Close Brothers

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Banking Investor Seminar

Preben Prebensen, Group Chief Executive Officer

Good morning and thank you all for coming.

This morning we look forward to giving you a detailed run through of our Banking Division, and we have a number of the Banking Executive team with us here today.

The purpose of today's presentation is to demonstrate how our distinctive business model generates value for the long-term, both through the specialist nature of our activities and our disciplined approach to managing our business.

I'll shortly hand over to Stephen, who will give you a strategic overview of the Banking business. Mike Morgan is then going to discuss how our financial model sustains value in the long run, with a particular focus on funding, capital and investment.

You will then hear from Bob Golden, Frank Pennal and Adrian Sainsbury, who will discuss our larger lending businesses, which will give you a sense of both the depth and the breadth of our activities, and the highly specialised nature of what we do.

We will of course be happy to take any questions at the end of the presentation. And after the wrap-up, we hope you will join us, with an opportunity for further informal discussion with the team.

First, I'd just like to start with a few words on how we look at our business model from a Group perspective.

We call our approach 'Modern Merchant Banking', which reflects how we continue to apply our focus on service, expertise and strong relationships, to meet the evolving needs of our clients in today's world. This is how we build leading positions within the specialist markets that we operate in which in turn generates strong profitability, allowing us to support our clients and reinvest in our business, while generating strong returns for our shareholders.

We are very focused on supporting and sustaining this business model over the long-term. We continually invest in our businesses and we ensure the Group is underpinned by prudent levels of capital, of funding and liquidity.

The Banking Division has a very distinctive business model, operating in specialist markets. This model has been a key driver of growth for the Group over the last five years and has enabled us to pay a progressive dividend to our shareholders, while at the same time maintaining our strong capital position.

We will stick to our model and we will continue to invest in it, to capitalise on the long-term opportunities we see for the business.

So thank you, and I'll now hand over to Stephen Hodges, the Chief Executive of our Banking Division.

Stephen Hodges, Chief Executive

Thank you Preben and good morning everyone. Today we would like to tell you about our banking business and its truly differentiated model. And I would like to start with an overview of our activities, focusing on three key areas: our concentration on specialist markets; our relationship-based lending model and local presence, giving high levels of service and commitments to our sectors and to our clients through the economic cycle; and our overarching focus on the long-term, maintaining our margins and the quality of our lending to drive sustainable returns rather than chasing short-term growth.

So, firstly, we focus on specialist markets. We have five distinct lending businesses. The markets they address and the assets that they finance are different, but there is a common approach across all the businesses.

These are markets which are not normally well served by the larger banks, and where sector-specific expertise and delivering superior customer service are critical. That's why we don't provide primary banking relationships or commoditised banking products like current accounts or mortgages.

Our core lending businesses are all well established and occupy a strong position within their respective markets. But today we will also touch on some of our newer initiatives, which provide opportunities to expand our model in the future.

Our footprint and local distribution network are core to our business model. We operate out of 45 locations in the UK, which allows us to build direct relationships with our customers and with our intermediaries.

Over the years we have built a large, specialist sales force, with around 500 direct sales people across our lending businesses. Our sales teams have local underwriting responsibility, which gives them the flexibility to provide our customers with tailored finance packages to suit their specific needs. And the same staff look after the loan throughout its life, from the initial payment through to the settlement of the loan.

We also work with many thousands of specialist intermediaries, including motor dealers, insurance brokers and specialist finance brokers, again using our strong relationship approach.

So the strategy for the Banking Division embodies the core values and strategic priorities that Preben outlined earlier.

The combination of long-term client relationships, a customer-oriented approach to lending, and the nature of our loan book, being short-term with prudent underwriting criteria, all translates into strong margins and stable returns over the long-term.

Many of you will have seen this slide before, but it's very important. It demonstrates the longevity of our business model and our long-term track record of driving consistent growth and returns through the cycle.

Throughout this 30 year period, we've done what we always do: we've stuck to our specialist markets and maintained our robust and prudent lending model. And the chart illustrates the ability of our model to deliver consistent growth and strong returns through periods of recession and financial stress, as well as both high and low interest rate environments.

And that's why over the last ten years, which include both the 'easy credit' years and the 'credit crunch', we've been able to generate an average net interest margin of over 9% and an average return on equity of over 20%.

Now of course these metrics fluctuate slightly at different points of the cycle. And as you know, we're currently at a point in the cycle where our NIM is at the lower end of its historical range, but we are also benefiting from very low bad debts. And so overall, our net returns remain strong and in line with the level that we've seen over the long-term.

But equally important is our long history of innovation in launching new products and entering adjacent markets. We have always looked for opportunities to extend our business model into new areas which fit with our specialist, expertise-led approach to lending. And this has supported our growth through previous credit cycles and is fundamental to delivering sustainable growth over the long-term in a wide range of market conditions.

And we look forward to sharing more detail on some of our current initiatives with you today.

We have a strong commitment to client service and long-term relationships, and this is highly valued by our clients.

One measure of this is the net promoter score, which you can see on the left of this slide, and these scores reflect what our customers think of us. All of our businesses have a positive net promoter score, and Treasury, Asset and Motor all score above 50. And these are strong scores by any standard, but particularly in the financial services industry.

And we've also monitored repeat business as we try to understand what our customers want and why, and we see consistently strong levels of repeat business across all our lending businesses, and this helps us to rewrite large portions of our loan book year-on-year.

So numbers are all well and good, but nobody tells the stories better than our customers themselves. Therefore, we would like to show you a couple of videos where our clients talk first-hand about the service they received from us and why they choose Close Brothers.

