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Modern Merchant Banking

Interim Results 2020

Tuesday, 10th March 2020

Preben Prebensen, Chief Executive

Good morning and welcome to the presentation of our 2020 first half results. Mike Morgan, our Group Finance Director will be taking you through our financial performance and then I will provide an update on the group and our strategy and outlook.

Also with us today are Adrian Sainsbury, the Managing Director of our lending businesses. Martin Andrew, the Chief Executive of Asset Management and Philip Yarrow, the Chief Executive of Winterflood.

As usual, we're happy to take your questions after the formal presentation. As I mentioned, we do have people phoning in and we do have people on webinar, and so we'll be taking questions from them as well.

The group maintained strong returns and profitability in the first half, during a period of low activity in the UK economy. While staying true to our disciplined approach and commitment to investing through the cycle.

A decline in profits in our Banking Division was partially offset by an improved performance in Asset Management and Winterflood, resulting in a 9% reduction in group adjusted operating profit year on year.

Our equity base continued to grow with an increased CET 1 ratio of 13.4%. Despite the decline in profits and growing equity base, our return on opening equity remains strong at 13.6%. And we're pleased to be increasing the interim dividend by 3% to 22.7 pence.

Performance in the Banking Division reflected lower SME business activity in the first half and some normalisation of bad debts across our businesses. Along with our ongoing investment in a number of multi-year strategic projects.

Asset management continued its good momentum with strong net inflows at 12% annualised. And Winterflood benefited from a recovery and investor appetite following the UK general election.

In the current uncertain period our specialised and disciplined model continues to serve us well, and we continue with our long-term investments to protect, to improve and to extend our business model. This leaves us well-positioned to make the most of our resilience and any opportunities that a shift in the trading environment may bring.

I will now hand over to Mike, who will take you through the first half performance in more detail.

Mike Morgan, Group Finance Director

Thank you, Preben. And Good morning, everyone.

As Preben said, we delivered strong returns in the first half of 2020 in a period of lower activity in the UK economy. As a result in Banking, our loan book remained broadly flat in the period with growth of 3.2% year on year. Our strong net interest margin was broadly stable on the last financial year at 7.8% and reflected our continued pricing discipline. The bad debt ratio increased to 0.9%, reflecting some normalisation of bad debts from historically low levels and a small number of new individual provisions in Commercial and Property.

Both the Asset Management division and Winterflood performed well, and benefited from a recovery and investor sentiment following the UK election. As a result, adjusted earnings per share reduced 9% in the period to 63.8 pence, and we generated a strong return on opening equity of 13.6%, and return on average tangible equity of 16%. Our CET1 capital ratio increased to 13.4%, with the leverage ratio also increasing to 11.3%. We are pleased to declare a 3% increase in the Interim dividend per share to 22.7 pence in line with our progressive dividend policy.

Looking now at the Income Statement, income was up 3 % to £420 million, with all three divisions achieving growth on the prior year. Expenses increased 4% to £258 million, reflecting the continued investment in Banking and Asset Management.

While the credit quality of our book remains strong, impairment losses increased by £15 million from historically low levels to £37 million. The effective tax rate reduced to 24% reflecting a reduction in the UK corporation tax rate. All else equal, we expect the effective tax rate for the full year 2020 to be around 23%. And we delivered £95 million of profit attributable to shareholders, 9% down on the prior year.

Moving onto segmental performance. In the Banking division, profit reduced 12% to £115 million, reflecting modest income growth combined with normalising bad debts and ongoing investment. Profit in Commercial reduced 19 % as loan book growth and a strong NIM were offset by an increase in individual provisions.

Profits in retail decreased 7%. This reflects a broadly stable loan book and some normalisation in bad debts relative to historically low levels. And Property reduced 9%, as we experienced high repayments in the loan book and increased bad debts due to individual provisions. Profit in the Asset Management division increased by 17% to £13 million, reflecting higher income and continued investment to support the long-term growth of the business.

Profit in Winterflood increased by 14%, reflecting a recovery in trading volumes following the UK general election. Overall adjusted operating profit reduced 9% to £126 million with reduced profit in Banking, partly offset by an improvement in Asset Management and the Winterflood.

Our Balance Sheet remains simple and transparent, and the majority of our assets and liabilities relate to our lending activities. We have maintained a prudent level of funding well in excess of the loan book at £9.8 billion.

