Banking

Good Loan Book Growth and Strong Margins

Banking adjusted operating profit increased 7% to £227.2 million (2021: £212.5 million), reflecting good loan book growth and a strong net interest margin. Statutory operating profit increased to £227.1 million (2021: £207.2 million).

The loan book grew 5.0% over the year to £9.1 billion (31 July 2021: £8.7 billion) driven by healthy new business volumes in our Commercial businesses and high demand in Motor Finance, partly offset by a contraction in the Premium Finance and Property loan books. Momentum picked up over the course of the year, as the 1.9% loan book growth in the first half of the year was supplemented by 3.0% growth in the second half of the year. The return on net loan book remained stable on the prior year at 2.6% (2021: 2.6%).

The net interest margin of 7.8% increased marginally on the 2021 financial year (2021: 7.7%), primarily driven by lower cost of funds. We continue to adopt a disciplined approach to pricing and our specialist, relationship-driven model positions us well to maintain a strong net interest margin, although the trajectory will depend upon our ability to pass on further rate increases onto our customers.

As a result, operating income increased 10% to £693.1 million (2021: £631.7 million), reflecting the good loan book growth and a strong net interest margin.

Adjusted operating expenses increased 10% to £362.6 million (2021: £329.1 million) as we progressed our key investment programmes and continued to exercise rigorous control of our costs, whilst recognising the current inflationary environment. BAU costs increased by 7% to £278.8 million (2021: £260.3 million), primarily driven by higher staff costs reflecting salary increases in the current inflationary environment and increased performance-driven compensation.

Investment costs rose 22% to £83.8 million (2021: £68.8 million), reflecting spend on our multi-year strategic investment projects and related depreciation charges.

Key Financials[1]

	2022 £ million	2021 £ million	Change %
Operating income	**693.1**	631.7	10
Adjusted operating expenses[2]	**(362.6)**	(329.1)	10
Impairment losses on financial assets	**(103.3)**	(90.1)	15
Adjusted operating profit	**227.2**	212.5	7
Net interest margin	**7.8%**	7.7%	
Expense/income ratio	**52%**	52%	
Bad debt ratio	**1.2%**	1.1%	
Return on net loan book	**2.6%**	2.6%	
Return on opening equity	**12.5%**	13.7%	
Closing loan book and operating lease assets[3]	**9,098.9**	8,667.4	5

1 Adjusted measures are presented on a basis consistent with prior periods and exclude amortisation of intangible assets on acquisition, to present the performance of the group's acquired businesses consistent with its other businesses; and any exceptional and other adjusting items which do not reflect underlying trading performance. Further detail on the reconciliation between operating and adjusted measures can be found in note 3.

2 Related ongoing costs resulting from investment projects are recategorised from investment costs to BAU costs after one year. For comparison purposes, £5.2 million has been recategorised from investment costs to BAU costs in the 2021 financial year to adjust for investment projects' ongoing costs that commenced prior to the 2022 financial year.

3 Commercial, Asset Finance and Invoice and Speciality Finance loan books have been re-presented for 31 July 2021 to include £222.9 million of operating lease assets (£1.3 million in Asset Finance and £221.6 million in Invoice and Speciality Finance).

Our investment projects align with our strategic priorities of protecting, growing and sustaining the business and continue to deliver tangible benefits. Our IRB spend has driven enhancements in our risk management framework, whilst investment in our customer deposit platform has enabled the expansion of the Savings product offering, supporting a lower cost of funds. In Asset Finance, investment in our systems has added new functionality and improved customer insights. Our Retail businesses are benefiting from digital investment, with Motor Finance utilising API links to connect to strategic partners and offer our finance at various points of the customer journey and Premium Finance have launched insight tools to support brokers.

Whilst we remain mindful of inflationary pressures, we continue to exercise cost discipline. We expect costs related to existing investment programmes to stabilise over the next financial years, although depreciation charges related to these programmes will continue to increase.

The compensation ratio was flat on the prior year at 29% (2021: 29%) and the expense/income ratio also remained stable at 52% (2021: 52%).

Impairment charges increased to £103.3 million (2021: £90.1 million), corresponding to a bad debt ratio of 1.2% (2021: 1.1%). Excluding Novitas, the bad debt ratio was 0.5% (2021: 0.2%), reflecting the release of Covid-19 provisions, partially offset by the ongoing review of provisions and coverage across our loan portfolios, including certain individual exposures in the Commercial business, as well as higher IFRS 9 provisions to take into account the outlook for the external environment.