Customer video

Well, I hope some of those real life examples provide some context as to how our model and customer proposition are truly differentiated and valued by our clients.

As I mentioned earlier, we operate in five primary lending businesses, which we group for reporting purposes into Retail, Property and Commercial. Today, we're going to focus specifically on the largest of these businesses: Asset, Motor and Property Finance.

We will also talk a little about our consumer point of sale finance initiative, which is not material to our loan book today, but provides an interesting example of how we're extending our business into new areas.

In the interests of time, we're not going to talk in detail today about our Invoice and Premium Finance businesses, but they both remain important parts of the business, and you can find further details on them in the appendix. Sharon Bishop, CEO of Premium, is also here today and will be happy to take any questions.

So I'm now going to hand you over to Mike Morgan, our Banking CFO, who will talk you through our financial model and the investments that we're making in our business.

Mike Morgan, Banking CFO

Thank you, Stephen. Hello and good morning.

Over the past 25 years I have worked in a number of senior roles across the financial services industry and I joined Close Brothers as Finance Director in 2010.

Over the course of this section, I will talk you through some of the key aspects of our financial model and how they support our performance over the long-term.

As you have just heard, we have a long track record of achieving strong returns throughout all stages of the economic cycle, and we achieve this through our relentless focus on margins, credit quality and cost control.

As Preben and Stephen have said, we run this business for the long term. And therefore we balance our investment between the future needs of the business and protecting our strong and prudent financial position. This approach has served us well, and has underpinned our strong performance throughout the cycle. And I will expand on each of these points over the next few slides.

First of all, we continuously invest in our businesses and as you know, we operate a high touch business model. This reflects our direct sales model which is relationship-focused, with local presence and a manual underwriting capability. As a result, staff costs make up over half of our total cost base. To give you an indication, our headcount has risen by around 50% since the last cycle, driven by an increase in sales capability and business growth, as well as more recently through higher headcount in the control functions, primarily legal, risk and compliance.

In addition to this, we are undertaking ongoing investment in systems, as well as new product development, which I will talk more about shortly. We are extremely cost conscious and the underlying costs are managed carefully. The long-term average expense income ratio for the business is around 50%. And as you can see from the chart, we see our expense income ratio trend above and below this average, depending on where we are in the cycle.

Recently it has been below the long-term average, due to strong growth since the credit crunch. We are now seeing the ratio trend back up again as loan book growth moderates, but our essential investments continue. However we expect it to remain within the relatively tight range that we have seen historically.

This slide illustrates some of the key investments we have made in recent years and some of the areas that we are proposing to invest in going forward.

People and systems are key areas which make up a large proportion of our cost base. Attracting and retaining the necessary talent remains an important area of focus; the quality of our people is high and we need to build on this if we are to ensure sustainable growth. We continue to invest in training and development, with a notable new initiative being our training academy for the next generation of sales staff in our Asset Finance business.

Although we are a people driven model, technology is present throughout our business, therefore investment in it is essential to support our growth. Across all industries the protection of client data is a priority. Over the last two years we have migrated our hardware infrastructure to two state of the art data centres providing greater robustness and increased protection against the ever-increasing levels from cyber threat.

On the slide you will see some examples of significant IT projects that have been implemented in recent years; Property and Treasury systems being notable examples. These have ensured that our infrastructure has remained robust as the business has grown, whilst at the same time allowing us to improve the processes that serve our customers more effectively. This is essential to our proposition and therefore we will deploy technology wherever we believe it can improve our offering.

Looking forward, we are undertaking an extensive piece of work to better understand how digital technology can improve the customer value proposition in our Premium Finance business. Other businesses are building on, and will take advantage of, this work.

Data analytics is also a key area of focus that is allowing us to gain greater customer insight, and we will be harnessing technology to improve business-wide efficiency.

Finally, we have a long history of entering new markets and launching new products. Stephen's earlier slide showed how important these have been to our growth, but of course they do require upfront investment, and you will hear more about some of these initiatives shortly.

To minimize the financial risk of our business our strategy is to maintain a simple, straightforward and transparent balance sheet supported by prudent levels of funding. This funding is both diverse and long-term in nature. Our philosophy has always been to borrow long and to lend short, an important attribute that differentiates us from the wider market. Funding levels are maintained well in excess of our loan book, and total funding is at over 130% of the loan book.

Access to diverse funding sources provides us with resilience, should funding markets come under pressure, as they did in the last financial crisis, and allows us to optimise the cost and maturity of our funding in more benign markets.

This slide illustrates the true depth of our funding in terms of diversity on the left-hand side and maturity on the right and, as you can see, the funding maturity more than exceeds our 14 month average loan book maturity.

I want to reiterate how important capital is to our model. Our priority has always been to maintain a strong and prudent group capital position, and this has allowed us to continue to lend to our customers through recessionary periods, when other lenders have had to withdraw. As our loan book is predominantly secured and we have a long track record of profitable growth, we are comfortable with our current capital position.

Lastly, I should like to touch on our credit ratings, which we believe are another differentiator. We are now one of the highest rated banks in the UK with Moody's recently upgrading the Banking business to Aa3/P1. Fitch has recently reaffirmed their rating at A/F1. Moody's explicitly referenced our strong financial position, robust business model and our long-term track record, and we think this helps provide further validation of our model, which ranks us above many other financial institutions and many new players who are not yet rated.

We will now move on to look at a number of our businesses and I will begin by handing over to Bob Golden who will talk about our Motor finance business.

