Close Brothers Group plc

Half Year Results 2024

Edited transcript*

Tuesday 19th March 2024

Adrian Sainsbury, Group Chief Executive Officer

Good morning, and welcome to the presentation of Close Brothers' First Half 2024 Results. I'll start with a brief reflection on our performance in the first half. Mike will then cover our financials. I'll come back and talk about recent developments following the FCA's announcement of the review into Motor Finance and also our strategy update. At the end, we'd welcome your questions which you can submit either via the telephone conference line or over the webcast, either submitted during or after the presentation.

Our businesses delivered a resilient performance in the first half. In Banking, the loan book increased 4%, with disciplined growth across our businesses at strong margins of 7.5% and an improved credit performance. CBAM delivered net inflows of 9%, although Winterflood's performance remains affected by weakness in retail trading activity.

We maintained our strong balance sheet and conservative approach to managing our financial resources, a long-standing priority for us. Our CET1 capital ratio was 13%, significantly above our applicable requirement of 9.5%.

Finally, the FCA's review of motor finance commissions is ongoing, with significant uncertainty arising for the industry and the Group. At this very early stage, it would be premature to predict the outcome of this review or estimate the potential impact on the Group. However, the Board recognises the paramount importance of preparing for a range of outcomes from this review and we're taking decisive actions to strengthen our capital position materially.

We've identified management actions, which combined, could strengthen the Group's CET1 capital by approximately £400 million by the end of the next financial year. I'll set these actions out during the presentation.

While we're working through this period of uncertainty, we're confident that the Group will emerge well positioned to take advantage of future opportunities. These steps are being taken whilst continuing to provide excellent service to all our customers and protect our valuable franchise. This is our key priority.

I will come back to talk about the enduring strengths of our model after Mike's presentation.

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

I'll now hand over to Mike to talk through our financials and I'll come back afterwards to update on our strategy and the motor finance review.

Mike Morgan, Group Finance Director

Thank you, Adrian, and good morning, everyone.

Firstly, I'd like to run through the underlying performance highlights and draw out some key items that impact the year-on-year comparison.

In Banking, the prior year income benefited from mark-to-market swaps and Novitas, so excluding these items, we achieved income growth of 6%. We also saw higher costs in line with our previous guidance. We delivered loan book growth of 9% year-on-year with healthy demand of across our businesses. Our NIM remained strong and broadly stable on an underlying basis. We also saw a reduction in impairment charges, with an annualised bad debt ratio of 0.9%. Overall, the significant year-on-year increase in profit reflects the impact of Novitas-related impairment charges in the prior period.

Turning to the income statement, our businesses delivered a resilient income performance, with growth in both Banking and Asset Management, offset by a decline in Winterflood and interest expense on the Group bond. Expenses increased 12% from higher staff costs, as well as continued investment. On a pre provisions basis, profit was down 22% to £136 million. Impairment charges were £42 million, down significantly from the prior year, which included £115 million of Novitas-related charges. And as a result, adjusted operating profit increased materially to £94 million.

In Banking, profit was £112 million, with the increase reflecting the Novitas-related impairment charge in the prior period.

In Asset Management, we generated strong annualised net inflows of 9%, although profit reduced to £6 million, as investments in our hiring strategy more than offset income growth.

Winterflood's performance reflected lower trading income and unfavourable market conditions, with an operating loss of £3 million.

We also saw an increase in Group net expenses to £21 million, primarily due to interest on the Group's £250 million bond.

And as we announced in February, we took the difficult decision to not pay any dividends for this financial year, as we further strengthen the Group's capital position in light of the significant uncertainty arising from the FCA's review of the motor finance industry.

Moving to the Banking division, income grew modestly to £365 million, although excluding the prior year benefit of Novitas and the swaps I previously called out, income was up 6%, reflecting good loan book growth and strong margins. Expenses rose by 13% to £212 million, reflecting higher staff costs and spend on our strategic investment programmes. Pre provisions, profit declined 13% to £154 million. Impairment charges decreased to £42 million, remaining below our long-term average of 1.2%. Overall, adjusted operating profit increased to £112 million.

Now, highlighting the key metrics from across the Banking division, excluding Novitas. We saw income growth of 3% and year-on-year loan book growth of 9%, taking the loan book to £9.8 billion. The net interest margin was strong at 7.5%. Expenses grew 15% from increased staff costs and investment. The bad debt ratio was 0.8%. And profit was down 7% to £112 million.