Overall, there was a marginal decrease in provision coverage to 3.1% (31 July 2021: 3.2%). Excluding provisions related to the Novitas loan book, the coverage ratio reduced slightly to 1.9% (31 July 2021: 2.3%), primarily reflecting provision releases, mainly driven by reduced Covid-19 forborne balances.

Whilst we are not yet seeing a significant impact from rising inflation and interest rates and their effect on customers on our credit performance, we are alert to the highly uncertain macroeconomic environment and continue to closely monitor the performance of the book. We remain confident in the quality of our loan book, which is predominantly secured, prudently underwritten, diverse, and supported by the deep expertise of our people.

“We continued to see good demand across our lending businesses and strong margins.”

Banking adjusted operating profit

£227.2m

2021: £212.5m

Net interest margin

7.8%

2021: 7.7%

Banking continued

Loan Book Analysis

	31 July 2022 £ million	31 July 2021[1] £ million	Change %
Commercial	**4,561.4**	4,191.0	9
Asset Finance	**3,032.5**	2,845.9	7
Invoice and Speciality Finance	**1,528.9**	1,345.1	14
Retail	**3,064.0**	2,974.3	3
Motor Finance	**2,051.2**	1,924.4	7
Premium Finance	**1,012.8**	1,049.9	(4)
Property	**1,473.5**	1,502.1	(2)
Closing loan book and operating lease assets[2]	**9,098.9**	8,667.4	5

1 Commercial, Asset Finance and Invoice and Speciality Finance loan books have been re-presented for 31 July 2021 to include £222.9 million of operating lease assets (£1.3 million in Asset Finance and £221.6 million in Invoice and Speciality Finance).
2 Operating lease assets of £0.5 million (31 July 2021: £1.3 million) relate to Asset Finance and £239.5 million (31 July 2021: £221.6 million) to Invoice and Speciality Finance.

Return on opening equity in the Banking division reduced to 12.5% (2021: 13.7%).

The loan book increased 5.0% year-on-year to £9.1 billion (31 July 2021: £8.7 billion), reflecting strong growth in our Commercial and Motor Finance businesses, partly offset by a contraction in the Premium Finance and Property businesses. Momentum picked up over the course of the year, as the 1.9% loan book growth in the first half of the year was supplemented by 3.0% growth in the second half of the year.

The Commercial loan book increased 9% to £4.6 billion (31 July 2021: £4.2 billion), driven by 7% growth in Asset Finance, reflecting strong new business volumes in the Transport, Broker, Contract Hire and Energy businesses in particular, as we saw good demand from customers. Invoice and Speciality Finance grew 14%, reflecting strong sales volumes and increased utilisation. The core Invoice Finance loan book increased 29% as we grew SME customer numbers.

The Retail loan book increased 3% to £3.1 billion (31 July 2021: £3.0 billion), with 7% growth in Motor Finance as we saw strong new business levels, reflecting continued demand in the used car market and the benefits from investment in the Motor Finance transformation programme. This was partly offset by a 4% decline in the Premium Finance book as a result of lower demand for the funding of insurance policies from consumers, following previous Covid-19 restrictions.

The Property loan book contracted 2%, despite the growth seen in the second half of the year. This reflected high repayment levels, which more than offset drawdowns, given we continued to see heightened unit sales by developers as a result of the buoyant UK property market. Our new business volumes remained strong and our pipeline stands at over £1 billion.

The Republic of Ireland makes up approximately 7% of our total loan book (31 July 2021: 8%), with an offering from both our Commercial and Retail businesses.

The Republic of Ireland Motor Finance business accounted for 18% of the Motor Finance loan book (31 July 2021: 21%) and 4% of the Banking loan book (31 July 2021: 5%). As previously announced, from 30 June 2022, we ceased writing new business under our previous partnership in the Republic of Ireland. We remain committed to the Irish market and are considering our long-term options.

Well Positioned to Deliver Disciplined Growth

Loan book growth continues to be an output of our business model, as we focus on delivering disciplined growth whilst continuing to prioritise our margins and credit quality. As outlined at the Investor Event in June 2021, we continue to actively work to identify incremental and new opportunities in both our existing and adjacent markets.