Bob Golden, Chief Executive Retail

Thank you Mike. My background is that I've been involved in consumer and SME lending for 30 years. The last 16 years I have been at Close Brothers, leading various businesses and have been the Chief Executive of Retail since 2008.

Retail includes our Premium and Motor Finance businesses, but as Stephen explained, I am going to focus on Motor, which accounts for 28% of the loan book. I will also finish by touching on our new initiative in the consumer point of sale finance space.

As you see, the majority of our loan book is used cars, and this business is sourced from our strong relationships with motor dealers, who are typically smaller, family run businesses. We also provide loans for light commercial vehicles, including fleets for SMEs, and some new cars and motorbikes. Our strength comes from the expertise of our people, who thoroughly understand the motor market and the vehicles we lend against.

Our Motor Finance business has a network of 18 regional offices across the UK, which manages our relationships with 7,500 motor dealers. This provides us with a local presence, and additionally our sales teams have underwriting authority which allows quick decisions; and that's key in this industry.

Our manual underwriting gives us the flexibility to accept good quality customers that other prime lenders may auto-reject based on credit score alone. We take account of the specific vehicle they are buying and the track record of the dealer they are buying from, and then make a decision based on all three factors together: credit score, the asset and the dealer.

Our dealers understand the value of this approach, and our bad debt rates remains consistently low throughout the economic cycle, which reflects this underwriting expertise. The unique combination of local presence and flexible underwriting are the key differentiators of our model.

Our core product is a hire purchase loan for used cars, but in line with the wider market we are seeing significant growth in demands for our Personal Contract Plan product, which now makes up 8% of the motor loan book. We are still some way below the market average of approximately 40%, which implies there should be an opportunity to further increase our penetration, as long as this business is within our risk appetite.

The UK Motor Finance market is looking buoyant. Strong demand is driving record levels of car sales, particularly for PCP products, reflecting the wider consumer shift towards usership rather than ownership.

A record £89bn was spent on new and used cars in 2014, with unit volumes returning to the pre-recessionary levels of 2006. Given that the majority of our book is made up of used car loans, this slide focuses on the used car finance sector in particular, which is worth approximately £11bn per year.

The outlook for the market as a whole, is favourable, with Mintel research predicting that the point of sale car finance market will grow by 44% in the five years to 2019. During this time our focus will continue to be on maintaining our margins and delivering strong returns across the cycle, rather than chasing growth.

There are a lot of players in the motor finance market, but there are also a number of distinct segments. We are predominantly a prime lender where, for many of our customers, buying a car is a major financial decision. We do not compete with the captive, in-house lenders in the new car sector and whilst we do overlap with the high street banks, they primarily target the larger franchised dealer groups rather the smaller, independent dealers.

Close Brothers is the only lender with a regional branch network and is therefore uniquely positioned to service the long tail of over 7,500 small to medium-sized dealers in the UK. This allows us to provide an unrivalled level of service to our dealers and is, again, a key differentiator of our model. And whilst we do not operate in the sub-prime sector, we are in the process of piloting a referral initiative, where we're passing on some of our declined customers to a panel of brokers in exchange for a referral fee.

Our customers are typically from lower/middle income groups, they are in full-time employment and value the support and advice of a trusted dealer to get them a good deal on the part exchange, the new car and the finance they are obtaining.

We do see our customers researching their options online, they are typically driven by convenience rather than pricing, and tend to enter the online purchasing journey later than other car buyers.

Approximately 90% of our dealers are independent, single-site dealerships and small family-owned groups, which reinforces the importance of our regional branch network and generates higher margin business than from larger dealerships. That's an important point.

Whilst we do not work with the largest, nationwide dealer franchises, we do have a dedicated Key Accounts team to service the larger dealers in our network, who now account for 17% of our UK motor loan book.

In volume terms the majority of our business comes from about 1,500 dealers, who tend to be independent dealers and small franchises that are professionally managed and increasingly sophisticated in their use of technology.

As you know, the supply of credit is a cyclical process, with our share of the market moving up and down as it fluctuates. Over the last five to six years the market has grown significantly and we have seen our market share peak during the credit crunch at about 12% of the independent used car finance market: this was when other lenders were pulling out. Now with credit supply returning, we are currently at around 8%.

The motor finance market is going through a period of change due to a combination of increased regulation, changing consumer habits and the rise of new online motor finance models, but we continue to see good opportunities for growth that fit with our proven model.

Point of sale motor finance is a sustainable, long-term market and the role of the dealer remains absolutely key to both our model and the used car sales process, although there is likely to be a gradual reduction in dealer numbers as the trends of consolidation and increased regulation continue.

Notable opportunities for growth include increased penetration of our PCP product and our business in the Republic of Ireland, which has grown rapidly in recent years. Adrian will give you more details on Ireland shortly.

In conclusion, we expect to see continued long-term growth in this business, albeit tempered by market conditions and competition. We will always focus on maintaining the quality of our book and the strength of our returns, and growth is obtained by continuing to enhance our dealer proposition.

As Stephen highlighted earlier, we have a track record of delivering growth by actively pursuing new initiatives in adjacent markets that fit with our model. One such example in Retail is our recent initiative exploring the unsecured consumer point of sale finance sector. This is aimed at SME retailers, and we have identified a large, fragmented market that is underserved by banks and where we can generate superior returns. The profile of the retailers we are working with actually mirrors our motor finance dealers, predominantly small and medium-sized companies, with a handful of larger ones where we can again achieve our risk/reward objectives.