We continue to borrow long and lend short with the average maturity of funding at 18 months, ahead of the loan book at 14 months. We maintain the prudent liquidity position with £1.3 billion of Treasury Assets at 31st of January 2020, with the majority held with the Bank of England. Our funding base is well-diversified and includes access to both retail and non-retail deposits, as well as secured and unsecured wholesale funding. Despite mixed market conditions, our credit ratings remain strong and stable, with the Banking subsidiary rated Aa3 by Moody's.

Our average cost of funding was flat on the prior year at 1.7%, as we continue to further optimise and diversify our funding base. Our customer deposit platform supports continued growth and diversification of our funding sources. It has already allowed us to extend our range of deposit products with the launch of Notice accounts for our Retail, Pension and SME customers.

Our online portal launched last December, has proven popular with retail depositors and we have a suite of new savings products to come during 2020. This helped us to increase our retail deposits by 15% in the period to £2.5 billion.

Our capital position strengthened further in the period given our strong capital generation and stable loan book. This has allowed us to maintain capital ratios comfortably ahead of regulatory requirements. Our CET1 capital increased 3% to £1.2 billion, reflecting continued profitability. Risk weighted assets remained broadly flat at £9 billion, principally reflecting the loan book. As a result, the CET1 ratio increased to 13.4%. The total capital ratio also increased to15.5% and our leverage ratio increased to 11.3%.

UK countercyclical buffer is expected to increase to 2% from December, and the PRA is consulting on a counter-balancing reduction of Pillar 2a requirements. If implemented in the current form, we do not expect a material impact on our capital position.

Our strong capital base provides good headroom of 440 basis points to the minimum common equity Tier 1 capital requirement of 9%. Overall, we have a strong capital base and we remain committed to building capital to maximise long term flexibility. We are also on track towards our IRB application, which will further strengthen and optimise our capital position.

We take a prudent approach to managing our financial resources and remain comfortable with our current levels of capital liquidity and funding.

Moving onto the Banking division, we achieved income growth of 1% to £306 million, reflecting modest loan book growth year on year. The net interest margin declined on the prior year to 7.8%, reflecting lower fee income due to low activity levels and loan book mix, while we maintained our pricing discipline. Expenses grew 3% to £154 million, reflecting the continued investment in the business. The cost increase was primarily driven by our strategic multiyear investments to protect, improve and extend our business.

The bad debt ratio increased to 0.9% as we have seen some normalisation of impairments from historically low levels and a small number of new individual provisions in Property and Commercial. We are confident that the overall credit quality of the book remains strong and the bad debt ratio remains low relative to historical levels. This reflects our disciplined and prudent lending criteria.

The overall increase of 3% in banking costs was primarily driven by investment. Excluding investment costs, other operating expenses remained broadly flat on the prior year, reflecting our continued focus on improving operational efficiency. Investing through the cycle is a long term strategic priority for the group and we are currently undertaking a number of multi-year investment programs.

In 2020, investment spend will be skewed towards the second half of the year, reflecting the timing of depreciation and ramp up of our investment programmes. As a result total costs are expected to increase by circa 6% in 2020, in line with the growth seen in 2019.

We continue to look for tactical improvements, such as the review and consolidation of our London office footprint. This is the reason we are hosting this meeting at an alternative venue today. This constant focus on becoming more efficient is an important part of our cost discipline and allows us to create further investment capacity.

Overall, the loan book remained broadly flat at £7.6 billion, reflecting a softer demand environment driven by the economic and political uncertainty in the UK. The Commercial loan book increased 2% overall. The asset financed loan book increased 5%, supported by growth in specialist sectors, such as energy and contract higher.

Invoice and specialty finance decreased 3%, with growth in Novitas offset by a decline in the core invoice finance book. The retail loan book saw a marginal decline in the period. The premium loan book grew 1% as growth in personal lines was partly offset by a slight reduction in commercial lines. Premium continues to be well positioned competitively, following the completion of the transformation programme.

The UK motor finance book continue to grow, benefiting from recent investment and we continue to see growth opportunities in the UK used car finance market. This was offset by a contraction in the Irish book.

The Property loan book declined by 4% in the first half, reflecting a high level of repayments, which more than offset new business. This is partly driven by a high level of sales generated in the market segment in which we lend, allowing our customers to repay their loans quickly. While we have seen slightly softer activity for developers and associated lower drawdowns, our pipeline remains strong within undrawn commitments at high levels. There also remains growth opportunities in regional locations and good demand from expanded offerings, including from our new bridging finance office in Manchester.