Across our businesses, we recognise a significant opportunity in broadening our financing of green and transition assets, as the UK aligns towards a net zero economy. Our current lending already spans a diverse array of green assets including wind and solar generation, battery electric vehicles and grid infrastructure, including battery electric storage systems.

We have seen strong growth in battery electric vehicles in our Commercial business. Our Wholesale Fleet division provides finance for company car fleets and over one third of its loan book is now fully battery electric. As an initial green finance ambition, we have set ourselves the aim to provide funding for £1.0 billion of battery electric vehicles in the next five years.

Over the coming years, we will continue to build further our expertise in green and transition assets, cementing our reputation for specialist knowledge, financing and maximising commercial opportunities arising in the space, for example through the financing of battery electric storage systems and charging infrastructure across the UK.

The Asset Finance business is well positioned to capitalise on continued demand for asset financing. During the year, we have expanded our sector coverage, hiring agricultural equipment and materials handling teams who have both completed their first deals, and have increased our focus on the financing of green and transition assets.

In Invoice Finance, we expect the growth trajectory to follow the economic conditions. We continue to pursue opportunities in the ABL space, including identifying syndication opportunities, partnering with other lenders. Our Brewery Rentals business has delivered a record year and our direct-to-outlet container rental product, EkegPlus, continues to see strong demand.

Our investment in the Motor Finance transformation programme has enabled us to further broaden our offering in this market and take advantage of heightened demand for used cars. The programme has improved efficiency and the introduction of e-sign functionality has delivered sustainability benefits. We have developed a unique proposition to provide dealers with real-time data and market insights, in partnership with AutoTrader, which has supported an increase in dealer numbers and reducing vehicle sales times. We have also developed a set of APIs that enable us to connect seamlessly into strategic partners including AutoTrader and iVendi and provide our finance offering at various points of the customer journey. Alongside this, we continue to explore opportunities for growth over the longer term through the shift to Alternatively Fuelled Vehicles ("AFVs"), as they become more prevalent in the second hand car market. AFVs currently make up a low proportion of our Motor Finance loan book, in line with penetration in the wider second hand car market. We have expanded our credit policy to capture such vehicles and are currently piloting new AFV-suited offerings in selected markets.

For Premium Finance, we have launched new insight tools, Foresight and Focus 360, to enhance our offering and support brokers' decisioning. We anticipate demand for the funding of insurance policies could increase given the uncertain macroeconomic conditions.

In Property, we continue to make good progress expanding our regional presence, which now contributes over 50% of our loan book, as well as building out our bridging finance offering. In partnership with Travis Perkins, we have established a new facility, allowing SME housebuilders to access discounted building supplies and materials directly via a credit facility, without the need to demonstrate any trading or credit history, where a relationship with the client already exists and funding has previously been agreed. We are also piloting a specialist buy-to-let extension to our existing Property bridging finance clients, which is a natural evolution of our expertise in Property Finance and well aligned with our business model and risk appetite. Our pipeline of undrawn commitments remains strong at above £1 billion, although the heightened economic uncertainty is expected to continue to impact activity in the property market.

Overall, we remain confident in the growth outlook for the loan book over both the short and medium term.

Banking: Commercial[1]

	2022 £ million	2021[2] £ million	Change %
Operating income	**343.4**	288.9	19
Adjusted operating expenses	**(180.0)**	(158.2)	14
Impairment losses on financial assets	**(72.4)**	(77.9)	(7)
Adjusted operating profit	**91.0**	52.8	72
Net interest margin	**7.8%**	7.7%	
Expense/income ratio	**52%**	55%	
Bad debt ratio	**1.7%**	2.1%	
Closing loan book and operating lease assets[3]	**4,561.4**	4,191.0	9

1 Adjusted measures are presented on a basis consistent with prior periods and exclude amortisation of intangible assets on acquisition, to present the performance of the group's acquired businesses consistent with its other businesses; and any exceptional and other adjusting items which do not reflect underlying trading performance. Further detail on the reconciliation between operating and adjusted measures can be found in note 3.
2 Commercial, Asset Finance and Invoice and Speciality Finance loan books have been re-presented for 31 July 2021 to include £222.9 million of operating lease assets (£1.3 million in Asset Finance and £221.6 million in Invoice and Speciality Finance).
3 Operating lease assets of £0.5 million (31 July 2021: £1.3 million) relate to Asset Finance and £239.5 million (31 July 2021: £221.6 million) to Invoice and Speciality Finance.