We are seeing strong demand for our services in this market and believe it represents a good fit with the Close Brothers' model where we focus on relationships and service, with a direct sales team who are experts in their specialist areas. But, we are still very much in the test and learn phase and looking to build our infrastructure. Unsecured lending will always be a smaller part of our book due to the associated risks. However, we do see this business as a potential growth engine for the future.

I will now hand over to Frank Pennal to speak on Property. Thank you.

Frank Pennal, Chief Executive: Property

Thank you Bob and good morning everybody. Before I talk you through the slides, I think it would help to give a little background to myself as it adds context to some of the points I make. I have spent 30 years in specialist property finance, 18 of those years at Close Brothers within Property Finance and ten years as Chief Executive.

Our Property business comprises Close Brothers Property Finance and Commercial Acceptances. Property Finance was established in excess of 30 years ago and has been a continuous lender to the residential property development market ever since. Commercial Acceptances was established in 1982 and acquired by Close Brothers in 2008. You will probably be aware that we have seen significant growth in our Property business in recent years, and the loan book now stands at £1.3bn, 23% of the total.

Here are a few pictures to illustrate the wide variety of projects that we finance. These are in our core market, which is predominantly residential development in London and the South East. The top two pictures are examples of our typical residential developments where we have a strong relationship with the borrower. The one on the top left has been a borrower for more than six years, and has completed a range of developments but only in the town of Sevenoaks. The one on the top right we supported through the credit crunch, and this site in particular shows an example of our bespoke lending due to the awkward nature of the site with the railway bridge behind it. Both of these customers only borrow from Close Brothers.

The bottom left shows an example towards the top end of our scale, this property sold for £6m. And finally the bottom right, which is a typical Commercial Acceptances refurbishment in Fulham, where the floor space has been tripled in size.

Whilst each of these developments is different, we apply the same prudent lending criteria against all the projects that we finance, and our conservative loan to values fall in the range of 50%-60% of gross development value. Importantly, we have no exposure to buy-to-let or developments that are marketed solely to investors. We are looking to support developers targeting owner/occupiers, not speculators. In more recent times we have also sought to reduce our exposure, which in any event is limited, to the super prime London sector. This market is now more reliant upon overseas buyers and demand has been impacted by changes to Stamp Duty.

This slide provides you with an overview of our Property Finance business. These are run as two separate brands targeting different niche areas of the property development market, but both share common characteristics. They both have market leading positions within their specific markets. Both provide a similar high quality customer proposition based on market understanding provided by specialist teams.

Our speed of decision making and a willingness to be flexible rather than box ticking, helps build long-term trusted relationships, which is reflected in the high level of repeat business which stands above 70%. Importantly, the businesses complement each other, with cross-referrals a regular feature.

Both businesses continue to grow their loan books strongly. For example, when we acquired Commercial Acceptances in 2008 it had a loan book of £80m and eight staff. We have since increased this to £350m supported by a team of 25.

Our average loan size is £1.1m. This is due to the mix with Commercial Acceptance at an average £300,000 for bridging finance – this is largely for properties acquired at auction – and £600,000 for refurbishment projects. This against £1.7m for the average new build Property Finance development.

Our loan durations also vary, six to 12 months is the average for Commercial Acceptances and Property Finance is slightly longer at 12 to 18 months. Our underwriting criteria is core to our model across our developments. We will always visit the site in question, and have a detailed understanding of the track record of the developer before we lend.

Residential developments make up 75% of the loan book, and our core customers tend to be smaller limited companies, often family run businesses. We also work with quite a few regional house builders and some Housing Associations who increasingly have supplemented their income by undertaking private for sale developments.

We only provide senior secured debt, and so all of our developers have to put in their own equity to fund the initial stages of a project. And we only work with developers that have a proven track record with several successfully completed developments under their belt.

Our bridging finance is short-term secured lending where the asset is key, 95% of which is located inside the M25. As with our residential developers we look for a proven track record, although these projects are generally on a smaller scale. On the commercial development side this is a relatively small part of our business, and we will only finance the development if it has been pre-let. Similarly, we only fund a limited amount of commercial investment properties.

It's important to note that many of our customers have been working with us for many years, in a number of cases in excess of 20 years, and as you have seen we have very strong levels of repeat business driven by the high touch level of service that we provide.

The period of reduced competition during the credit crisis has resulted in very strong growth, with 19% loan book growth on average over the last five years. We are well positioned to move forwards as the market supports our service driven business proposition, with high barriers of entry. We have a strong position in the sub-£10m development finance market, where we are the largest non-clearing bank lender by market share. De Montfort University research evidences that we have 20% of our niche by business origination. This puts us third overall.

As you all know, competition is returning to our markets and Property is no exception. We are seeing the larger clearing banks starting to encroach back into the smaller ticket sizes, some of the other smaller banks are looking to enter the market, and some privately backed funds and lenders are competing for business.

Commercial Acceptances has always operated in a competitive environment. Interestingly, they compete at the lower risk, lower return end of the market, albeit the returns at this level are still very attractive from our perspective. A number of lenders are willing to lend at higher loan to values, but this is a market we don’t play in. We are only willing to write business on our terms and with developers we want to work with.

However, this is a market where our service and expertise really make a difference and allow us to continue to grow our business throughout the economic cycle.

We are all aware that the UK economy is improving and the economic growth is increasing activity and demand for our core products. We have a strong market position in London and the South East. This part of the country is seeing good population growth, and the improving economy is increasing the general level of activity across the housing market which gives a positive demand outlook.

Our business mix will remain weighted towards London and the South East, but we are already present in the major cities in Scotland via our Edinburgh office, and are now selectively targeting other regional markets that are seeing improving demand as the ripple effect from London progresses and regional economies improve.

