Close Brothers Group plc

Preliminary Results 2023

Edited transcript*

Tuesday 26th September 2023

Adrian Sainsbury, Group Chief Executive Officer

Good morning. And welcome to the presentation of Close Brothers full-year 2023 results. I'll start with a brief reflection on our performance, Mike will then take us through our financials, I'll then come back to talk about our business and strategy, after which you can submit your questions either via the telephone line or during the webcast, which you can submit during the presentation or afterwards.

We've had a challenging market backdrop this year where mixed economic conditions in the UK have created substantial uncertainty for our consumer and SME customers.

Our financial results were impacted by the provisions we took in relation to Novitas in the first half, resulting in a material reduction in operating profit.

We're clearly disappointed with these developments and the impact they've had on our financial performance this year. However, we've seen good momentum in Banking and CBAM in the second half and we're encouraged with our good start to the 2024 financial year and we're well placed to move forward on the delivery of our strategy. In Banking, we've been encouraged by the acceleration of loan book in half two, with growth of 5% or 8% excluding our businesses in run-off with strong margins. We've accelerated our growth strategy in CBAM and attracted more clients which led to strong net inflows of 9% with a significant contribution from talented staff who joined the team.

Winterflood's performance was impacted by a continued slowdown in trading activity. Albeit with strong growth in WBS.

We've maintained strong capital, funding and liquidity positions with our CET1 capital ratio at 13.3%, significantly ahead of our minimum regulatory requirement, and we're pleased to propose a final dividend of 45.0p, resulting in a full-year dividend of 67.5p. This reflects our underlying performance and our confidence in the group's outlook.

We are confident that we have the right model to support customers during these uncertain times by leveraging our long-term relationships, the deep expertise of our people, and our customer-centric approach.

* This transcript has been edited to correct minor factual inaccuracies.

The consistency of our lending model gives us confidence in the quality of our loan book.

We have a strong balance sheet which stems from our prudent management of our financial resources and the events impacting the global banking sector earlier this year have highlighted the benefits of our approach.

We apply our business model consistently through the cycle. This means we're always there for our customers, even when others may pull back and have a long-track record of delivering loan book growth. In turn, this allows us to deliver progressive and of sustainable dividend growth. We're well positioned to build on the second half's momentum and our good start to the 2024 financial year.

I'll now hand over to Mike to take us through the financials , and then I'll come back to talk about our business and strategy.

Mike Morgan, Group Finance Director

Thank you, Adrian. Good morning everyone.

As you can see, this year's headline numbers have been materially impacted by the provisions taken against Novitas. This was the primary driver of the reduction in adjusted operating profit to £114 million, and the decline in adjusted earnings per share to 55.1p.

Excluding Novitas, we performed well in the current environment. Since the first half, we've been encouraged by the positive momentum seen in the loan book, with strong margins and stable credit performance.

Income was broadly stable, as 3% growth in the Banking division offset reductions in both market-facing businesses.

Costs increased 3%, as higher staff costs and ongoing investment in Banking and Asset Management, more than offset lower variable costs in Winterflood.

And on a pre-provision basis, profit was down 6% to £318 million.

We generated a return on tangible equity of 12.0% excluding the impact of Novitas, which I'll refer to as the 'underlying basis' throughout this presentation.

And as Adrian mentioned, the board has proposed a 45p final dividend, taking the full year dividend up 2% on last year to 67.5p.

Although the proposed level of dividend cover for 2023 is below our historical range, driven primarily by the adverse impact of the Novitas provisions on our profitability, the proposed dividend reflects our underlying performance and the board's confidence in our outlook.

We remain committed to our dividend policy, which aims to provide sustainable dividend growth year-on-year, while maintaining a prudent level of dividend cover.

Turning to the divisional performance.

In Banking, performance was significantly impacted by higher impairment charges in relation to Novitas, as well as forward-looking provisions, reflecting the uncertain macroeconomic outlook.

As a result, profit reduced 47% to £120 million.

Profits were down in the three Banking businesses, notwithstanding strong new business volumes.

In Asset Management, we generated strong net inflows of 9%, although profit reduced 27% to £16 million, reflecting challenging market conditions, and investment in accelerating our hiring strategy.

Winterflood's performance was impacted by the continued market-wide slowdown in trading activity, particularly in higher margin sectors, with profit down 75% to £4 million.

Moving to the Banking division.

Although we have experienced a challenging market backdrop this year, we have maintained our commitment to lending through-the-cycle and retained our pricing discipline.

We saw 3% growth in income to £714 million, reflecting good loan book growth and strong margin.

The net interest margin decreased marginally to 7.7% mainly reflecting the reduction in Novitas income.

Costs rose by 7% to £390 million reflecting salary increases and spend on progressing our strategic investment programmes.

Pre provisions, profits declined 2%.

Impairment charges increased to £204 million, mainly driven by Novitas, which corresponds to a bad debt ratio of 2.2%.

Overall, profit was down 47% to £120 million.

Now, highlighting the key metrics from across the Banking division, on an underlying basis.

We saw income growth of 6%, as well as loan book growth of 6%. The net interest margin was strong at 7.6%, as we maintained our pricing discipline.

Costs grew 9% reflecting increased staff costs and investment in our strategic programmes.

The bad debt ratio was 0.9%, below our long-term average.

And pre-provisions, AOP was up 2% to £314 million.

Moving onto Commercial.

We saw income growth of 7%, driven by good loan book growth of 8%, with strong new business volumes.

Whilst the marginal decline in the NIM reflected the timing lag in passing through higher rates to customers, partly offset by increased fees.

Costs grew 12% from higher staff costs and investment spend on our Asset Transformation programme.

The bad debt ratio increased to 0.5% to take into account the weaker external environment.

And pre-provisions, AOP was up 1% to £143 million.

Moving onto Retail.