The overall performance of the Banking Division reflects the diversity of our businesses and different market dynamics faced by each segment. So let's look at the key metrics across the Banking division. The net interest margin reduced 30 basis points to 7.8%, mainly driven by Commercial. The decrease reflects lower fee income in Commercial and Property and changes in business mix in commercial and premium.

The Banking bad debt ratio increased to 0.9% from historically low levels. This primarily reflects a small number of individual provisions in Commercial and Property as well as some normalisation of bad debts in motor.

The expense income ratio remained flat at 50% due to our strong cost discipline and continued investment in the business. While the ratio remained flat in Commercial and retail, it increased to 28% in Property, reflecting the opening of our new Manchester Bridging Finance Office and marginally lower income.

Moving on to Asset Management, which delivered a strong performance in the period with adjusted operating profit up 17% to £13 million. We continued to see strong momentum in the division with annualised net inflows at 12%. Managed assets increased 8% to £12.7 billion, reflecting net inflows as well as positive market movements. Operating income was up 12%, driven by strong growth in investment management fees. Overall, the revenue margin remained broadly stable at 95 basis points.

Expenses increased 11% to £53 million, driven by continued hiring of advisers and portfolio managers, investment in technology and higher variable staff costs. Overall, the operating margin improved to 19%.

And finally, Winterflood which delivered and improved performance since the UK election. The division continued to deliver strong trading profitability, with no loss days in challenging trading conditions. This reflects the expertise of our traders and strict risk management of trading positions. Income increased 5% to £48 million, reflecting a significant increase in trading volumes in late December and January, with average bargains per day up 6% on the prior year. Expenses increased 2% to £37 million, reflecting higher variable costs. Overall Winterflood delivered an operating profit of £11 million, up 14% on the prior year, and return on equity remains strong at 22%.

In a challenging environment, I'm pleased with the discipline and consistency in the application of our model demonstrated by these results. I will now and now hand over to Preben. Thank you.

Preben Prebensen, Chief Executive

Thank you, Mike.

Our purpose is to help the people and businesses of Britain thrive over the long term. Continuing to deliver on this purpose means investing to enhance our services, extend our reach and adopt new technologies to prepare for the future. It means building on our expertise to continue delivering strong returns and to maintain our long term resilience. It means helping our customers and partners adapt to new trends, and supporting the next generation and the small business of Britain. And it means thinking sustainably in all we do, which is embedded in our strategy and in our culture and reflected in the talent and diversity of our employees and through our high levels of customer satisfaction.

As a business that focuses on the long term, acting sustainably is integral to our strategy and culture and forms a fundamental part of our purpose. As part of this focus, we remain on track to achieve the series of targets we set ourselves during the last year. Over 30% of our senior managers are female and we regularly receive strong customer satisfaction scores across our businesses. We continue to encourage good levels of payroll giving, and our head office now sends zero waste to landfill while our fleet vehicle emissions continue to reduce, well underway to achieving our 20% target. We work with an increasing number of partners to help focus our efforts and continually look for opportunities to make a lasting positive impact for people, communities and the environment.

Our broad range and number of businesses across the UK bring us diversity and resilience. We have three separate divisions in Banking, Asset Management and Securities, each with a distinct product offering and customer base. Within Banking, we have five primary business lines, each of which contains multiple specialist lending businesses in distinct markets. This diversity gives us resilience in difficult markets and also creates opportunities for us to benefit from increases in demand or through structural growth.

We have a distinct lending model focused on long term discipline, which has supported strong returns and profitability over many years. Here we illustrate how our loan book has performed through the cycle with faster growth in periods of low credit supply and slower growth in more competitive market conditions. In all market conditions, we maintain the disciplined application of our lending standards, protecting our margins and investing for the future through the cycle. Our long track record shows that we have consistently delivered strong returns and support from our customers and maintained our progressive dividend across a wide range of market conditions. As demonstrated over a number of cycles, we do not change our approach. After the dot com bubble and the global financial crisis, you can see that we were well-placed to lean in and generate strong growth in the periods following. In the benign environment of more recent years, our growth has been moderating, reflecting the high supply of credit at this stage in the cycle, with active competition present across our businesses.