We will be cautious in our approach and highly selective in which markets we target, but last year we secured 26 new client relationships in the regions outside London and the South East.

In addition to this, there are other opportunities which will support our growth profile over the coming years. For example, the recent extension to legislation around conversion of commercial property to residential should increase demand for us in the near-term, as we stopped funding this type of development last April given the uncertainty around renewal.

Overall, the supply of credit is increasing but the economy is improving and so demand is robust across our core markets. We are well positioned to deliver future growth over the long-term, but our priority will always be to maintain our margins and the high quality of our loan book.

Thank you. I will now pass you over to Adrian.

Adrian Sainsbury, **Chief Executive: Commercial**

Thank you, Frank. I’m Adrian Sainsbury and I’ve worked in SME and Corporate Lending for 25 years. I’ve previously headed up secured SME lending businesses at Barclays and RBS, and was Chief Executive of ANZ Bank in Europe. I've also been Chairman of the Asset Based Finance Association, the UK and Ireland industry body. I joined Close Brothers in July 2013 as the CEO of the Commercial Division.

The Commercial Division is made up of our Asset and Invoice Finance businesses which provide direct and indirect loans to SMEs. Today we're going to focus on Asset Finance which makes up the significant majority of the commercial book, but we've also included a page in the appendix which gives an overview of our Invoice Finance business.

Our Asset Finance business funds a wide variety of assets, sectors and industries, as shown on the slide. The majority of our business comes from our transport and industrial equipment sectors where we lend against assets such as trucks, forklifts, yellow plant, manufacturing and recycling equipment. We also fund a wide range of other assets from beer kegs and buses, to onshore wind farms and football transfers.

The majority of our customers are based in the UK, although the Republic of Ireland accounts for a small but increasing share of the Asset Finance loan book, and I'll talk more about the Irish market a little bit later.

We have a well-diversified, high quality loan book which is mostly secured and small ticket. Our Asset Finance businesses operate through two channels: our direct sales teams, who account for approximately 55% of our business; and approved brokers, who account for the remaining 45%. We have local teams of specialists providing customers with direct access to decision makers. Our teams are experts in their fields, who have an in depth understanding of what our customers need in terms of both asset types and solutions, and are able to tailor deals appropriately.

Our customers are typically owner managed SMEs and medium-sized limited companies who are looking to either invest in new assets to support business growth, or to refinance their existing asset base. Refinance is a key differentiator for us, and we're seen as a market leader thanks to our strong customer relationships and detailed understanding of our customers' businesses and assets.

Refinance is a specialist area used throughout the cycle helping businesses release funds to invest and assisting with cash flow management at the time our customers need us most. We're able to quickly assess the customer's requirements by identifying, inspecting and valuing the assets and creating a tailored refinance solution. Our high levels of repeat business are testament to our focus on delivering fast and effective customer service.

Our sales model delivers, and here's a good example seen at the Manufacturing Technology Exhibition at the NEC last year. Here you can see our Close Brothers stand being manned by our Industrial Equipment team, clearly a great place to meet with suppliers and customers.

One of our existing customers, GWR Fasteners, a specialist metal manufacturer, visited our stand after seeing a sliding head lathe, that's a large piece of hi-tech kit and which they wanted to buy. Our salesman remotely uploaded the details using their tablet technology and the finance for the deal was agreed that same day. The customer immediately placed the order for their new machine: a great example of modern merchant banking in action.

This chart shows how our loan book has grown consistently over the last five years. While the overall market shrunk in the years immediately following the financial crisis our model allowed our business to grow strongly during this period. More recently, following a number of years of modest growth, demand in the UK for asset finance has picked up and volumes in our primary sectors now stand at almost £18bn.

As you'll be aware, competition has been increasing in our sectors, particularly in the broker channel and now is at pre-crisis levels. Larger retail banks are competing for the asset finance business of their SME current account customers, specialist banks are looking to build volume with flexible credit and pricing requirements and new tech models are entering the marketplace. As a result our growth was moderated in the last couple of years, but by sticking to our model and with a backdrop of improving demand we've maintained our market share which currently stands at around 7%. We continue to write record levels of new business and our net returns are still very good which highlights the strength of our customer relationships, expertise and speed of service.

As Stephen discussed earlier, we've always looked to proactively grow our business and Asset Finance is a good example of this. As this timeline shows we have an established track record of providing credit and driving growth throughout the economic cycle. This is something that sets us apart from the competition and helps us build trusted longstanding relationships with our clients. Growth has come from a combination of expanding our core product offerings and a range of organic and inorganic initiatives in adjacent markets that represent sensible extensions to our model.

I'll now talk you through three of these initiatives in a bit more detail, two focussing on new markets and one on geography.

We see strong opportunities for growth in the Republic of Ireland as the country continues its recovery from the economic downturn. GDP growth is currently running at 5%, roughly twice that of the UK. We operate in the motor, invoice, asset and premium finances markets in the Republic of Ireland and our total loan book now stands at around £300m. We operate the same model in the Irish market as we do in the UK, with an emphasis on service and expertise.

Asset and motor finance, as Bob mentioned earlier, have been the key drivers of the growth in the region, with compound growth of our loan book in the Republic of Ireland of around 45% per year over the last three years.

Another example of the growth opportunity, this time in an adjacent market, is our renewable energy finance business. Last year we recruited a specialist renewable energy team with a very strong reputation in the market and have already built a book of over £100m across a range of onshore wind, solar and hydro deals. We have a very positive pipeline for the next couple of years and are also seeing some examples of larger ticket deals written by the business in the £20m to £30m range.