Where income was up 5%, reflecting growth in the UK Motor book and our strong margin of 8.2%, as we adhered to our model of pricing discipline.

Costs rose 8%, as we invested in the Retail simplification programme and incurred higher staff costs.

The bad debt ratio increased to 1.6%, reflecting the weaker macroeconomic outlook and increased arrears in Motor.

And pre-provisions, profit was down 2% to £84 million.

And finally in Property. Income grew 5%, reflecting strong loan book growth, as well as higher fee income.

With the NIM down marginally to 7.4% reflecting higher cost of funds.

Costs were stable as we maintained strict cost discipline.

We also saw a rise in the bad debt ratio to 1.1% to reflect the weaker environment, particularly projected lower house prices and pre-provisions, profit was up 6% to £87 million.

Moving onto the loan book.

We saw 5% growth on a reported basis. And 8% when excluding the businesses in run-off – Novitas and our Irish motor finance book. 7% of this growth was in the second half.

Our Commercial book grew 8% on an underlying basis, despite the impact of CBILS lending running off with Asset Finance up 5% and Invoice & Speciality Finance up 16%.

Our Retail book grew 4% when excluding the Irish Motor Finance business with the UK Motor book up 3% and Premium Finance up 4%, and Property delivered strong growth of 16%.

We're encouraged by the acceleration seen in half two and expect to broadly sustain this growth momentum this year.

Overall, we are confident in the outlook for the loan book over both the short and medium term and remain well positioned to deliver disciplined growth.

Turning now to our net interest margin.

Our specialist, relationship-driven model and disciplined approach to pricing, have enabled us to maintain a strong net interest margin.

On an underlying basis, we achieved a NIM of 7.6%, reflecting our pricing discipline on new lending and the optimisation of our liability mix and funding costs in the rising rate environment.

While we expect cost of funds to increase further in the next financial year, we remain focused on prioritising our margin and are well positioned to maintain strong margins in FY24

Moving onto costs in the Banking division.

There was a 7% increase overall, reflecting both salary increases and continued spend on our investment programmes.

Business-as-usual costs rose £18 million, with over half of the increase driven by higher staff costs. This reflected both inflation-related salary rises, as well as growth-driven hires, and was partly offset by lower performance-linked compensation, due to the reduction in profit in the year.

Investment costs also increased £11 million, driven by spend on our strategic growth initiatives and cost management programmes, with depreciation charges related to our investment projects rising £4 million.

Looking forward, we expect our Full Year 24 cost base to increase by c.8 to 10%.

The main driver of this increase will be the higher average salary awards at the end of the 2023 financial year, and a normalisation of performance-linked compensation.

This will also be driven by volume and activity-driven growth, as we look to build on the momentum in loan book growth seen in H2, as well as continued investment in our strategic cost management programmes, which will be partly offset by efficiency savings coming through from our tactical and strategic cost initiatives.

For Full Year 25, we expect cost growth to more closely align with income growth as we remain focused on achieving positive operating leverage over the medium term. With lower inflationary pressures projected, and our investment spend expected to stabilise. And further efficiency gains coming through.

Delving further into our investment approach, which we see as critical to protect our business model, future-proof our income generation, and reduce costs.

Firstly, we are investing to support income generation and growth. Our relationship-based model and focus on niche markets, enables us to generate a consistently strong NIM through the cycle, whilst achieving high customer satisfaction scores.

Our growth initiatives have made a significant contribution to loan book growth this year. And our multi-year investment programmes are delivering ongoing tangible benefits, with retail deposits up 80% since the implementation of our deposit platform and the UK Motor loan book growing 30% following the launch of our Motor Finance transformation programme.

We are also investing to maintain operational resilience and regulatory compliance. We have made enhancements to our credit risk management framework as part of our preparations for IRB, and we've implemented a programme directly aligned to the requirements of the FCA's Consumer Duty. as well as continuing to strengthen our cyber and operational resilience.

Finally, as I mentioned on the previous slide, we are also investing to generate operational efficiency and cost savings, with strategic cost management programmes in progress and further opportunities being evaluated.

One such initiative is our technology transformation programme, which is focused on our strategic IT services. This will see us move to a single third-party provider, and reduce costs through outsourcing and offshoring, as well as reducing the number of IT applications in our estate.

Through these initiatives and our focus on cost discipline, we are creating capacity to accommodate growth, inflation and investment to support our high touch model, whilst also reducing our cost base.

Turning now to our credit performance.

The bad debt ratio was 2.2%, as we recognised £117 million of impairment charges in relation to Novitas, of which £115 million were incurred in the first half.

The underlying bad debt ratio of 0.9% was driven by forward-looking provisions to reflect weaker macroeconomic variables, as well as higher arrears in Motor Finance, which have stabilised since the first half.

We continue to closely monitor the evolving impacts of rising inflation and cost of living on our customers but have not seen a significant impact on credit performance at this stage.

We remain confident in our loan book, which is predominantly secured or structurally protected, prudently underwritten and diverse.

For FY24, we expect our bad debt ratio to remain below our long-term average of 1.2%, based on current market conditions.

Turning to Asset Management.

Managed assets increased 7% over the year to £16.4 billion, driven by strong net inflows, partly offset by negative market performance.

Total client assets were up 5% to £17.3 billion.

We delivered annualised net inflows of 9%, with a strong contribution from new hires.

Operating income decreased 2% to £145 million, reflecting the impact of difficult market conditions on client assets, and a reduction in client activity. This was partially offset by an increase in investment management income, resulting from growth in AuM delivered by our bespoke investment manager hires.

The revenue margin decreased to 84bps, primarily due to flows into our lower margin investment management, and non-advised products.

Costs increased 2% to £129 million, primarily reflecting inflationary-driven salary increases, and the onboarding of new hires, as we have accelerated investment for future growth.

As a result, profit decreased 27% to £16 million and the operating margin decreased to 11%.