Moving on to Commercial. Income was down 3%, notwithstanding the loan book growth of 11% to £5 billion, as the NIM declined to 6.7% as we sought to balance the repricing of new business written, with our focus on maintaining support to our customers. Expenses grew 13% from higher staff costs and investment spend on our Asset transformation programme, which we completed in the period. The bad debt ratio was broadly stable at 0.5%. And AOP was down 29% to £51 million.

Moving on to Retail, where income was up 7%, reflecting year-on-year growth in the Premium Finance book and our strong margin of 8.7%, as we maintained our pricing discipline. Expenses rose 15%, driven by the handling of elevated complaint volumes in Motor, as well as higher staff costs and the acquisition of Bluestone Motor Finance in Ireland. The bad debt ratio reduced to 1.5%, reflecting an improvement in the macroeconomic outlook. And profit increased 29% to £19 million.

And finally, in Property, income grew 11%, reflecting strong loan book growth of 21% year-on-year to £1.8 billion, although the NIM decreased to 7.3%, reflecting lower fee yields. Expenses were up 22%, reflecting higher staff costs. The bad debt ratio reduced to 0.6%, largely reflecting the improved macro environment. And overall, profit was up 25% to £42 million.

Moving on to the loan book. We saw 4% loan book growth in the first half on a reported basis, and 5% when excluding the businesses in run-off, Novitas and our legacy Irish Motor Finance book.

Our Commercial book grew 4% and reached £5 billion despite the impact of CBILS lending running off. Asset Finance was up 6%, with particularly strong new business volumes in Leasing. And Invoice and Speciality Finance was broadly stable, as we saw the usual seasonal decline in January.

Our Retail book grew 3% when excluding the legacy Irish Motor Finance business, with growth in the UK Motor book and the acquisition of Bluestone in the Republic of Ireland. Premium Finance contracted 1% due to normal seasonality, despite the book reaching record levels in the first half.

And Property delivered 8% growth, with strong drawdowns and a healthy new business pipeline.

We continue to see good growth from our initiatives across the businesses, such as the recently hired teams in Asset Finance and our regional expansion in Property. And looking forward, we expect to broadly sustain the underlying loan book growth in the second half of FY24.

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. As I've mentioned previously, the main drivers of the year-on-year reduction in NIM are the mark-to-market swaps and Novitas, which benefited the prior year period. So whilst NIM reduced around 50 basis points to 7.5% on a reported basis, this was broadly stable at 7.6% on an underlying basis.

In line with our model, we remain focused on pricing discipline on new lending and we benefited from optimising our liability mix and funding costs in the higher rate environment. Looking forward, we remain well positioned to maintain a strong net interest margin, broadly aligned with the reported NIM in the first half.

Moving on to costs in the Banking division. Although expenses were up 13% year-on-year, on a consecutive halves basis, they increased only 4%. This was mainly due to the timing of investment spend.

The overall increase reflected higher staff costs from inflation-related salary rises and new hires, as well as the investment spend in our strategic programmes and cost-saving initiatives. Other increases came from volume and activity-driven growth and the acquisition of Bluestone Motor Finance. We also incurred costs related to the handling of heightened complaint volumes in Motor Finance. These increases were partly offset by efficiency savings from our tactical and strategic cost initiatives.

We expect the drivers of growth over the full year to be aligned to the categories previously outlined and will include £10 million of costs related to motor commissions complaints.

Overall, we remain on track to deliver in line with the guidance of 8% to 10% growth in the Banking cost base in Full Year 24. And as noted previously, this guidance is net of costs related to Bluestone, which we expect to be approximately £7 million for the full year.

We are redoubling our efforts to enhance cost efficiency in Banking. We have already made good progress on our strategic cost management initiatives in the technology space, with our technology transformation programme, which we initiated in 2023, simplifying our technology estate and increasing our use of outsourcing. As part of this, we've already removed 83 IT applications with more planned and have reduced our headcount by approximately 100 people.

We have also mobilised further cost initiatives to partly offset the adverse impact on the Group's income as a result of the actions that are being taken to strengthen our capital base, with the aim of supporting the ongoing profitability of the business, whilst ensuring we protect our valuable franchise.

Within suppliers and property, initiatives are focused on rationalising our supply chain, reducing our suppliers and consumption of services, and reducing our property footprint and we are rightsizing our largest London office. Then, on the people side, we are adjusting our workforce to improve efficiency and effectiveness.