Next, Close Brothers Technology Services, a new green field initiative. We're in the process of setting up a new business focusing on technology assets, an asset class we've not previously targeted. Expertise is essential in this niche market so we've again recruited a specialist team. The business will offer a holistic range of financing and technology services, covering every part of a technology's life cycle from procurement through to disposal. Initially we'll focus on assets such as PCs, servers, tablets, data centres and telecoms equipment, but in the future we may look to expand into other asset types such as digital print and broadcast equipment. And the expertise of our team will be key in helping our customers to effectively manage the regular renewals and upgrades that these types of assets typically require.

The target customer segment will be UK based mid to large corporates with multi operating locations and an average expected facility size of around £150,000. We intend to enter the market cautiously, adopting the same prudent lending criteria model as the rest of our business, but we believe this sector offers interesting growth potential for the future.

In summary, we believe our Asset Finance business remains well positioned for the future, with growth coming from continued strong demand for our core product offerings alongside a pipeline of sensible extensions to our model in adjacent markets such as Ireland, Technology Services and renewable energy. The expertise of our people remains absolutely at the heart of our model. We're continuing to invest in this area, with recent initiatives including the establishment of our in house training academy which is designed to develop the next generation of our specialist direct sales force.

The head of Asset Finance at the FLA industry body recently commented: "The Close Brothers Asset Finance Sales Academy is an excellent initiative that is ensuring that asset finance practitioners have the right knowledge about products and the industry as well as ethical standards. The Academy is a very positive contribution to the industry."

At the same time as developing our people, delivering consistently high quality customer service will help us to maintain strong net promotor scores and high levels of repeat business. We have a resilient model which focuses on long term opportunities and high returns. We'll continue to win business with our expertise and speed of service and most importantly we'll continue to focus on the quality of our book rather than targeting volume.

I'd now like to hand back to Stephen for closing remarks.

Stephen Hodges

Thank you, Adrian. So in conclusion, we wanted to explain to you today the strengths of our model and why we believe our business remains extremely well positioned for the long term.

As you've seen, we have a long track record of growth and profitability, and we focus every day on maintaining the disciplined approach which supports that track record. As we've said many times before, we don't have a growth target; growth is the output of our model. Having said that, we see many ongoing opportunities for long-term structural growth.

Of course we're at a stage in the cycle where we're seeing more competition from both established and new players, but I hope our speakers today have shown what sets our business apart and why our customers really like dealing with us.

We've also shown that we have a long history of innovation and that we're always continuing to actively seek out and invest in new initiatives. And of course we remain focused on protecting and investing in our business to ensure that we can continue to deliver strong returns through the cycle and to deliver growth while maintaining a strong and prudent capital and funding position.

So thank you very much for listening, we'd now be happy to answer any questions you may have. In addition to the speakers you've heard from we're joined by Sharon Bishop, CEO of our Premium Finance business, James Broadhead, CEO of Motor, and Malcolm Hook, our Treasurer, who will also be happy to answer any questions you may have. So we have a couple of microphones available and as usual, please state your name and company before asking a question.

Question and Answer Session

Question 1

Nick Longhurst, Marathon Asset Management

In the Asset Finance business you always stress the salesforce are local, and yet I'm always struck by the fact that 45% of the business still comes through the broker channel, which compared to say, property, is obviously a much higher proportion. And I just wondered, does that vary a lot over the cycle or are we just at a high point because there's just a lot more appetite that brokers can fill, or is there just something structural that means that no matter how much you invest in the sales force there's always going to be that broker element to it that you don't have a direct relationship so much?

Stephen Hodges

I'll hand over to Adrian in a moment but you're absolutely right that in Commercial and in Asset Finance that broker chunk is larger than we see in for example Property, that's correct. It's always been the case that a reasonable proportion of that business has come from very specialist brokers with whom we have long-term relationships with and who we've dealt with over a long period of time, but we also have as well as that a direct broker channel. So Adrian, do you want to address that point?

Adrian Sainsbury

Thank you. Yes Nick, I'd say the broker proportion of the total has not changed dramatically in recent years, we do have a direct sales force of 121 direct sales people as well, and that channel is going particularly well. I mention the training academy we've got where we've got 31 new starters there that we're training up and they'll join our sales force in February next year. So the direct channel is a particularly important channel to us. I mentioned the competition, that's stronger in broker than the direct channel.

Question 2

Jamie Clark, Liontrust Asset Management PLC

Could you discuss the retail points of sale opportunity in a bit more depth - competition, size of opportunity, typical size of purchase etc. please?

Stephen Hodges

Yes, I'll hand over to Bob for that. As we've explained, it's a relatively new venture for us, it's at the sort of test and learn stage but as with a number of our other markets we see it as a fragmented, poorly served sector which is significant. So Bob, over to you.

Bob Golden

Yes, I think there's a number of points when looking at this particular market, the first thing is actually is there a market there, is there a demand for this product? The second thing is that if there's a big market there, actually can we get retailers to be interested in this product, and then thirdly, if you've got retailers would their customers actually buy the product?

So at the start of this actually is I'd ask yourselves the last time you bought something either online or in a retailer and it cost £600, £1,000, were you offered a loan facility? Actually, unless you went to one of the very large retailers it's unlikely, so that was our starting point, that we felt that this was an underserved market.

So we started a pilot about 18 months ago, the pilot has gone well, we've got multiple hundreds of retailers on board, we gave you some examples of the type of people who are using us, like Clifton Cameras, also people like Mothercare at the top end, but the vast majority of our retailers are really the small and medium sized retailers who are very much underserved by the banks. And we think, as Stephen said, that it's very much a fragmented market, it's a huge market, measured in tens of billions of pounds and we only need a very, very small market share to make it material. But it's very early days, because this is unsecured, it is a new area for us and we're not going to rush in, we're taking our time.