And now onto Winterflood.

Income was down 21% to £75 million driven by lower trading revenue, reflecting a market wide slowdown in trading activity, particularly in our higher margin sectors.

Over the year, average daily bargains decreased to 60,000, marginally above pre-pandemic levels, as macroeconomic uncertainty impacted retail trading activity. Nevertheless, we maintained our market-leading position.

Diversification across trading sectors has also helped to mitigate the difficult market conditions, with Fixed Income benefiting from volatility in bond markets.

And Winterflood Business Services grew significantly, with income up 45%, and assets under administration increasing to £12.9 billion.

Costs reduced by 11% to £72 million, reflecting lower variable staff costs.

As a result, operating profit declined 75% to £4 million.

Moving onto our balance sheet. Where our prudent approach to managing financial resources served us well, during the recent market dislocation.

We maintained a strong balance sheet and increased our total funding to £12.4 billion, well in excess of the loan book.

We continued to “borrow long and lend short” with the average maturity of allocated funding at 21 months, ahead of the loan book at 16 months.

We manage liquidity conservatively, with our Liquidity Coverage Ratio at over 1,000%.

We had £2.2 billion of treasury assets at 31st July, with the majority held with the Bank of England.

We have a diverse funding base, with an established presence across wholesale markets, along with our mix of retail and non-retail deposits.

Although market rates increased materially, we were able to mitigate this, in part, through actions taken to optimise our liability mix, resulting in an average cost of funds of 3.2%.

We successfully issued a £250 million senior unsecured bond out of our holding company earlier this year.

And we increased our total deposit base to £7.7 billion, with 35% growth in retail deposits, which now make up 54% of all deposits.

Our credit ratings remain strong, with Moody’s rating Close Brothers Limited at Aa3, helping to support our ongoing issuance plans.

Turning now to our capital position.

Our transitional CET1 capital ratio was 13.3%, down from 14.6% at 31 July 2022. The movement mainly reflects the impact of Novitas, as well as loan book growth and underlying profitability.

We maintained headroom of c.380bps, above our minimum CET1 regulatory requirement of 9.5%.

Our leverage ratio remained strong at 11.4%.

On IRB, we continue to engage with the regulator, and have submitted additional documentation as part of the Phase 2 process, although the timing remains under the direction of the PRA.

And finally, turning to our capital framework, which articulates how we are thinking about excess capital.

We are targeting a CET1 capital ratio range of 12% to 13% over the medium term, which will allow us to maintain a buffer to minimum regulatory requirements, while also retaining flexibility for growth.

We remain encouraged by the available opportunities to deploy capital to deliver disciplined growth, which remains one of our key strategic priorities.

The board remains committed to our dividend policy, which aims to provide sustainable dividend growth year-on-year, while maintaining a prudent level of dividend cover.

Further capital distributions to shareholders, will be assessed based on future opportunities.

We remain committed to further optimising our capital structure, including the issuance of debt capital market securities, if appropriate.

Thank you. And I will now hand back over to Adrian.

Adrian Sainsbury

Thanks, Mike. Despite the challenging market backdrop, UK economy is still growing.

However, uncertainty and challenges for SME firms persist, with interest rates rises and cost of funds remaining a key concern for many business owners.

We recently published the Close Brothers Asset Finance Business Sentiment Index, which gives us interesting insights about our core customers' plans for the future.

The survey shows that SME business confidence continues to recover, a continued reversal of last year's downward trend.

Overall, the appetite to invest remained stable, with three quarters of SME firms surveyed aiming to seek funding for investment in the next 12 months.

Demand this year also remains robust, particularly in our Commercial and Property businesses, and we're encouraged to see cautious optimism slowly returning for UK SMEs.

While sticking to our underwriting and pricing criteria,we continued to support customers in the current uncertain economic environment, and are consistently there when they need us the most.

Our customers value that consistency, our specialism and excellent service, and we've a strong balance sheet to support them.

I firmly believe that we can thrive in this environment, which will create further opportunities for us to lean in and support consumers and SME businesses.

We're well positioned to deliver our strategic priorities to protect, grow, and sustain our valuable business model, and I'll now take you through the progress we've made this year.

Looking ahead, by continuing to focus on disciplined growth, cost efficiency and capital optimisation, I'm confident that we can resume our long-term track record of earnings growth and returns.

We're continuing to drive our strategic growth agenda, and I'm pleased to see a significant contribution from our growth initiatives this year.

In Banking, we remain excited about the opportunity to broaden our sustainable finance offering, as the UK heads towards a net zero carbon economy.

At the start of Full Year 2023, we set an initial green finance ambition to provide £1 billion of funding for battery electric vehicles by 2027, and we've lent over £164 million in the first year.

Our recently hired materials handling and agricultural equipment teams are executing deals, and have built strong pipelines.

We continue to grow in the Asset Based Lending space, and participated in our first syndication deal. Our newly hired team, which provides bespoke term loan structures to SMEs for growth and investment finance, closed their first deal this year.

Our specialist buy-to-let extension pilot, with existing customers in our Property business has proven successful, and wrote healthy levels of business during the year.

We're delighted to have recently announced our agreement to acquire Bluestone Motor Finance. We see Ireland as a strategic market, and this acquisition provides a platform for us

to build our Irish Motor Finance business. We're excited to be re-entering a market we understand well, and where we've been successful in the past.

In Asset Management, we accelerated our growth strategy and delivered net inflows of 9%. With a significant contribution from new hires, we also continue to build our pipeline of in-fill acquisitions to support the long-term growth potential of the business.

We continue to see significant growth potential in Winterflood Business Services. Assets under Administration reached £12.9 billion,. exceeding our £10 billion target for this year and with a strong pipeline, we expect WBS to grow AuA to over £20 billion by full year 2026.