During the first half of this year, growth slowed further as heightened macro-economic and political uncertainty in the UK led to low levels of economic activity. And since the period end this uncertainty has been further heightened by concerns over the Corona virus.

In this current uncertain environment, we have a lot of confidence in our proven and resilient business model, which is deeply embedded in our organisation. Our lending is prudent, predominantly secured and diversified across sectors, across asset classes and geographies within the UK. We operate with prudent levels of funding, capital and liquidity. We lend at high margins and we have a very experienced team, many of whom have been through previous downturns with extensive capability in underwriting, but also in collections and recovery.

And we're small enough and flexible enough to make decisions quickly and reallocate resources to the areas that are most needed. Over the last year, we have dedicated significant time and resource to preparing and planning for the possibility of a significant downturn in market conditions. This has included developing detailed playbooks and running simulation exercises at the business level to ensure that we remain resilient and can react quickly as the external environment changes.

Asset Management's vertically integrated model and long-term diversified investment proposition leaves it well-positioned to maintain its structural growth potential, although performance is inevitably linked to fluctuations in market levels. Winterflood has a long track record of resilient trading in very challenging conditions, and as today's results show benefits immediately from any uptick in trading activity. So we have the resources, we have the experience, and we're well-prepared to navigate this challenging external environment and ultimately make the most of any opportunities that it may create.

Investing for the future is a key part of our strategy, and we continuously seek to identify new opportunities, whether it be expanding our offering into new products or locations, exploring new markets and responding to changing consumer behaviour or incorporating new technologies and capabilities. Our strategic objective throughout is to increase the value of our business for the long term by intentionally investing through the cycle, even when trading conditions may be challenging, and focusing on ways to protect, improve and extend our model.

We undertake a process of strict challenge and prioritisation for all our prospective investment programs. We require our business initiatives to deliver a clear financial benefits and expect many of our projects to deliver material improvements in operational efficiency or resilience, improved capital efficiency or strengthened funding. Some examples of the investments currently underway in our businesses include our transformation programmes in Motor and Asset Finance, aimed at enhancing sales effectiveness, customer propositions and operational efficiencies. And the expansion of our Property finance offering into UK regional markets. And in Asset Management, we continue to grow our asset base through front office hires and investing in systems and technology.

We also remain on track with our preparations for using the IRB approach to optimise our capital flexibility and continue to make significant investment in our cybersecurity and resilience to ensure we protect our business and our clients. Our new customer deposit platform has already begun to attract new retail depositors and will optimise our diversity and cost of funding, longer term.

Investments in our data centers and cloud computing will allow us to reduce the cost of our IT footprint in the long term.

Our commitment to maintaining this investment is a key differentiator of our model in the long term and ensures we are able to protect our business and lean in when the opportunity arises.

The Asset Management division is a good example of a business where we've invested significantly over a number of years and is now a well-established player in a market with ongoing structural growth opportunity. We have an attractive, vertically integrated offering and a strong reputation. Our multi-channel distribution approach has supported good net inflow rates over several years now, and this allows us to steadily grow our managed assets and build the profit contribution of the division over time. Ongoing investment in people and technology continues to enhance our operating efficiency and improve our client experiences, ensuring we maintain our strong reputation in the wealth management market and attract new portfolio managers, advisors and clients. We also continue to enhance our offerings in response to growing environmental, social and governance themes and our offering now includes a range of socially responsible investment portfolios.

And finally, Winterflood, which is an example of a business with strong downside resilience and the benefit of upside optionality. Winterflood's profits in the first half reflected low retail investor activity and trading volumes at the beginning of the period but they did experience an immediate benefit from the increase in positive market sentiment and activity following the UK general election.

The increased volatility of financial markets in recent weeks has resulted in a further significant increase in trading volumes. The business continues to make good progress in expanding its relationship with institutional clients and continues to grow its presence in the US market. Winterflood Business Services, which provides outsourced dealing and custody services for Asset Managers in the UK, continues to develop its client base with assets under administration now exceeding £4 billion.

Winterflood remains a long-established leader in market making and continues to focus on maximizing its trading opportunities. But clearly, as a daily trading business, it's sensitive to financial market conditions. It remains well-positioned to manage downside risk while making the most of any trading opportunities.

With an uncertain outlook for the UK economy, we remain focused on maintaining the discipline of our business model, and on our readiness to respond as market conditions change.