I think the last thing to say on this is that we do think that over the piece it absolutely fits within the model of Close Brothers, albeit it unsecured, and the reason for that is that one, it's fragmented but it is specialist in nature, this is not undifferentiated lending, and also it's very well protected, because once you sign a retailer up they typically sign a long-term exclusive contract with you and also you embed your sales process into their sales process so that again, similar to a Premium or a Motor, we're looking to have a relationship with that retailer over the long term.

So we think it's fragmented, it's specialist and it's highly defendable, what we need to do is to be cautious in going into it because as we know many people have come a cropper in unsecured lending in the past, we need to make sure we understand this business before we materially embark upon that particular area. Anything else? Did that answer the question?

Jamie Clark

Do you have to have the credit score though? Someone going into Mothercare could be a whole range of different types of people so do you have to have the credit score?

Bob Golden

Very much so.

Jamie Clark

And how does that work?

Bob Golden

Okay, it's a very fast process, so when you're in store we have some really neat frontend points of sale technology, it takes on average about 90 seconds at the point of sale to key in some information, we get automated credit scoring, automated decision making, the documentation is electronic and we're instantly being able to give a decision to the retailer so somebody can go into the store, purchase the goods and walk out with a loan. It's instant gratification in that sense, yes.

Preben Prebensen

You should just comment also on the credit scoring methodology that we're going to be using and some of the skill sets that we've brought in to the firm that are very specialised in this area, because I think that's important too.

Bob Golden

We use experienced Deal-feed data; we've brought in people from outside. We have a credit director who has got experience from Barclaycard and also from Black Horse. So actually very good cross credit score experience. We've also brought in two specialists in terms of their credit score knowledge and we call them, I suppose, sort of gurus, and they're very much into the analytics and the knowledge side. We've also brought in a head of counter fraud, because this is an area which, if you're not careful, you can be exposed to fraud and that person was the group head of counter fraud at Worldpay.

So we have invested heavily in the top tier and on the technical side of this business to make sure that the infrastructure's in place and it's solid before we actually move forwards.

Stephen Hodges

And Bob of course we're distributing this not just through the stores but online as well.

Bob Golden

About 70% is online.

<u>Question 3</u>

Gurjit Kambo, JP Morgan

Good morning I have two questions. Firstly you gave some data on market share for the different businesses, could you perhaps give the peak current market share and then just maybe directionally where you see that potentially moving over the next years in the different businesses?

And then the second one just on the net interest margin, you indicated it towards the low end of the range, so again just perhaps within the difference three businesses how that margin is developing?

Stephen Hodges

Yes I mean obviously you've got a lot of businesses and to go through the whole range of their market shares would take a long time. We've given in the pack you'll see where we describe some of the market shares of the Motor Finance and the Commercial businesses in particular.

I mean market share is obviously a factor but it's not something that we spend our lives thinking about to the nth degree. Growth, as we've said, is an output. What matters to us is that we see steady demand and growth for our products and services through the cycle. All of our businesses are growing at the moment. As you know last year our loan book grew by 8.5% and in the statement that we released last week we commented that the loan book has grown 2.8% in the first quarter.

So market share is a factor but at the end of the day it's not something that keeps us awake at night, what matters is being there to provide the services to our intermediaries and customers that they want and that the demand for those products and services is consistent through the cycle.

Preben Prebensen

Just to add to that in terms of market share the Motor story is quite an interesting one because it actually reflects that we are disciplined in the application of the model. So going into the credit crisis our share of that market was say, 7% or 8%. It peaked, as Bob said, at around 12% and notwithstanding the fact that our business has growth steadily during this period, our share has come down to about 8% now. And that's exactly what we would want to see, if you like, because we're not targeting share, we're targeting the maintenance of our returns.

In our other businesses our shares are more steady than that I would say, they move less demonstrably and Adrian you mentioned that yours have held pretty steady.

Adrian Sainsbury

Yes I mentioned Preben there was faster growth in Asset immediately after the crisis and we're now moderating towards the market growth but still growing very nicely.

Stephen Hodges

And I think Frank referred to the De Montfort research that showed that we have a market share of about 20% in our particular niche in the property lending business. So again markets are difficult sometimes to define and we're obviously not trying to play the entire market we're quite often looking just for a slice of that market. So I think it's important to remember that as well.

Preben Prebensen

And you had a question on net interest margin could you just repeat that?

Gurjit Kambo

Yes the question was just in terms of the net interest margin in different segments what sort of pressures you're seeing, either top line or from the funding side as well?

Stephen Hodges

Yes we don't reveal the net interest margins of all our different businesses. Again diversity is what we regard as the strength of our model and therefore for us the important thing is the average net interest margin across the face of our bank. We've said that it's at the lower end of our range but of course with bad debt at the moment running even more at the low end of its range our net returns are still extremely strong.

So there is more competition, of course, and some of that is impacting the net interest margin, but it's also impacted by which bits of the business at any moment in the cycle are growing. And of course the net interest margin is only an average and at any one time we have businesses producing a higher net interest margin and others producing a lower net interest margin.

So we're very happy with the position that we have at the moment, given the net returns that we make on our loan book.

Question 4

Justin Bates, Liberum

Good morning. Could I ask, just picking up on your points about credit quality there, is it sensible from this point on to assume a slight tick up, or given what you said, a stabilisation is sensible from this point onwards? That's excluding your point of sale.