These are all examples of our relationships, expertise and relentless focus on customer service being utilised to deliver disciplined growth, and we'll continue to actively evaluate new potential opportunities that are aligned with our business model.

I'll now give you a brief update on each of our businesses and provide some of the highlights of the year.

In our Commercial business, we lend directly, via our expert sales team, and indirectly to over 25,000 SMEs.

We lend against a diverse range of assets, and are specialists in refinancing second hand assets. These include trucks, vans, excavators, machinery and building equipment – essential assets for small businesses.

We also provide debt factoring, invoice discounting and asset-based lending providing crucial working capital to 6,000 thousand small businesses in our Invoice & Speciality Finance business.

We continued to see good demand this year, and loan book growth of 8% excluding Novitas. This is despite the roll-off of CBILS, and supported by the new growth initiatives I just covered. Average new business volumes were up 15% in the year.

In Asset Finance, the loan book grew 5%, as we saw strong new business volumes, particularly from our Contract Hire and Energy books. As well as good demand for our Agriculture offering. Despite the competitive market, we remained focused on pricing, actively choosing to pass through higher rates on new lending where appropriate.

In Invoice and Speciality Finance we saw record new business volumes and higher utilisation levels in Invoice Finance. with good growth in our Irish business and continued progress in the ABL space. Excluding Novitas, the Invoice and Speciality Finance loan book increased 16%.

In our Retail businesses, we lend to consumers and small businesses through our dealer partners and intermediary brokers across Motor and Premium Finance.

The second-hand car market remains in excellent shape. Our Motor Finance products support customers who tend to be in the low to middle income brackets. To these customers, their car is an essential and the second biggest commitment behind their rent or mortgage.

In Premium Finance, we provide a simple lending proposition that helps make insurance more affordable, allowing 2.6 million consumers and small businesses to pay in instalments rather than through a single upfront payment. Our products can help customers with the continued inflationary pressures in the current environment.

We were encouraged by the recovery in new business volumes seen since the first half. with average new business volumes up 4% year-on-year, excluding the Irish Motor Finance run-off book.

In Motor Finance, we completed our transformation programme, which created better digital capabilities and a stronger proposition for dealers and customers, as well as enabling us to explore additional routes to market. This supported the growth seen in our UK business. Throughout the year, we prioritised our margins, with 4 rate rises passed on by our dealer partners.

In Premium Finance, we continue to focus on our digital capabilities to enhance our offering and to support brokers' decisioning. Following a decline in the Premium loan book in the first half. we've seen an increase in new business volumes from individuals. And larger premium sizes reflecting inflation. resulting in the Premium Finance loan book returning to growth.

In Property, we specialise in short-term residential development finance through Property Finance, and also offer refurbishment and bridging loans through Commercial Acceptances.

We operate in London, the South East and selected regional locations. lending to around 700 professional property developers. We focus on small to medium-sized residential developments with an average unit price sold of around £600,000. This is the sweet spot in the market, given the structural demand for family housing in the UK.

This year has seen a slowdown across the UK property market. With buyer sentiment impacted by rising interest rates. and we've seen a fall in housebuilding levels and some contraction in house prices.

Despite this, our Property Finance business performed well. with record drawdowns, growth in active customer numbers, and our pipeline remaining healthy at over £1 billion.

We're also seeing good demand for the new offerings in Property Finance, such as our specialist buy-to-let proposition to existing bridging finance customers, and our enhanced loan-to-value product for select customers.

We continue to focus on growing our regional loan book, which makes up over 50% of our portfolio.

We've accelerated our efforts to grow CBAM.

Our hiring strategy is proving successful, with new bespoke investment managers significantly contributing to the net inflows of 9% achieved this year.

We increased our rate of hiring recruiting 15 new portfolio managers in the year, and opened new offices in Birmingham and Cheltenham.

We remain confident that our vertically integrated, multi-channel business model positions us well for the structural growth opportunity available to the wealth management industry.

Our focus remains on providing excellent service building on the strength of our client relationships whilst investing in new hires and building our pipeline of acquisitions to support the long-term growth potential of our business.

While CBAM is sensitive to financial market conditions, we remain committed to driving growth in the business.

Performance at Winterflood reflected the continuation of challenging market conditions.

Investors turned away from the higher margin, AIM and Small Cap sectors either to safer and better performing sectors such as Fixed Income and ETFs or withdrew from the market completely as they await more certainty in the macroeconomic environment.

This sentiment has inevitably led to fewer retail-driven trading situations and a fall in our volumes. Nevertheless, we've maintained our market leading position and were number one by volume traded in the year.

We remain confident in the track record of our trading business and are well positioned to benefit when investor appetite returns.

Winterflood has made good progress on the diversification of its revenue streams and is exploring growth opportunities to balance the cyclicality seen in the trading business.

WBS, our in-house developed business has continued its positive trajectory. AuA grew to £12.9 billion despite declines in equity markets, with Net inflows increasing to £5.5 billion, following the successful migration of custody assets of Fidelity International in the first quarter, resulting in WBS growing income by 45%.

We're confident that WBS is well positioned for further growth and expect AuA to grow to over £20 billion by full year 2026.

While the risk-off market sentiment continues to impact the number of IPOs coming to the market, our Investment Trust Corporate business is well positioned to benefit from a recovery in capital market activity.

We're also at the forefront of initiatives to simplify UK retail investor participation in capital markets and launched collaborations with PrimaryBid and JP Jenkins, alongside our proprietary solution, Winterflood Retail Access Platform.

We're well placed for when the market activity returns and are exploring growth opportunities as they present themselves.

We recognise the important role we play in enabling the transition to a low carbon economy.

We're supportive of the goals of the Paris Agreement and last year became signatories to the Net Zero Banking Alliance and Net Zero Asset Managers initiatives.