While it's too early to assess the impact of the Coronavirus on the UK economy, the Banking Division continues to apply our discipline model, maintaining our pricing and underwriting standards while progressing with a range of strategic multi-year investment programmes for the long term.

Asset Management, while clearly sensitive to market levels, continues to focus on its long-term growth potential through organic new business, selective hiring and exploring infill acquisitions.

Winterflood remains in a market leading position, benefiting from a sharp increase in volume since the period end and continues to maximise its trading opportunities.

Going forward, our experience and strategic discipline mean we're well equipped to navigate challenging market conditions. Our diverse portfolio of businesses provides resilience and leave us well positioned to continue serving our customers and clients and to make the most of any opportunities that changes in the market environment may bring.

Thank you. We will now be happy to take any questions you may have. We'll start with questions in the room and then we'll move on to questions that come to us over the phone. Could you, by the way, just identify yourself and your institution as usual?

<u>Q&A session</u>

<u>Question 1</u>

Robert Sage, Peel Hunt

Yes. Thank you. It is Robert Sage from Peel Hunt.

I've got a couple of questions round he asset quality of the group. It was really when I was reading your trading update in January, I think that you mentioned that the bad debt ratio at that stage for the first five months was about 0.8%, and today you're saying for the six months it was 0.9%, which obviously means that there was an uptick in January. But because you showed these numbers to one decimal place, it's kind of difficult to sort of get a feel for the magnitude of that. So I was wondering whether you could provide some commentary about the scale of the increase in the bad debt charge in January, relative to the first five months run rate.

Secondly, on a connected basis, I was wondering whether you could comment in terms of whether there's been any significant changes in terms of risk buckets. For example, stage one, stage two, stage three under IFRS 9 or whether it's sort of broadly stable.

And thirdly, I was wondering whether you could give any sort of feel for where you think the trends in the bad debt ratio might be heading in the second half of the year. Is it sort of further normalisation?

Preben Prebensen

Can I take the last one of those, perhaps? And then, Mike, if you could address the January question and also the risk buckets under IFRS9.

We did see an uptick. We say that that's really from two things. One is some normalisation in the retail side of the business, particularly in Motor. And bear in mind, you know, the long-term range is really 0.6%, which is an absolute bottom that we've seen right up to 2.6% with the 10-Year average, probably at 1.2%.

So we're still below our average for bad debts. So there was some normalisation, particularly in the Motor side, and then on the Commercial side and in Property, as we mentioned, there were a few cases of individual bad debts, but we don't really think that there's any connection of those dots. There's no kind of trend that's emerging as a result of those things. And so therefore, again, as we look today, we don't know what conditions will be as a result of the Coronavirus. But as we look today, we look at our arrears, we look at our experience, we don't really see that trend continuing. There's no reason to read, kind of, the change from 0.6% to 0.9% and extrapolate further. But that does depend on conditions and whether what we're all going through now ends up being a V-shape or a U-shape recovery, which we can't obviously tell.

But Mike, do you want to answer that specific question?

Mike Morgan

To put some specific metrics about that. You will have heard in my commentary that we have seen a £15 million uplift on bad debt. So from £22 million to £37million. So really small numbers on a loan book of £7.6 billion. So, to move from 0.8% to 0.9% really needs a very little amount, to just tip that over. So I think it's important to remember that we're talking about relatively small numbers here.

In terms of stage 1, 2 and 3, well, you'll be familiar that the vast majority of the book is in stage 1 with obviously the balances in stage 2 and then a relatively small amount in stage 3. We've seen a little uptick in to stage 3 over the first 6 months of the year, predominantly in Commercial and Property. It is important to remember that 90% of our book is secured. So the vast majority of those going into Stage 3, we don't expect to see losses coming through. And as Preben said, we're comfortable with the level of bad debts and where they are at the moment in terms of where we are in the cycle. And we're very comfortable about the level of arrears that we're seeing in the book. And there is nothing for us to suggest that there's a stress in any sense at all.

<u>Question 2</u>

Ian White, Autonomous

Thanks. Morning, it's Ian White from Autonomous. Two questions from me, please, both related to the Property business.

So first of all I just wanted to understand the rate sensitivity dynamics within that business. Previously you saw a headwind when rates rose. If we do get a Bank of England rate cut in the near term, can we basically assume there is a sort of symmetric impact there in terms of upside if we do see base rate cuts, that will be question one, please.