Commercial

The Commercial businesses provide specialist, predominantly secured lending principally to the SME market and include Asset Finance and Invoice and Speciality Finance. We finance a diverse range of sectors, with Asset Finance offering commercial asset financing, hire purchase and leasing solutions across a broad range of assets including commercial vehicles, machine tools, contractors' plant, printing equipment, company car fleets, energy project finance, and aircraft and marine vessels. The Invoice and Speciality Finance business provides debt factoring, invoice discounting and asset-based lending, as well as covering our specialist businesses such as Brewery Rentals, Vehicle Hire and Novitas.

Adjusted operating profit in Commercial rose 72% to £91.0 million (2021: £52.8 million) as the business achieved positive operating leverage and saw a decrease in impairment charges. Statutory operating profit was £90.9 million (2021: £35.9 million).

Operating income increased 19% to £343.4 million (2021: £288.9 million), reflecting strong loan book growth in both Asset Finance and Invoice Finance. The net interest margin increased marginally to 7.8% (2021: 7.7%), mainly driven by a lower cost of funds.

Adjusted operating expenses of £180.0 million (2021: £158.2 million) were 14% higher than the prior year, reflecting higher staff costs to reflect business growth and the inflationary environment, as well as costs in relation to the group's withdrawal from the legal services financing market. In addition, investment spend in the Asset Finance transformation programme continued. The expense/income ratio decreased to 52% (2021: 55%) as the growth in operating income more than offset the cost increase.

Impairment charges decreased 7% to £72.4 million (2021: £77.9 million), corresponding to a reduced bad debt ratio of 1.7% (2021: 2.1%), reflecting the reduction in the Covid-19 forborne book and a lower charge in the year relating to Novitas, partly offset by an increase in provisions against certain individual exposures. A significant portion of the impairment charges reported in Commercial related to credit provisions against the Novitas loan book (2022: £60.7 million, 2021: £73.2 million), which reflect the latest assumptions on the case failure and recovery rates in this business.

The provision coverage reduced marginally to 4.0% (31 July 2021: 4.2%) reflecting reduced Covid-19 forbearance, partly offset by provisions against the Novitas loan book to take into account updated assumptions on case failure rates. Excluding Novitas, the provision coverage ratio reduced to 1.6% (31 July 2021: 2.1%).

Banking continued

Banking: Retail[1]

	2022 £ million	2021 £ million	Change %
Operating income	**237.0**	219.8	8
Adjusted operating expenses	**(151.6)**	(138.0)	10
Impairment losses on financial assets	**(24.4)**	(9.9)	146
Adjusted operating profit	**61.0**	71.9	(15)
Net interest margin	**7.8%**	7.6%	
Expense/income ratio	**64%**	63%	
Bad debt ratio	**0.8%**	0.3%	
Closing loan book	**3,064.0**	2,974.3	3

1 Adjusted measures are presented on a basis consistent with prior periods and exclude amortisation of intangible assets on acquisition, to present the performance of the group's acquired businesses consistent with its other businesses; and any exceptional and other adjusting items which do not reflect underlying trading performance. Further detail on the reconciliation between operating and adjusted measures can be found in note 3.

Banking: Property

	2022 £ million	2021 £ million	Change %
Operating income	**112.7**	123.0	(8)
Operating expenses	**(31.0)**	(32.9)	(6)
Impairment losses on financial assets	**(6.5)**	(2.3)	183
Operating profit	**75.2**	87.8	(14)
Net interest margin	**7.6%**	7.6%	
Expense/income ratio	**28%**	27%	
Bad debt ratio	**0.4%**	0.1%	
Closing loan book	**1,473.5**	1,502.1	(2)

The Commercial loan book increased 9% to £4.6 billion (31 July 2021: £4.2 billion). The Asset Finance book grew 7% to £3.0 billion (31 July 2021: £2.8 billion), reflecting strong new business volumes. The Invoice and Speciality Finance loan book increased 14% to £1.5 billion (31 July 2021: £1.3 billion), driven by high sales volumes, supported by the Recovery Loan Scheme, and improved utilisation, albeit this continues to remain slightly below pre-Covid-19 levels.