We're making good initial progress, as you can see on the slide, and I look forward to sharing our initial intermediate net zero targets, and roadmaps for carbon-intensive sectors in our loan book during the year.

We also recognise the significant growth opportunities for green asset lending as a specialist, adaptable lender with deep understanding of our customers' needs. We can support our clients in their transition to new, cleaner technologies to meet their own sustainability targets.

Our inclusion agenda remains very active, with a number of initiatives focused on diversity, inclusion and social mobility.

In summary, we're making the most of opportunities and are encouraged by the momentum generated in Banking and CBAM in the second half, which has continued into the start of the 2024 financial year.

We're well positioned to maintain stable returns this year as we sustain growth momentum and pricing discipline, with a resilient credit performance, despite near-term cost pressure.

Our strengths are our strong relationships, deep expertise and our commitment to excellent service. These strengths have been evidenced through many cycles and remain unchanged.

I strongly believe that we've the right model to thrive in this environment. I'm confident in the opportunity it creates for us, and we're well placed to resume our long-term track record of growth and returns.

Thank you, and we'd now like to take any questions you may have.

And we're going to start with some questions on the call.

Q&A session

Question 1

Benjamin Toms, RBC

Good morning and thank you for taking my questions. Two, please. Firstly, I think you've previously talked about making good progress in respect to the legal claims against insurance companies that were supposed to cover your Novitas losses. Can you give us an update here? And is an expectation of recovery baked into your cost of risk guidance for 2024 of below through the cycle levels, or should we model below through the cycle even with no recovery in respect to Novitas?

Then secondly, you've given guidance that you expect to maintain strong NIM. Can you put some meat on the bones here, please? Maintain suggests flattish, but I guess the key here is flat to what base? Is the base FY 23? Half two 23? Is the base inc. Novitas or ex. Novitas and is the base inc. the benefit of mark-to-market swap movements or ex.?

Thank you very much.

Adrian Sainsbury

Thanks, Benjamin. Let's take those questions in turn. On Novitas, clearly, what we did in the first half was take the sizable provision. And what we effectively were saying at half one was -- we've looked at the future expectation for Novitas, we'd like to baseline it and take that in half one, and you'll see a cleaner position in half two, more of the underlying position. That's what we spoke about. That's what I see these results show.

Let's look at the progress that we have on the recoveries. As the market will know, we're in litigation with the major insurer in the Novitas business. We started that litigation in the High Court in November 22, and that will play through its journey. Now clearly, any case that goes to the High Court takes a long time to reach the court. Part of our assumption on recovery is based on when that case will come to the court. And as we've said before, we've clearly taken our own legal advice in that case.

If I look at the third largest insurer, it's significantly smaller than the largest two. We've reached a settlement with that insurer and that is included within the figures this year. That was a positive recovery as I see it, relative to that which we had expected. But I wouldn't draw that as a direct look through to the other positions.

And then we have the second largest insurer, which we haven't litigated against yet, and we're in discussions with. Clearly, in any case that is moving towards litigation, there is an option to reach a commercial settlement at any time.

In terms of the provision guidance that we've given that Mike talked about, where we've got the long-term average of 1.2%, we're 0.9% underlying for full year 23, and we said we expect to be within the 1.2%. That includes anything we would expect to see on Novitas. In fact, when we talked about, we baseline the position in the first half, that's really looking to have a clean Novitas position, unless we see something completely unexpected in the recovery, either good news or not so good news.

On the strong NIM, the Slide 13 shows the picture there. I think this is a good story. If you look back a year ago, we did this presentation only days after the Truss and Kwarteng budget. I'd say there was quite a bit of scepticism in the market, whether we would be able to maintain our NIM at the levels we have, given that we don't have interest-free, interest non-bearing NIBCA accounts, current accounts.

And as you can see, we pretty much sustained the NIM over the last couple of years. Over the last two years, clearly, base rate has gone up 515 basis points. And in full year 23 for us, the base rate went up 375 basis points. We've managed to pass on those yields, pass on those rises by the good deposit work Mike talked about and the good work of our front office teams as well to sustain our NIM in that picture.

As you rightly say, the NIM is a little bit softer in half two than half one. But clearly, even the decision last week by the Monetary Policy Committee to maintain interest rates has led to swaps actually tailing off a bit in the market. So our guidance really is, look at the 7.6% underlying number that you see on Slide 13, and that's really what we're looking to work to going forward. That's been a trend that you can see on that slide for quite a long-term period now.

Thank you, Ben.

Question 2

Sanjena Dadawala, UBS

Good morning, thanks for taking my questions. Two from me. The first is if you could elaborate on the growth momentum expectations for FY24 – what percentage loan growth do you think is achievable, which segments are expected to be the driver, especially with some having seen mid-teens growth already in FY23? What kind of trends you're seeing recently and the risks and opportunities?

Then second, if you could give more colour on the asset quality trends and what you think is keeping credit performance relatively benign? And what are the risks against this?

Adrian Sainsbury

Thanks Sanjena, I'll start on number one and then I'll kick off on two and Mike will give some extra detail on the provisions position as well.

So it's a good story, we've seen momentum in half two. If you look at the underlying loan book, as we said, half one was plus 1%, half two was plus 7% and all of our books have returned to growth and pretty much accelerated in half two. I'll talk through them each broadly and then what's happening and what we could see going forward.

So if we look at Property, you can see the growth in the year is 16%, and it grew 12% in the second half. So that's really good growth. What we've seen there is the mathematics of our portfolio working in our favour. The slide that Mike showed on the Property business showed that record drawdowns, up 8% in the year, but repayments falling a little bit, down 12%. So that's helped the loan book trajectory.

Some of the initiatives we've talked about are working well. Our pilot in buy-to-let is working well, for select customers we're at 65% LTV as well. So we're seeing good momentum in the Property book. We're still seeing good confidence in our builder customers. In part, that's because the cost of inputs, supplies, has gone down a bit. There's a lot of energy price into materials in building, and those have fallen a bit. And clearly, that is helping developers along the way. So we're encouraged with our position in the market there.