And then if we include the point of sale business as you look over the next three to five years, including that in your plans what it might do to the risk-adjusted margin?

And then a final question is there any solicitor lending in the book?

Stephen Hodges

Is there any solicitor lending in the book? Negligible, I mean there might be a little bit in terms of our professional activities. There is some solicitors' professional indemnity insurance premium financing that we do, which we've been doing for very many years and which has an extremely high return and a very, very low bad debt rate but specifically lending to solicitors isn't a core activity for us I would say. The minimum piece in our professional lending business but pretty small.

On the bad debt position clearly it's right at the low end, below the low end of our range at the moment. There isn't a clear trend at the moment one way or the other so it's stable at the current position but taking any medium-term view we would expect it to track back closer to the long-term average. But low interest rates do support very, very low levels of default and that's not just for us that's for the market as a whole. And of course there's no immediate threat to the interest rate environment in any material extend. So I think if it does move it'll move gradually and over a period of time.

I think as Bob rightly said you would expect an unsecured product to have a higher incidence of bad debt but we will be looking at, as he rightly implied, a risk-adjusted return and therefore we'll be setting the net interest margin for that business at a level that can support a slightly higher level of bad debt through the cycle.

Preben Prebensen

But just again on that there we'll be using the test and learn process to make sure that that business would never really change the long-term performance of the whole portfolio. We're going to make sure that it doesn't get to a size where the volatility of that business would change the long-term characteristics. That's very important for us.

Stephen Hodges

It's a key aspect to the way in which we manage the bank as a whole. But that's the diversity point really being made in spades. It's really important that no single asset or bit of our business can distort the overall returns.

Justin Bates

Is it fair to assume you're not anticipating any punitive macro prudential measures to curtail lending?

Stephen Hodges

Well whether one should assume that I don't know.

Preben Prebensen

We don't do buy to let. In terms of last night.

Stephen Hodges

Yes I mean I think the Statement yesterday demonstrates that it's dangerous to try and predict what's going to happen because I think very many people were taken by surprise by a number of his pronouncements. But diversity certainly helps. And many of our activities are aimed fairly and squarely at small and medium-size businesses who are making things, who are exporting things, who are employing people, who are employing apprentices and we think that the majority of the businesses that we're supporting are absolutely in the heartland of the British economy and are the sort of businesses that any government will be trying to support.

So one can't anticipate what might happen in the future but we're not in those sectors where there's sufficient concern about speculative demands, for example, that you can see a government might wish to temper. That isn't our target market.

Preben Prebensen

I think one of the things we talk about a lot is that our model is built very consciously to have buffers in it, whether that's from a funding perspective or a capital or liquidity perspective or indeed even building dividend cover at the same time as a progressive dividend. All of these things are very consciously developed so that while we can't predict external events, or indeed control them, their impact on us is not going to deflect us from the long-term strategy of the firm. And we do spend a lot of time that that is as true as it can be.

<u>Question 5</u>

Ian Gordon, Investec

Good morning. Could you just say a bit more on the funding model in terms of how you expect the mix to evolve over time and the maturity? Clearly you quite deliberately position yourself very conservatively in terms of maturity, should I anticipate any scope for maturity transformation as the size evolves?

Stephen Hodges

No to the last question. But I'll hand over the Malcolm to say a little bit more. But the key elements of borrow long, lend short, and diversity are key planks to our funding model.

So Malcolm do you want to say a little bit more about how we fund the book?

Malcolm Hook, Treasurer

Yes good morning. I think what is key to us is the borrow long, lend short, model, I think you've seen that in our announcements over the years and I don't see that changing. Going with that I think has also been an emphasis on the diversity of the funding model and over the years we have seen a number of moves into adjacent areas to improve the diversity. I think the importance of the borrow long, lend short really comes through in two ways to my mind: firstly it obviously gives a certainty of funding to support the growth in our lending, which is key. But secondly it also gives us a degree of choice over when and where we source new funding dependent upon, obviously, how market conditions evolve over time. And certainly with regard to the strategic view of the way forward I see no change in the direction in which we're going to go, or broadly a change in the balance of the mix or tenor split of our funding.

Stephen Hodges

Yes I think it's important to emphasise that we don't place too much reliance on any single source of our funding and FLS is a relatively small bit of our overall book and customer deposits again are only a tranche of our funding.

Question 6

Neil Welch, Macquarie

What degree of competition are you seeing from peer to peer lenders in the SME space and is it a significant risk going forward?

Stephen Hodges

I would say it's one of the new entrants in the space. It's obviously a new type of lending. It's unproven so we haven't seen how it will react through the cycle but Adrian is that something you can comment on?

Adrian Sainsbury

I would agree with that Neil it's relative to the market I described that we play in Asset Finance of £18bn, peer to peer lending is a very small part of that and certainly in the Invoice Finance business there are 40 competitors broadly, new entrants are a small part of that and they're looking at different parts, maybe single invoice rather than whole portfolio funding as well. So it's a small part of the market at the moment obviously something we'll watch but we believe that the value of the relationships that we have with our clients is something that is more important than the direct aspects of peer to peer lending.

Stephen Hodges

And Frank, are you seeing it at all in Property lending?

Frank Pennal

Yes there are a number of new entrants but it's very small and they tend to be focusing on the stretch lending, the higher returns end of the market, which is a market that we don't play in. So even if they do become bigger it's unlikely that they're going to be a real threat to what we do.

Stephen Hodges

Thank you. Well if there are no other questions there are some refreshments at the back of the room and thank you very much indeed for attending today.