We expect these measures to deliver annualised savings of around £20 million by the 2026 financial year. With the benefit of these additional measures, we remain committed to more closely aligning income and cost growth in FY25, excluding any restructuring costs, and delivering positive operating leverage over the medium term.

Turning now to our credit performance. The annualised bad debt ratio was 0.9% as we recognised £42 million of impairment charges, primarily reflecting the improved macroeconomic outlook, loan book growth, and the ongoing review of provisions and coverage. We continue to closely monitor the evolving impacts of 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. Over the second half of 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 8% in the first half to £17.7 billion, driven by strong net inflows, particularly from our bespoke investment managers, and positive market performance. Total client assets were up 7% to £18.5 billion. Operating income also increased 7% to £76 million, driven by both positive net inflows and market movements, resulting in higher investment management income. And the revenue margin increased marginally to 84 basis points.

Costs rose 12% to £70 million, reflecting inflation-driven salary increases and the recruitment of bespoke investment managers, which accounted for £5 million of costs. And so, whilst the operating margin reduced to 8%, this would have been 15% when excluding the costs related to bespoke investment manager hiring. Overall, profit decreased £2 million to £6 million.

Looking forward, we continue to target net inflows in the range of 6% to 10%, notwithstanding our move to selective hiring of bespoke investment managers. We expect our operating margin to increase from 2025 onwards towards a longer-term target of above 20%.

And now on to Winterflood, where the challenging market environment continued to impact investor confidence. Income was down 12% to £34 million, with the decline in trading revenue more than offsetting growth in Winterflood Business Services. And whilst we saw average daily bargains decrease to 52,000 in the first half, we maintained our market-leading position, ranking number one in terms of volumes traded.

Winterflood Business Services, which provides outsourced dealing and custody services, saw good momentum continue, with income up 24% and assets under administration increasing to £13.8 billion.

Costs were marginally up as inflation-related salary increases were partly offset by reduced variable compensation. And following a cost review, we expect to benefit from annualised fixed cost savings of 5% in FY25.

Overall, we saw an operating loss of £3 million, although performance did improve in the second quarter. Looking forward, we expect to grow Winterflood Business Services assets under administration to over £20 billion by the 2026 financial year.

Moving on to our balance sheet, where we continued to follow our prudent approach to managing financial resources. We maintained a strong balance sheet and increased our total funding to £12.7 billion. We borrow long and we lend short, and we hold £2.2 billion of liquidity, with our liquidity coverage ratio over 1,000%.

Our funding base is diverse, covering both wholesale markets and a mix of retail and non-retail deposits. We have continued to build and diversify our deposit base, with retail deposits up 16% in the first half, now around 60% of our total deposits. Our deposits are predominantly term, with only 5% of deposits available on demand. And we have seen no significant changes to our deposit base since the end of January.

Although our average cost of funds increased to 5.4%, due to the higher base rate and deposit pricing, we took actions to optimise our liability mix and mitigate this pressure. Looking forward, we expect cost of funds to be nearing the peak of the current interest rate cycle.

Close Brothers Limited continues to be rated Aa3 by Moody's.

Turning to our capital position, our CET1 capital ratio was 13%, with the reduction since the year-end mainly driven by loan book growth, offset by capital generation from profit. We maintained headroom of circa 350 basis points above both our applicable CET1 and total requirements of 9.5% and 13.4%, respectively. It is worth highlighting that no foreseeable dividend on ordinary shares has been deducted from CET1 capital in line with our decision to not pay any dividends this financial year.

While we start from a strong capital position, we are implementing a number of actions to further build capital strength in light of the FCA review, which Adrian will cover shortly.

In line with our strategy and capital management framework, we issued £200 million of Additional Tier 1 securities in November, optimising our capital structure.

Our leverage ratio increased to 12.7%.

On Basel 3.1, we are waiting for further clarity on the potential removal of the SME supporting factor, which is the main driver of the expected increase in risk weighted assets of up to 10%. This update is due by the 30th of June 2024.

Finally, on IRB, our application remains in Phase 2 of the process and engagement with the regulator continues.

In conclusion, we have seen a strong underlying business performance and our liquidity and capital strength positions us well.

I will now hand back over to Adrian who will go into more detail on the Motor Finance review and the actions we are taking in response. Thank you.