If I look at the Commercial business, the Commercial business has grown well for us for a number of years. That's based mainly on the direct sales forces we have, the true experts that we have.

The Asset Finance business has grown well through the year, up over 5%, and that's whilst replacing around £290m of the CBILS business that rolled off in the year. We've done well there with our expert team, new teams we brought in in materials handling and agriculture. And particularly doing well is our Contract Hire business. That's part of the EV lending we've talked about, that's on new cars, predominantly car fleets. And also our Energy's renewable business, part of our sustainability agenda, is going well. So I see good prospects continuing in the Asset Finance business.

Invoice Finance business has been our strongest growth book for quite a while now and up 16% in the year, and that was up 11% in half two. We've done particularly well on ABL. There's a bit more utilisation by our clients using their facility a bit more. And as we mentioned, we're doing syndications - we've started on that area for larger deals. And also, we have a new bespoke secured lending team as well, they've done their first deal. We're encouraged with that.

If I look at the Retail businesses, I said before that Premium was a little bit disappointing. If I looked at half one, that was the message we gave. It didn't grow in the first half, and were struggling to see why the cost of living wasn't working and drawing more demand into this product.

The good news is we've seen that book return to growth, and it's up 4% in the full year. And we've seen, as Mike said, some premium inflation coming through. We've all read about motor policies going up in the market. We're seeing that come through now, and that's benefiting our loan book a little bit as well.

And on the Motor Finance, as I said, I see the used car market in good shape. The internet providers that have launched into the market really haven't taken off as they would have expected in the last three or four years. And our investment that Mike touched on, Motor 2020, that's now concluded, has given us some really good new capabilities. We've signed deals with AutoTrader, CarFinance 247, iVendi, all giving us new routes to market along the way.

So what I'm talking about there is an acceleration in half two. It's spread well across the businesses as well, which gives us encouragement. And the guidance we're really saying – the market had a loan book consensus around 5.4% for full year 23. Clearly, we've exceeded that. We're feeling a bit more confident. I can see the sort of half two number is a good guide for what could happen in the full year next year. And clearly, I could paint a scenario where

there's more upside. But if I was looking to put a number in a spreadsheet, I'd be looking more at what happened in the second half.

The other area we've talked about with really good momentum is CBAM. I touched on the acceleration of the net flows, 6% in half one, 9% full year and a good start for FY 2024, replicating the good start we've seen in Banking.

If we have a look at the trends that we're seeing in the bad debt to answer your second question, Sanjena. Underlying, excluding Novitas, and I covered the Novitas position a bit on the earlier question, the bad debt charge is 0.9% for the full year, below our long-term average but increased from the 0.5% in full year 22. That's largely because of worsening macroeconomic assumptions feeding into our models.

We talked about at the half year stage, the Motor book and the arrears had increased similar to other players in the market. The good news is we've seen that effectively plateau in half two. And realistically, we've all read about insolvencies increasing in SME world. I think that's more at the micro end, and we're lending more in the S and M of the SME world. We haven't really seen that come through. And the other benefit, of course, of our model is 90% of our book is predominantly secured or structurally protected.

Mike, would you build on that?

Mike Morgan

Yes. I mean you're absolutely right. If we look across the book, we're pleased with the performance from this year.

As Adrian says, we did see the arrears increase in Motor in the first half, but the cure rates have been good and that has stabilised going forward. I think there's a couple of factors that are sort of driving that. There is still high employment levels or low unemployment levels in the U.K. Obviously that's a big factor. I think the second thing is that the loans typically have an average value of around about £7,000. So these are cars that are fundamental to people's lives – it's going to work, taking the children to school, going shopping. So these are assets that they want to finance and keep going.

There is also the point there that these loans are fixed in terms of the amount that's paid. So the fact that interest rates have gone up, wouldn't have an impact for the end customer for either Asset or Motor.

Interestingly, if you look at the Commercial book, that's performing well. The real drivers there are GDP. It's more of a book that's driven by Loss Given Default rather than Probability of Default. But GDP would be a factor there and also maintaining strong asset values because as Adrian says, it's 90% secured or structurally protected. So I think overall, the book is looking good at the moment.

Question 3

Gary Greenwood, Shore Capital

Thanks for taking my questions, I've got three, if I can. So the first one is just on Banking division cost/income ratio. Obviously for many years, it was sort of running around about 50% level. Over the last few years, it's drifted up to sort of mid-50s. You've talked about costs growing faster than income next year and then stabilising the year after. Are you now thinking that this is sort of structurally a mid-50s cost income growth -- cost income ratio business? Or

can it sort of drift back down to that 50% level over time as your sort of efficiency projects come through? So that's the first one.

Second one is just a quick one really on shareholder distributions and where buybacks come into your thinking given the current stock rating?

Then the last one was just on Basel 3.1, there's obviously a story in the FT yesterday regarding the potential delay to implementation to July 2025. I was just wondering if you had any thoughts on that?

Adrian Sainsbury

Thanks, Gary. Let's look at the cost-to-income ratio first. You are correct. We've broadly over quite a long-term operated in a range of sort of 48% to 51%. And clearly, we've ticked up to around 54%, 55% now. As Mike explained, the costs were up in full year 23 by 7%, and we can see it being slightly higher in full year 24. As Mike explained, that's for a wide range of reasons.

The good news is we're seeing volume exciting, as I mentioned in an earlier answer, that does have some follow-on cost. We're investing for the future of the business, protecting the business, protecting the NIM and creating future growth opportunity as well. And also, we have investments in cost efficiency. Some of these programmes, Mike talked about the technology investments that we're making, the savings there are starting to only just come through and we will look for other areas.