Retail

The Retail businesses provide intermediated finance, principally to individuals and small businesses, through motor dealers and insurance brokers.

Operating profit for Retail reduced 15% to £61.0 million (2021: £71.9 million), driven by higher impairment charges and increased operating expenses, which more than offset income growth.

Operating income increased 8% to £237.0 million (2021: £219.8 million), reflecting loan book growth and an increase in the net interest margin to 7.8% (2021: 7.6%), mainly driven by higher fee income in Premium Finance and a lower cost of funds.

Operating expenses rose 10% to £151.6 million (2021: £138.0 million), driven by higher staff costs and the cost of responding to ongoing regulatory change. In addition, ongoing investment in the Retail businesses, alongside related depreciation, continued. The expense/income ratio increased marginally to 64% (2021: 63%).

Impairment charges increased to £24.4 million (2021: £9.9 million), with a bad debt ratio of 0.8% (2021: 0.3%) which reflected a more normalised level of cancellations in the consumer portfolio in Premium Finance following the strong credit performance in the prior year and a rise in arrears in the Motor Finance business as a result of the impact on customers from the cessation of the UK government's Covid-19 job retention scheme and the increase in inflation.

The provision coverage ratio remained stable at 2.2% (31 July 2021: 2.2%), mainly driven by the release of model-driven adjustments, partly offset by expected credit losses increasing to reflect loan book growth.

The Retail loan book increased 3% to £3.1 billion (31 July 2021: £3.0 billion). The Motor Finance book grew 7% to £2.1 billion (31 July 2021: £1.9 billion), as high new business levels reflected continued demand, and strong prices continued in the used car market.

The Premium Finance book declined 4% to £1.0 billion (31 July 2021: £1.0 billion) primarily as a result of lower demand for the funding of insurance policies from consumers. This was partially offset by strong new business volumes as customers look to ease cash flow pressures in the commercial market.

We remain confident in the credit quality of the Retail loan book. The Motor Finance loan book is predominantly secured on second-hand vehicles which are less exposed to depreciation or significant declines in value than new cars. Our core Motor Finance product remains hire-purchase contracts, with less exposure to residual value risk associated with Personal Contract Plans ("PCP"), which accounted for c.11% of the Motor Finance loan book at 31 July 2022. The Premium Finance loan book benefits from various forms of structural protection including premium refundability and, in most cases, broker recourse for the personal lines product.

Property

Property comprises Property Finance and Commercial Acceptances. The Property Finance business is focused on specialist residential development finance to established professional developers in the UK. Commercial Acceptances provides bridging loans and loans for refurbishment projects.

Operating profit decreased 14% to £75.2 million (2021: £87.8 million) primarily reflecting a reduction in income, as well as an increase in impairment charges on the prior year.

Operating income was down 8% to £112.7 million (2021: £123.0 million) reflecting the reduction in the loan book. The net interest margin was stable at 7.6% (2021: 7.6%), mainly driven by lower cost of funds, partly offset by the negative impact of rising rates in the last few months of the financial year on the interest rate floors, which were set at 1%. With the UK base rate now above 1%, we expect no further impact in respect of these floors as a result of future rate rises.

Operating expenses were 6% lower at £31.0 million (2021: £32.9 million) as we maintained our rigorous focus on cost discipline. The expense/income ratio remained broadly stable on the prior year at 28% (2021: 27%).

Impairment charges increased to £6.5 million (2021: £2.3 million) following the ongoing review of provisions and the prior year benefiting from the release of Covid-19 related provisions, resulting in a bad debt ratio of 0.4% (2021: 0.1%). The provision coverage ratio decreased marginally to 2.4% (31 July 2021: 2.6%).

In spite of strong new business volumes, the Property loan book reduced £29 million to £1.5 billion (31 July 2021: £1.5 billion), as high repayment levels more than offset drawdowns, with the buoyant UK property market resulting in heightened unit sales by developers. Our pipeline of undrawn commitments remains strong at £1.0 billion (31 July 2021: £0.9 billion) and we continue to see success from regional expansion, with the regional loan book making up over 50% of the Property Finance portfolio.

The Property loan book is conservatively underwritten, with typical LTVs below standard market levels. We work with experienced, professional developers, with a focus on mid-priced family housing, and have minimal exposure to the prime central London market. Our long track record, expertise and quality of service ensure the business remains resilient to competition and continues to generate high levels of repeat business.

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