Adrian Sainsbury

Thanks, Mike. Let me start by giving you an update on recent developments following the FCA's announcement in January and the historic commission models operated by Close Brothers. In January, the FCA announced that it's undertaking a review of the motor finance market. This is due to the high number of complaints coming to the Financial Ombudsman Service from customers regarding discretionary commission arrangements.

Close Brothers Motor Finance has operated successfully in this market for a number of years and we've sought to comply with the relevant regulatory requirements. Prior to 2006, we operated an Upward Difference in Charges model. This allowed the dealer or broker discretion over the customer rate and the commission earned.

From 2016, we voluntarily introduced a Downward Scaled Commission model, which capped both the interest charged to the customer and commission paid to the dealer or broker. This meant that we set the headline rate for the customer and the dealers only had discretion to reduce the rate, which would reduce their level of commission.

Then, from 2021 onwards, following the FCA's ban on discretionary commission models, we introduced a Risk Adjusted Pricing model, which adjusted the rate based on the customer's risk profile. So the dealer discretion was removed entirely.

It's important to note that all of our historical models included a hard cap on the commission amount paid to the broker or dealer.

The FCA review is ongoing and it aims to communicate a decision on next steps by the end of September 24. There's significant uncertainty for the industry and the Group regarding any potential remediation action as a result of the review.

The estimated impact of any redress scheme, if required, is dependent on a number of assumptions. For example, we don't yet know the time period covered. We also don't know about the parameters that could be used in any potential redress scheme, such as the appropriate or fair reference commission rates and whether it be a proactive or reactive industry-wide scheme.

Therefore, it would be premature to predict the outcome or estimate the potential impact on the Group. So, as we communicated in our February trading update, no provision has been taken at this stage.

As mentioned by Mike, since the FCA announcement, we've seen a further increase in complaints and there will be a cost associated with processing these. We continue to monitor the impact on our handling of complaints and are following our playbooks in place to ensure we have the appropriate resources to respond effectively.

There's a range of possible outcomes from the FCA's review and as announced in February, we're further building the Group's capital position. Safeguarding and strengthening our valuable franchise is the Board's priority. We believe taking these actions is the prudent thing to do. These actions include the difficult decision we took last month not to pay dividends in respect of the current financial year.

Let's look at these actions.

Action one. The Group has a long-term progressive dividend track record and the decision to not pay any dividends for this financial year was not made lightly. However, as a result of this decision, we expect to retain around £100 million of CET1 capital in the 2024 financial year.

Action two. In addition, we're taking steps to optimise our risk weighted assets. We expect to reduce RWA growth by up to £1 billion through a combination of more selective loan book growth, partnerships, and significant risk transfer of assets related to our Motor Finance business. It'll also be supported by the additional cost saving actions that Mike outlined. We estimate that this could enhance our CET1 capital by up to around £100 million. The impact of these actions is expected to be minimal, if any, in the 2024 financial year.

Potential action three. We've also identified other potential management actions which give us the option to further strengthen capital, over and above our ongoing organic capital generation through 2025. If required, these include potential securitisation of other portfolios, a continued review of our businesses and portfolios, including possible sales and other tactical actions. We estimate this could enhance available CET1 capital by at least another £100 million.

Potential action four. Finally, as our business continues to organically generate capital, the retention of earnings could potentially further strengthen the Group's available CET1 capital in 2025, if required.

So, in all, these identified and potential management actions could give us the option to strengthen the Group's available CET1 capital by approximately £400 million by the end of the 2025 financial year.

To be clear, the £400 million is not based on any specific scenario, but is our response to protect our franchise and balance sheet.

These actions leave us well positioned to withstand a range of scenarios and potential outcomes, although they are expected to adversely impact the Group's income and operating profit in the next financial year.

An update on our guidance will be provided at our full-year results announcement. While we're working through this current period of uncertainty, we're taking decisive actions and are confident that the Group will emerge well positioned to take advantage of future opportunities.

The distinctive strength of our business model, our long-term relationships, the deep expertise of our people, and our consistent service endure. We're confident that we've the right model to support customers through the cycle and we're taking decisive actions to protect it.

The consistency of our lending model gives us confidence in the quality of our loan book. We have a strong balance sheet, which we further strengthened by the actions I just described. We apply our business model consistently. 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 has allowed us to historically deliver strong organic capital generation.

This is all underpinned by our valuable business franchise, which is why our key priority during this period of uncertainty is to safeguard and strengthen it.

