceptional items	47.8			
Profit before tax	83.8	31.7	26.3	25.8

Source Panmure Gordon, company data

Group net income/(costs) (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	10.8	19.0	19.6	20.2
Administrative expenses	-25.6	-33.0	-34.0	-35.0
Depreciation	-0.5	0.0	0.0	0.0
Operating profit	-15.3	-14.0	-14.4	-14.9
Interest/investment income	18.7	21.0	21.0	21.0
Profit before tax	3.4	7.0	6.6	6.1

Source Panmure Gordon, company data

DIVISIONS – ALTERNATIVE PRESENTATION

Asset Management & Private Banking (net of group central costs) (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	500.9	585.0	634.8	688.2
Divisional expenses	-379.7	-422.2	-466.1	-504.4
Group costs	-26.1	-33.0	-34.0	-35.0
Operating profit	95.1	129.8	134.7	148.8
Interest/investment income	3.0	3.0	3.0	3.0
Associates	0.2			
Pre-exceptional PBT	98.3	133.0	137.9	152.0
Opening AUM (£bn)	98.3	105.6	115.2	124.4
Investment return	9.3	10.6	9.2	9.9
Net flow	-2.6	-1.0	0.0	1.0
Other	0.6			
Closing AUM	105.6	115.2	124.4	135.3
Average AUM (£bn)	102.0	110.4	119.8	129.8
Revenue/avg AUM (bp)	49.1	53.0	53.0	53.0
Costs/avg AUM (bp)	-39.8	-41.2	-41.8	-41.5
Operating profit/avg AUM (bp)	9.3	11.8	11.2	11.5
Operating profit margin (%)	19.0	22.2	21.2	21.6
Shareholders funds	379.0	435.8	435.8	435.8
Average equity	379.0	435.8	435.8	435.8
Pre-exceptional ROE (%)	18.2	21.4	22.1	24.4

Source Panmure Gordon, company data

Investment activities (Group & Private Equity) (£m)

Year to December	2004	2005E	2006E	2007E
Net revenues	42.5	40.3	40.9	41.5
Administrative expenses	-2.8	-3.0	-3.0	-3.0
Operating profit	39.7	37.3	37.9	38.5
Interest/investment income	20.0	22.3	22.3	22.3
Associates	5.8	13.0	8.0	8.0
Other income/expenses	0.0	-0.9	-1.3	-1.8
Pre-exceptional PBT	65.5	71.7	66.9	67.0

Source Panmure Gordon, company data

Distribution of investment ratings for equity research (as of 30 June 05)

Overall Global Distribution (Banking Client*)		
Buy	Hold	Sell
46% (26%)	37% (9%)	16% (3%)

* Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients

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

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24 August 2005

Equity Research

COMPANY PROFILE

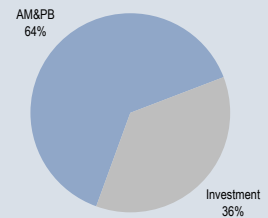
Business Profile

Schroders is an asset management and investment holding company. Assets under management totalled around £112bn as at 30 June 2005, at which time private equity and other investments amounted to around £415m and net liquid resources a further £420m.

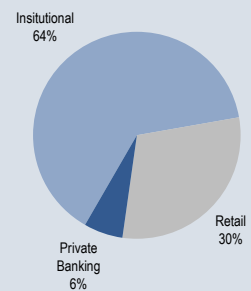
Recent News

The first half results were better than we expected, driven by a substantial increase in second quarter profitability from the Asset Management, excluding Private Banking, and aided by a significant IFRS uplift. Offsetting profits growth were flat Q2 net retail sales and outlook comments hinting at stable rather than rising margins from now on.

PBT by activity* (%)



AUM by client type* (%)



*End-June 2005

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	Corina Blum Evans

Major Shareholders (%)

Schroder family	44.09
Fidelity	4.26
Legal & General	3.05

Financial Diary

Next Statement	Q3 Trading Update
Next Results	Q3 – November 2005
Next ex dividend	March 2006

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