So the guidance you've correctly reflected, more aligned to income in full year 25. And clearly, we'd like thereafter to have positive operating leverage over the medium term, that's what we're looking for along the way. And if we can achieve that, clearly, we'd look to move down in the longer term from the 55% back to that position. It is important, though, in this inflationary environment, we still protect this business and the NIM is a big story I think, for our investment case, and that's part of what the cost is about.

In terms of your second question on shareholder distribution, Mike explained our capital strategy. And a little over a year ago, we launched our target range for CET1 of 12% to 13%. We're a little ahead of that at 13.3%. Clearly, the best use of our group's capital is investing in the loan book at the sort of yields and margins that we achieve, and we want to protect the capability to be able to do that.

In the second half of the year, clearly, the underlying growth was pretty strong, the sort of 7% in six months. And if you double that, that's over what we call capital neutral that Mike mentioned, broadly 7%. So clearly, we need to maintain some scope for that, and we've got an uncertain economic environment. So the answer, if you're looking for, we're not looking at shareholder buyback sort of program based on exactly where we are today. That's not what we're looking to do. We do have the very strong progressive dividend strategy that Mike alluded to.

Mike, would you build on that at all?

Mike Morgan

No, I think that's pretty much covered everything off on that point.

On the Basel question, yes, I saw that article as well, Gary, moving back six months in line with the U.S. regulator. So we're looking at the middle of 2025. It's interesting because it's clearly an article in newspapers, so we need to determine what the exact facts are.

But it does seem that there's been quite a significant response to consultation around that SME support factor, which obviously would be important for us as well. So, I think they want to have a think about that SME support factor, whether they'll phase it in over a period of time or do something else. But, I read the same article as you yesterday Gary.

Question 4

Ed Firth, KBW

Good morning everybody, I just have two questions. One, on the cost, the 8% to 10%, is it possible to give some sort of breakout of that of how much – you talked about the sort of one-off investment spend and technology spend? So is it possible to break out how much of that relates to what I would call specific one-off projects, where we should get some savings going forward and is not part of just sort of ongoing costs? I don't know if that's possible, but any sort of colour around that would be very helpful, if that's okay.

Then the second one is, 16% growth in Property is quite startling. I mean, 12% in the second half. And certainly, if I look around the wider market, you don't sort of feel that the property market is that active or that exciting. And a lot of people are really pulling back very strongly from it. I know you keep your credit criteria the same, and therefore, in the sense it's your model working. But I imagine that for some people, that is quite a scary number. I'm just trying to think what sort of comfort you can give us or perhaps additional comfort you can give us about what exactly you're lending on, how confident you are? Do you assume a pickup in the property market sort of later next year to justify that? Or is that based on even if the property market stays dead for like a multiyear period?

Adrian Sainsbury

No, that's absolutely fine. I'll handle the property question, and then I'll hand on to Mike for the extra detail on the cost question.

So I'm very confident in our Property book is the answer. And really, when I talked about the mathematics of our portfolio, I actually spoke quite extensively this time a year ago and six months ago because our loan book had gone backwards during Covid.

If I take a step back three years, we're broadly returning the loan book now to where it was pre-Covid. The loan book went back at that stage, partly because of the Stamp Duty concession announced by the Chancellor, around September 20, I think it was announced and ran for a period. That drove, bizarrely when GDP went down with sort of 20% in full year 20, a record housing market in terms of volumes, record transactions.

House sales for us drive repayments of our house builder loans, and that's what happened. We've seen a reversal of that effectively because we've got a very strong pipeline, a little over £1 billion, that's moved into drawdown as our expert repeat property customers have got confident on delivering their developments, and we've seen slower repayments along the way. So less out of the bottom of the bath with the repayments, more in the top of the bath as we've seen drawdowns and that's led to the growth that we've seen.

To answer the other side of your question, I'm very confident in the credit quality of what we're seeing. We're at the very sweet spot of structural demand in the U.K. market, the sort of £600,000 number that I talked about. As a generalisation, we don't have super prime London properties or super prime everywhere. That's more likely to have stick.

And also, another way of looking at this in the demand, we're predominantly dealing here, of course, with new houses. New houses are still attractive to buyers. The used houses are more what's sticking. Typically, in the used market, there's broadly just over 1 million sales a year in the U.K. We all know how many houses are built in the U.K. and sold. It's more around the 150,000 to 200,000 level. So there's clearly less new houses, more demand for those.

The LTVs that we lend that as well are conservative relative to the market. You've rightly said some of our competitors are struggling a bit. One of our competitors, I won't name who they are, have stopped their direct market and moved to broker market. That provides opportunity with our expert face-to-face business. So I'm very confident here.

We have a range of measures, of course, on our portfolio for credit quality. One of our guides is the sales price at the end of the development when it's closing out, relative to the sales price predicted at the start of the development and that's still comfortably over 100%.

And if you think of the LTVs we're lending at, typical across the portfolio, high 50s percent. We've got a very comfortable margin of safety there, aided by what I said on material costs going down as well to see the development through and the cost of it. So we're confident there.

Mike, would you like to build on that with the cost?

Mike Morgan

Yes. I agree with everything on the Property.

I mean in terms of the costs, we don't break down the 8% to 10%, but what I can do is give you the factors that are driving that. First of all, we had across the board 6% salary increase for all of our staff. That came through on the 1st of August, so you will get a full year of that. So that comes through.

Secondly, there will be a normalisation of bonuses next year because, clearly, with the Novitas events that have taken place in FY23, there has been a reduction in bonuses paid. That will come back next year. We've got the volume-related growth and the costs that sit with that. As Adrian said, the numbers are clearly up year-on-year. So that would be a factor.

Then we talked about the strategic initiatives, and we've shown a number on the board of the kind of things we're doing, whether those are growth initiatives, whether they are to protect the organisation through resilience, compliance, cyber. So there's a whole range there.