In our Banking division, we employ almost 3,000 colleagues across 40 locations throughout the country. Our primary focus is helping customers by offering additional borrowing capacity to acquire essential assets for the personal lives or small businesses.

In our Commercial business, we lend directly via our expert sales team and indirectly to over 28,000 SMEs across Asset and Invoice and Speciality Finance.

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

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

While sticking to our underwriting and pricing criteria, we support customers through the cycle and are consistently there when they need us most. Our customers value that consistency, our specialism, and excellent service.

Close Brothers Asset Management is a top 20 UK wealth manager. CBAM provides personal financial advice and investment management services to private clients. These are distributed both directly via our advisors and investment managers, and through third-party advisors. 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.

Winterflood is a leading UK market maker, delivering execution services to platforms, stockbrokers, wealth managers, and institutional investors. WINS also provides corporate advisory services to investment trusts and outsourced dealing and custody services via Winterflood Business Services.

WBS, our in-house developed business, has continued its positive trajectory and is well positioned for future growth, both organically and supported by a solid pipeline of clients. Having exceeded its original target AuA of £10 billion in the 2023 financial year, we remain confident in the outlook for WBS and expect the business to grow AuA to over £20 billion by full year 26.

Winterflood has a long track record of trading profitably through a range of conditions. It remains well placed to retain our market position and benefit when investor appetite returns. WINS continues to make good progress on the diversification of its revenue streams and is exploring growth opportunities to balance the variability seen in the trading business.

That brings me almost to the end of the presentation. I hope that in the past slides we've given you a clear sense of our performance, the strengths of Close Brothers' unique portfolio and the work we're doing to grow the business and maximise our returns.

The uncertainties arising from the FCA's review of motor finance will inevitably be with us for some months to come. While we can't change that, we're taking a series of clear, proactive steps. That includes work to continue to grow our valuable businesses and also includes a decisive four-step programme to strengthen our capital base. That will, in turn, ensure we can best meet the eventual cost of any redress programme, whilst protecting our valuable franchise.

This programme has inevitably entailed some hard choices, but we believe that if we act decisively now, we'll be in a far better position to trade through this current period of uncertainty and emerge well positioned to take advantage of future opportunities.

Our core strengths are our long-term relationships, our long-standing expertise, and our commitment to excellent services. These strengths have endured and prospered through many cycles and will do again.

Thank you, and we'd now like to move to questions.

Q&A session

Question 1

Benjamin Toms, RBC

Good morning, both. Thank you for taking my questions. You noted in the presentation that Close Brothers has the optionality to reduce RWAs by £1 billion, partially driven by securitisations of Motor Finance. Can you just confirm, are you intending to take this action whatever the outcome in September? And could you clarify what this could potentially mean for revenues and NIM? So I think the action implies securitisation of over half of the Motor Finance book.

And then secondly, a softening of Basel 3.1, although not listed as one of the capital drivers on slide 23, I guess because the outcome is not within the Bank's control, could potentially provide some material capital relief. One of your peers last week identified that the regulator seems most inclined to soften their initial proposal in respect of commercial finance, which would be particularly helpful for Close Brothers. Have you been hearing similar noises? I guess, in theory, this could add up to another 100 basis points of capital versus your current plan.

Thank you.

Adrian Sainsbury

Thanks, Ben. Let's start with the securitisation question. And when we talked about the RWAs for this year, we talked about a £1 billion RWA potential. And that could be in a range of areas. It could be in the moderation of the loan book that we talked about, while still growing the loan book. It could be in partnerships as well, for example, in Property, we're looking at club-based arrangements. And also, as you correctly said, the Motor securitisation.

Let's look at how we've done securitisations in the past. They've been in the Motor and Premium business and they've been for funding purposes. What we're looking at here is to achieve capital risk transfer as well.

So you're quite correct, the loan book in Motor is around £1.9 billion, so it would be somewhat less than that. And you question the timing of that securitisation. Clearly, as you moved on in your question, there is an income reduction as a result of a securitisation and there's a cost to achieving the transaction as well.

So what we're doing, we're doing all the work to prepare for that securitisation and then we'll judge the timing on how this develops. I would expect that we will do it before the September date that we've talked about for the likely FCA review.

On Basel 3.1, as Mike said, we're waiting for the next stage, or the final stage, of the Bank of England and the PRA's discussion points on this, and we're expecting that in June 24. If it's implemented as described currently, as Mike said, there is an impact on RWAs there and the sort of 100 basis points that you've talked about is correct. There has been some discussion in the market that there could be a transitional impact if that is the area that it comes in, and that's the help you could get. We have no certainty on that. So of course, we will prepare for the full outcome if that arrives.