And just the second part, I'd like to understand perhaps a bit more about the dynamics within the front book on the new lending within Property. And thanks for the extra detail you provided there. And kind of put simply, are you seeing market share erosion in terms of the new drawdowns in the areas where the business currently operates? And if so, what levers can you pull in order to mitigate that? Obviously, pricing would be one, but are there other things that we should think about in terms of restoring market share there. If indeed that is a fair description of what's happening. Thanks.

Preben Prebensen

Can I again, just start with some kind of broader comments? And then, Mike, if you can pick up some specifics.

I think it's important to say that that we never target growth, as a firm and nor do we ever target market share. What we do is to stick by our return criteria and our credit quality criteria. And the other two are simply outputs of that. We have a very significant market share in Property Development financing, particularly in that sub £10 million category. And that continues to be the case. So that remains a competitive field. But we have, as I mentioned, a significant market share and a significant market presence.

So, I think what you should read into the first half is a lot of repayments, which are actually quite a good thing because the things that are being built by our developer clients are being sold. And by the way, sold at prices that are right at the expected levels at the outset. And a little bit more caution in terms of new developments, at the replacement end, if you like. So that's why you see more repayments than drawdowns. However, these things are also timing, you know. They are quite lumpy. And that's why the comment was made about the kind of the undrawn commitment book, which is still in a very healthy position. So that's kind of the overarching comments. Mike, if you want to make any specific comments on this rate sensitivity.

Mike Morgan

Yeah. Ian you're absolutely right. The simple answer is yes. It obviously eats into the income as we move up, because we have floors in the property contracts. So, those are set at 1%. So, to the extent that we go down, we're able to broaden our margin to the extent we move up until 1%, we aren't able to pass those on. Therefore, we have to absorb them. So currently all things being equal at 75 basis points, if we had another 25 basis point increase, we would have to absorb that and then we could pass that on. As you say, though, it's more likely at the moment, I suspect that it may go down, in which case that would be able to help us widen the margin.

Ian White

OK. Thanks.

<u>Question 3</u>

Ian Gordon, Investec

Hi, Ian Gordon from Investec. Can I have two, one on funding one on capital? On funding you were a fairly light user of TFS, assuming that we get a bit more largesse from the authorities, would you be a bit more opportunistic this time around?

And then secondly, on capital. I know it's only a marginal change, but clearly you slightly slowed the pace of dividend progression. So that was a deliberate decision to bolster your pace of capital growth and your outlook statement signals in the very near term no material step up and down growth. So, are you A, just being prudent or B, building up the stock of capital to take advantage of potential opportunities in the medium term or C, is there anything else at play? And I'll just throw in the fact that you, in your remarks, commented that there's an expectation of the countercyclical buffer rising in December. That's not my expectation.

Preben Prebensen

So just on that. I think we may well see them reverse that decision. I think the important thing on a countercyclical buffer is that the mitigation that they were going to bring through was going to largely make that immaterial for us anyway. So actually, you could say that then dropping that, given that it was not going to have a material impact, isn't going to have a material impact either. But we too, wouldn't be surprised to see them decide to delay the imposition of the increase in the countercyclical buffer.

Just on the whole sort of topic of capital, if you take a kind of broader, higher altitude view of that. We think it's very important that we maintain a lot of strategic optionality in terms of our capital base. The highest and best use of our capital base is to is to be there to finance loan growth when it arrives. And we can't anticipate when that will be. But we always want to be in a position to take advantage of that. And we also a very prudent organization. Those are the things that are really kind of driving the fact that we are very relaxed about seeing our capital levels tick up.

And then with respect to the dividend, you know, we've never cut the dividend in 35 years. That's important to us. We like to keep it moving forward to the extent that we can. And it's simply a kind of nuanced interplay between dividend and cover, the rate of progression of the dividend and how we feel about signaling our confidence in the business, which is why we wanted to continue it moving forward. It's very nuanced as between, you know, a kind of half a P moving up or not so I wouldn't read too much into that.

Mike Morgan

On the funding point on TFS. Clearly, we will look at that. The most important thing for us is to have diversity of funding and not be overly reliant on one source. We also need to look at our needs at that particular time from a demand perspective. We've got a balance of around about half a billion with them at the moment and we're very comfortable with it at that level. So if it does come back onto the table, then I'm sure we will use it. But we will determine at the time what the appropriate level to hold is.