And of course the other thing we're doing, the technology transformation programme that Adrian was talking about, that will ultimately have cost savings coming through. But we need to spend to be able to do that. So those are the four factors: the salary award of 6%, the bonus normalisation, volume-related and the strategic initiatives.

Edward Firth

Mike, just on the strategic initiatives, though, should we expect some of those to be lower in sort of 25 and 26 onwards? Or is it more just sort of the new world of the investment spend?

Mike Morgan

I think there is an element, we are always seeking to make them lower. I mean if you actually look at what we've done over the last few years, we've re-platformed a number of

businesses, so you won't need to re-platform, we're doing a very big Asset transformation programme at the moment and replacing the alpha system with the latest version. So those sorts of investments won't need to take place, our Treasury system, for instance, as well.

However, I would see that we would want to invest in the growth of the organisation and Adrian’s given some examples there. So whether we will see less, I'm not entirely certain, but what I do feel, there will be more of a shift into growth-orientated investment if we choose to do that, and that is simply our choice. So I think there will be more of a shift in that direction, Ed.

Question 5

Corinne Cunningham, Bernstein Autonomous

Good morning, everyone, thanks for taking my calls. A couple of things. Have you had any thoughts on the impact of the latest FCA rules on the cost of premium finance, whether you think that's got any read across to yourselves?

Second one, you talked about the efficiency of the capital stack. I presume that also implies thinking about issuing AT1s. What kind of, I suppose, what kind of market conditions or what kind of pre-conditions would you need to see before thinking about issuing AT1s?

Adrian Sainsbury

Thanks, Corinne. I'll take the premium question and then I'll hand on to Mike for the debt securities question.

So Premium Finance is a good business for us. We see as it's really helping consumers to spread the cost of what is an increasingly expensive payment, their household insurance or their motor insurance, so it works well. Now clearly, with the Consumer Duty having come in for the FCA on the 1st of August, we've done a wide range of work in all of our regulated businesses to ensure that we're offering, as part of that, fair value for our customers. So we've undertaken that work.

In Premium, we have done some adjustments to our fees that we take, and we're comfortable with that. That would be clearly, it's not material, and will be clearly accounted for and included with our sort of expectations of our income profile going forward. But I'm very comfortable in terms of the value that we add on those products and the prices that we charge.

Mike, would you like to pick up the capital question?

Mike Morgan

Yes. I mean you're absolutely right. If you look across our capital stack, we meet our Tier 1 ratio with pure equity. The fact we don't have AT1 is probably a little unusual. So it is something that we are interested in going forward. I mean clearly, over the last 12 months, the market has not been conducive to AT1 issuance, certainly, since the Credit Suisse issues at, I think in February earlier on this year.

But the market seems to be stabilising a little bit more. We are seeing some issuance in euros, we are seeing some reissuance in the U.K. as well. So it's something that we're

looking at and if the opportunity is right, then we may well move. But we would want to see a period of stability before we do that.

Corinne Cunningham

Thank you. Just one small question, have you mentioned the size of the buy-to-let book. I know you've been talking about it, but have you actually mentioned the size?

Adrian Sainsbury

We haven't disclosed that. We don't disclose further down the line of our Property book than at the Commercial Acceptances level and the overall Property Finance book. But it's a good initiative, and it's working well for us.

What I would say, what I like about it is, it's very similar to a buy-to-let option, it's offered to our Commercial Acceptances customers and typically, they'll have done a property up and rather than selling it at the end, they'd like the option to rent it. We've already done all the work here on taking the security, the origination cost, and we're able to term it out for five years or so, and we're getting a better margin than the buy-to-let market there. So it's effectively the professional buy-to-let sector it's competing with. It's for our existing customer base, and it's working well for us.

Question 7

Sheel Shah, JP Morgan

So the next question is from Sheel Shah at JP Morgan. WBS is a strong growth area for the group, with income of around £15 million for the year, 20% of the Winterflood division. How should we think about the profitability and returns of this division and its outlook given the technology investment needed and potential for scale benefits?

Adrian Sainsbury

Sheel, I think you've termed it very well there. The way you've described it – we own the system here, we own the proprietary value of the system here, and we're seeing really good growth. The slide shows the sort of trajectory and we talked about a £10 billion target for this year. We've got it up to £12.9 billion, which is a good start.

It is wholly scalable. The fixed costs now are pretty low, the increase of those as we grow the business. And as we mentioned, we can see it moving to over £20 billion in the next couple of years, and we've got a very strong pipeline. Now clearly, there are different margins on different types of business that we take. So on the website, you can see some of the very strong financial houses that we are effectively, they are effectively outsourcing to WBS. If they do all of dealing, custody and settlement with us, clearly, you'll get a better margin than if they do one of those activities.

We see good growth for this business going forward. It doesn't have the volatility of a trading business. It's more akin to an assets under administration and endowment type of business. So I think as we move forward and we talk more about where the growth of that business has come from and we reveal more about it as it gets towards the £20 billion, we'll be able to talk

more about the direct profits, and that's what we will do going forward. But I see that it's a good opportunity for the future.

Question 8

Sheel Shah, JP Morgan

The next question is also from Sheel Shah at JP Morgan. CBAM net inflows were strong this year with the CBAM growth strategy accelerating. What sort of net inflow rate should we think about? Possibly at the top end of the 6% to 10% target range?

Adrian Sainsbury

Thank you, Sheel. That's a good question. There's a graph in there that shows the history of our net flows. And as I mentioned, there's a good acceleration, 6% in half one to 9% for the full year. So you can clearly see if you annualise half two, you'd be doing better than 9%. We've said, we've started the year well in CBAM, so I'm encouraged towards the top end of that range for full year 24.

And we've now concluded the questions. That's all we have. We're out of time.

So thank you very much for your time this morning. Thanks for the questions.
And have a good day. Thank you.