Thank you, Ben.

<u>Question 2</u>

Sanjena Dadawala, UBS

Hi. Good morning. Thank you. Maybe some follow-ups on the securitisation, please. So could you give some idea about the economics of the transactions and then just clarification on the timing. So, given that we probably won't know more on the FCA outcome than today by full-year results, how do we think about that and whether that £1 billion number is appropriate or too large given the associated income impact?

And then maybe some clarifications on the mechanics of recognition in the book. So you mentioned the income and cost impact. So just in terms of recognition, does it get recognised in the income line with operating costs and impairments continuing to be recognised as usual? And then, do we still see the loans recognised on the books or will the loan book be reported net of that? I presume it depends on the type of securitisation, but just trying to triangulate it with your second half loan growth guidance, please.

Adrian Sainsbury

Thanks, Sanjena. So this fits a little bit with the answer we just gave to Ben just now. So let's have a look.

The £1 billion number, as I said, that will depend on how much we do on moderating the loan book, how much we might do on partnerships, and how much we do on the securitisation to add up to that. We're not actually disclosing the income and cost impact. We'll come back to that when we do our full-year results. And that's largely because the structure hasn't been defined yet. What we're looking to achieve clearly is a capital transfer to reduce the RWA on the balance sheet but we need to look at the structure and depending on how that works, that will define the economics.

What we are looking to do, though, of course, is the cost actions that we've talked about, the £20 million extra opportunity that Mike mentioned, and that's looking to offset the income reduction that may come from such securitisation. We'll come back to this at the full year.

Mike Morgan

I think Sanjena, just to build on that, I think you were asking about guidance around loan book. We saw 4% in the first half. We would anticipate a number of roughly that in the second half as well.

<u>Question 3</u>

Portia Patel, Canaccord Genuity

Thanks. Good morning. Thanks for taking my questions. I just wanted to clarify, where you talk under other potential management actions about the sale of portfolios, review of businesses, and restructuring. Are you talking there about review of other aspects within the Banking loan book and the potential sale of other loan book parts, or are you talking about other divisions of the Group?

And then secondly, where you talk about potential retention from FY25 earnings, are you talking there about continuing to put the dividend on hold, or is there something else you meant by that? Thank you.

Adrian Sainsbury

Portia, so we're in what I described as potential action three with your first question, and that covers a wide potential range of areas that we're looking at. Naturally, on an ongoing basis, we look at each of our businesses and divisions and the returns that they make, and we present that to the Board annually in our May event as well. So, this is an ongoing period of work to ensure the returns appear attractive. So, what we're saying there is, it's nothing specific, but we're looking at a range of activities and levers that may come out of such a review, and we're not going to disclose anything further about that.

On the capital side, this is potential action four. Clearly, if our loan book is growing at the lower end, we will accrete capital. And as you rightly say, we've got a future optionality on what we might decide to do on the dividend. As we said on our February the 15th announcement to the market, when we cut the full year 24, we'll make future dividend decisions when certainty has re-arisen after the FCA review. So, this is a potential action we can take, and we'll discuss that with the market. To be clear, we're not saying that we're not paying a dividend in full year 25. That will be a decision that will be made when certainty re-arises, depending on the environment at that time and the performance of the Group as it stands.

<u>Question 4</u>

Gary Greenwood, Shore Capital

All right, thank you. I've got three questions, if I can, please. So, first, with just clarification on the loan growth, where I think you had said sort of 4% in the second half, similar to the first half. Does that take account of the fact that you're planning to slow loan book growth, i.e., you would have expected loan book growth to have been faster had that not been the case?

And the second question was just around management actions. I know the one thing that isn't on your list is potential business disposals or sales. So I was just wondering if that's something that you considered with regards to either Asset Management or Winterflood.

And then lastly, on costs. I know you're taking some action on costs, but I just wonder whether this goes far enough. I mean, there was a very significant differential between cost growth and income growth in the first half of the year. So, are there further levers that you can pull to bring costs down and bring the cost to income ratio sort of back to a more respectable level? Thanks.

