Financial Overview

Close Brothers delivered a strong performance in an evolving environment, making the most of opportunities as the economy recovers from the Covid-19 crisis.

Return on opening equity

14.5%

2020: 8.0%

Adjusted operating profit

£270.7m

2020: £144.0m

Summary Group Income Statement[1]

	2021 £ million	2020 £ million	Change %
Operating income	**952.6**	866.1	10
Adjusted operating expenses	**(592.1)**	(538.4)	10
Impairment losses on financial assets	**(89.8)**	(183.7)	(51)
Adjusted operating profit	**270.7**	144.0	88
Banking	**212.5**	99.2	114
Commercial	**52.8**	4.8	1,000
Retail	**71.9**	34.9	106
Property	**87.8**	59.5	48
Asset Management	**23.7**	20.4	16
Winterflood	**60.9**	47.9	27
Group	**(26.4)**	(23.5)	12
Amortisation and impairment of intangible assets on acquisition	**(14.2)**	(3.1)	358
Goodwill impairment	**(12.1)**	–	–
Exceptional item: HMRC VAT refund	**20.8**	–	–
Operating profit before tax	**265.2**	140.9	88
Tax	**(63.1)**	(31.4)	101
Profit after tax	**202.1**	109.5	85
Profit attributable to shareholders	**202.1**	109.5	85
Adjusted basic earnings per share[2]	**140.4p**	74.5p	88
Basic earnings per share[2]	**134.8p**	72.8p	85
Ordinary dividend per share	**60.0p**	40.0p	50
Return on opening equity	**14.5%**	8.0%	
Return on average tangible equity	**16.5%**	9.4%	

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 Refer to Note 8 for the calculation of basic and adjusted earnings per share.

Basis of Presentation

Results are presented both on a statutory and an adjusted basis to aid comparability between periods. 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. Please refer to page 43 for further details on items excluded from the adjusted performance metrics.

Operating Profit and Returns

Adjusted operating profit increased 88% to £270.7 million (2020: £144.0 million), primarily reflecting higher income across all divisions and significantly lower impairment charges in Banking, partially offset by increased costs. After exceptional and other adjusting items, statutory operating profit before tax increased by 88% to £265.2 million (2020: £140.9 million). The group delivered a strong return on opening equity of 14.5% (2020: 8.0%) and return on average tangible equity of 16.5% (2020: 9.4%).

Adjusted operating profit in the Banking division increased by 114% to £212.5 million (2020: £99.2 million) primarily due to lower impairment charges and strong income growth, partially offset by continued investment in the business. The Asset Management division achieved good net inflows of 7%, delivering adjusted operating profit of £23.7 million (2020: £20.4 million), 16% higher than the prior year, as growth in operating income more than offset the cost of continued investment to support the long-term growth potential of the business. Winterflood delivered a very strong trading performance, with operating profit up 27% to £60.9 million (2020: £47.9 million), as the business benefited from elevated market activity for most of the year. Group net expenses, which include the central functions such as finance, legal and compliance, risk and human resources, increased on the prior year at £26.4 million (2020: £23.5 million), primarily driven by higher performance-related compensation and share-based award payments.