<u>Question 4</u>

Portia Patel, Canaccord

Thank you. Portia Patel from Canaccord, I've got two questions, please. Both on Banking.

Firstly, on the investment programme. How many years should we expect to see cost inflation of the order of or around 6% that we've seen last year and that you're guiding for this year?

And secondly, I just wondered if you could provide some context on the Irish Motor book, which seems to be struggling. I seem to remember that was an area of growth for you in the past, so just some colour there would be helpful. Thank you.

Preben Prebensen

Mike do you want to take the investment?

Mike Morgan

Yeah. So as you know, our philosophy is to invest in our business through the cycle. You've heard us make this point today and we've made it in the past, as important for us to do that. Our business model allows us to do that and our margins allow us to do that. And we will continue to invest in the business. We cannot be dogmatic, though, and over the long term, we have to make sure that income and cost are in line. At the moment our E / I ratio is at 50%, we're very comfortable with that. We may see that go up a little bit, we may see it go down a little bit. But over the long term, we recognise that cost and income growth needs to be, as they say, commensurate.

What we want to avoid is once we've started an investment to stop it. That ‘stopping and starting’ investment, we think is absolutely the wrong thing to do. So, the important point for us is to make sure that when we are looking at potential investments that are coming on to the stock, that we have a rigorous process in place around those. And we do. And we are currently looking at a number of things that would be very interesting for our businesses going forward. What we then have to do is hold those up against what we think the business is going to do in terms of income growth, and we will assess that. So we will see the growth of 6% coming through this year. And then we will need to take a view on next year where we want to position that, based on how we think the business is going to perform. But we recognise in the long term those two metrics need to be more in line than perhaps they are just at the moment.

Preben Prebensen

So, on the Irish Motor book that as you know, is a relationship that we have with an organisation there. It was an opportunity that we saw a number of years ago because there was a significant credit contraction in terms of supply in Ireland. And so we were able to capitalise on that quickly by going into that partnership. It's a fixed contract in terms of term, and there was a period when it grew very significantly and that offset some softness in the UK. The UK is several times larger, obviously, than the Irish Book. And now we're seeing the reverse happening where we're seeing a comeback in the UK business. And in fact, we're recording growth in that UK business for the first time for about three years, actually. And that is quite usefully offsetting the credit cycle in terms of supply catching up with us in Ireland. So that's not a problem. Overall, it's a small proportion of our business. And clearly what we're experiencing, as I say, is some growth returning to the UK side, which is much bigger.

Question 5

Shailesh Raikundlia, Panmure Gordon

Morning it is Shailesh Raikundlia from Panmure Gordon. Just one question on competition and just generally the credit cycle. I mean, you obviously talk about the fact that the economic backdrop is getting worse in a way. At the same time, you're sort of implying that there's a huge amount of competition in the market, particularly your markets in the Banking side. You start to get a sense of where you think we will be in a year's time, 18 months' time in terms of, you know, the economy, but more importantly, your loan growth? Thanks.

Preben Prebensen

So, we don't know where we're going to be in a years' time or 18 months' time. I think it's quite difficult to see where we're going to be in a week's time. I think that the important thing for us is looking at the controllable factors that we have. So we say it until we're to a blue in the face and we really made it. You know, this is a very resilient model, and we are very experienced at managing the kinds of difficult conditions that we may be entering right now. That is very good news. We practice, we simulate, we're ready. And that is very good news.

We have that slide which shows that over long periods and long cycles, we go through hyper growth periods and slower growth periods as a function of the supply of credit. If you look at our very long term rolling averages of growth, they're quite interesting. We did this exercise, I think back in September. And if we look at 30 years of the bank and we look at 10-year rolling growth rates, which we can obviously measure for the past 20 years, since we have 30 years of data, the 10-year rolling growth rate of our bank is double digit.

And that gives you a sense of our presence in the UK banking landscape and opportunity over a very, very long period of time. And that's because we're local, because we're specialists, because we're experts, because we don't leave the pitch. We're very consistent. We have very high repeat business levels. Those are the things that we rely on and perpetuate. So we can't possibly predict when that cycle turns. But we can say that we're ready for it when it turns.

No questions that I think there no questions over the phone or on the webcast. So, unless there are any other questions from here? Thank you very much.

Mike Morgan
Thank you.