Adrian Sainsbury

Thanks, Gary. So let's have a look at the loan book growth. You're absolutely right. So, the reported growth in the first half was 4% or 5% underlying when you strip out Novitas and the ROI Motor business in run-off. And what we're saying is we expect a similar level of growth in the second half. Clearly, any actions we take at this stage will not have a big impact on a slowdown before the end of the financial year on the 31st of July. And that's why we see a similar level of growth. For example, later in the pack, each of the businesses in the appendix are broken out. You'll see Property has a pretty much record level of new business pipeline at £1.1 billion at the moment as well. So this is a balance for protecting the balance sheet, looking after our customers as well.

It's also interesting to look at that question in the context of our borrow long, lend short model, and the average length of our loan book at 16 months compared to the average funding of 21 months. So the average length of the loan book at 16 months means on a loan book of £9.8 billion, you're pretty much writing £6 billion a year. So importantly, we'll still be writing a lot of new business, but we'll just be flexing as we move into the next year, the rate of the growth. We won't be shrinking the balance sheet, we'll be moderating the growth level. And it is correct to say the 4% or 5% that we'll deliver in the second half does include those actions that we'll be taking.

Your second question on management actions and potential business disposals. This relates to the answer I just gave to Portia as well. So we're describing a number of initiatives there that we could possibly take on portfolios and businesses. You asked about CBAM and WINS specifically. Just to be entirely clear, we're not running sales process on any of our businesses. They're good businesses. They all have excellent growth prospects. We highlighted the 9% inflows that we've got into CBAM in the first half. And that's been a pretty consistent trend ahead of peer group for a long time. And we see accretion in the profit, as Mike described, from slowing down the hiring we had. 15 new business hires in the 2023 financial year and nine in H1 24. It'll be a much smaller number this year that will work through the profit. And quite clearly, WINS has an excellent position in the market and WBS is an excellent platform story that's growing already and will grow into the future. Not with - having said that, of course, if any offer came into the group, we would have to consider that, we'd be duty bound for.

The last question on costs – we take costs very seriously and we recognise that we want to get the rate of cost growth slowing relative to our income growth and they've been out of line for a little while. Importantly, whilst the cost growth in the first half was 13%, on half one 23, as Mike pointed out, on a half-on-half basis, it was only 4%. We're taking this very seriously and that's where we've identified this other £20 million opportunity. As we've already alluded to, from some of the management actions, moderating the loan book and securitisation, income will fall somewhat relative to that we have predicted. And therefore, we're taking these cost actions to still meet the existing guidance we had in the market of 8 to 10 per cent for this financial year, moving to more closely aligned next year and achieving leverage in the medium term.

Question 5

Corinne Cunningham, Autonomous

Hi there. Morning, everyone. I had a question on the real estate book. I wonder if you can perhaps give us a bit more detail on specifically where the growth is coming from. Is it really exclusively drawdowns?

And then also if you can talk a bit about asset quality. Cost of risk has dropped off and I just wonder specifically what's behind that and whether that's release of management overlays or whether it's, you're actually seeing a much higher quality of the underlying book? Thank you.

Adrian Sainsbury

As I mentioned, there is a slide later in the pack on Property and it shows the undrawn pipeline that we have, and it's now accreted to £1.1 billion. The pipeline, that's pretty much at a record level. What we've seen is, I'd say, some positive confidence from our customers here. Drawings are a little bit higher on facilities and we've seen good developments in our regional areas as well. So the regional lending is strong as well. We've also got some initiatives we've talked about before, like with Travis Perkins, we have a facility where customers can allocate some of their facilities to get product, then supply all of it from Travis Perkins. That's starting to work well as well. And also in our trading business, the Commercial Acceptance business, again, we're seeing some confidence come through.

I'd say asset quality is strong. And you commented on that. That's for a range of reasons. We're still seeing good volume of sales. A key measure that I look at with the team is the valuation or the estimates of property, that the properties will sell at the start of a development when we lend at it, and then actually what we sell them at. And that's pretty much at the continued trend we've seen, over 100% of the sales achieving more than at the start of the development. And when we've got the relatively conservative LTVs, we've typically got an LTV of the portfolio in the high 50s. That gives a high level of confidence, a high margin of safety along the way.

So the book is performing well. And why is that? We're lending in the absolute sweet spot of structural demand in the UK housing market. These are typical properties, family homes in the range of sort of £600,000 average. We're not talking about super prime, let's say, in London, and we like areas like London and the southeast and conurbations outside of London, within commuting distance of those, let's say Bristol, Edinburgh, Manchester, those sort of areas. So the book is performing well and the profile is good.

Corinne Cunningham

Can I just, the cost of risk, was that due to releases or just lower additions to the provision?

Mike Morgan

It was a combination of both of those factors, but the broad position is the book is performing well. As Adrian said, 90% of the book is secured or structurally protected. We have conservative LTVs right across the portfolio. So it's a combination of those two factors.

<u>Question 7</u>

Ed Firth, KBW

Thanks very much. Morning. Just had a couple of quick ones. Firstly, WBS, you've talked a lot about this in the past, and I think you said the revenue was up 24%, something like that. So it sounds like everything's going very well. At what point do you think we will be able to see that in WINS' numbers? And at what point do you think we get to a stage where that actually starts to drive the profitability of that business rather than, or become significant relative to the trading business? So I guess that's my first question.

And then the second question is a broader one. Are you seeing any signs that the publicity surrounding the FCA review and/or other issues are actually impacting your ongoing business in any way? Maybe in the Motor Finance business, obviously, I don't mean so much the complaints, I mean, in terms of how your customers behave with you, how your funding is going, etc etc. Are there any impacts that you see that are reading across from that? Thanks so much.

Adrian Sainsbury

Thanks, Ed. So on WBS, yes, I agree, this is a really good business. It's a platform business that's highly scalable. We own the proprietary system and as we've seen, the AuA has gone up really well, and as you rightly say, the income is up sizably over the first half of last year as well. We see this as a big driver for Winterflood for the future, and I absolutely expect that Winterflood, with its market-leading trading position, will also see its profit accrete when the markets come back, particularly AIM and Small Cap. We have commented previously that WBS went through breakeven, that was a couple of years ago. We will look in the future at when the right time is to disclose at a more granular level rather than just AuA and revenues in WBS. We'll look at that for the future.

In terms of the publicity on the FCA and any customer impact that we've seen, and I'll run through broadly the customer bases. On deposits, we've actually seen, as Mike said, the deposits have grown in the first half and they've grown since the 11th of January announcement from the FCA as well. 85% of our retail deposits are covered by the FSCS guarantee. And as Mike said, the vast majority, 95%, are not on demand as well. And we're seeing renewal and rollover levels over the BAU that we expect normally. So there's no significant impact there.

If I look at the customer bases in the Bank, in the lending businesses, we've seen no impact. We're lending to customers. These are products that customers want. They're valuable products, whether it's helping a customer to get a car, to take the kids to school or to drive to work, to help them fund their insurance policy at a time when there's inflation and cost of living challenges, helping SMEs, and I just talked about the Property business, helping with family homes. All of those things still are true. And as I said, we lend a significant amount each year, with the 16-month average term and the loan book at £9.8 billion. This is helping UK businesses and UK consumers, and we're seeing no change in demand as a result of the FCA's announcement.

The one area I think there may have been a very small softening is perhaps in CBAM, with some High Net Worth customers being a little bit more cautious about moving funds over. But that's at the very modest end of what I'm talking about there. So there's been little impact, Ed. Thank you.

<u>Question 8</u>

Peter Richardson, Berenberg

Your cost guidance includes £10 million of expenses related to processing motor complaints. Can you provide some colour on what this assumes about processing costs per complaint and the trend for complaint volumes versus recent experience?

Adrian Sainsbury

Okay. We're not disclosing the exact per pound complaints. You might have seen, Pete, that there has been some market commentary on each complaint that goes to the FOS, regardless of whether it has merit or not, does have a £750 charge. Now, clearly, not all our complaints go to the FOS. They come to the company first.

You may have also seen that Martin Lewis did an announcement last week, a press announcement where he commented, since his television show or talking about motor commissions, he's had 1,080,000 complaints. And he mentioned which bank had had each amount. We had 2.4% of those, Martin Lewis said, resulting from that, which you'd work out is broadly 25,000 or so. We're not disclosing the amount of complaints, but there's a possible barometer for that.

What we have done is we've built a robot, effectively, to analyse those complaints in an automated way. We have to see if it's just a motor commissions issue. And as a result of the FCA's announcement, there's a nine-month effective stop on having to respond over the usual eight weeks, or if that complaint may involve something else as well that we need to obviously respond to in the normal eight-week way. So, the £10 million is our estimate for what we will see for this financial year, and clearly, we'll see how this develops going forward.

And there are no more questions. So, thank you for your questions this morning and your time, and we look forward to updating you further at the full year. Many thanks and have a good day. Thank you.