Operating Income

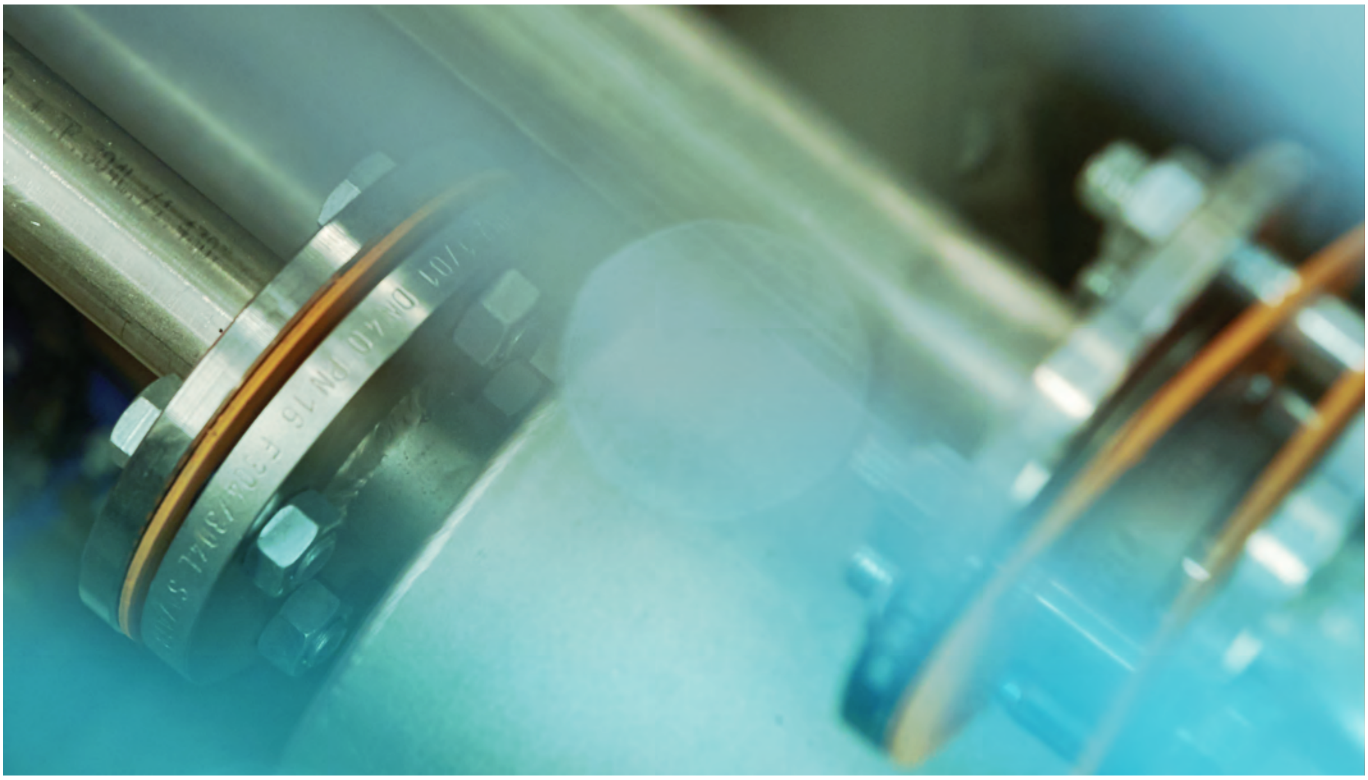
Operating income increased 10% to £952.6 million (2020: £866.1 million), with growth in all divisions. Income in the Banking division increased by 8%, reflecting high new business volumes and a strong net interest margin of 7.7% (2020: 7.5%). Income in the Asset Management division was up 9%, reflecting an increase in client assets. Income in Winterflood increased by 20% as a result of elevated trading volumes and very strong trading performance.

Adjusted Operating Expenses

Adjusted operating expenses increased 10% to £592.1 million (2020: £538.4 million), mainly driven by higher costs in Banking and Winterflood. In the Banking division, costs increased by 8%, mainly driven by continued investment to protect, grow and sustain the business. Costs increased 8% in the Asset Management division, primarily driven by continued hiring of portfolio managers and increases in variable costs, as well as investment in technology. Winterflood's operating expenses increased by 17% due to higher variable costs such as staff compensation and settlement costs. Overall, the group's expense/income ratio was in line with the prior year period at 62% (2020: 62%) and the group's compensation ratio increased marginally to 38% (2020: 37%). Statutory operating expenses increased to £597.6 million (2020: £541.5 million).

Impairment Charges and IFRS 9 Provisioning

Impairment charges decreased significantly in the year to £89.8 million (2020: £183.7 million), corresponding to a bad debt ratio of 1.1% (2020: 2.3%).



We experienced strong underlying credit performance across Commercial, Retail and Property as well as a reduction in Covid-19 provisions. The bad debt ratio of 1.1% reflected an increase in provisions against the Novitas loan book, which accounted for a significant portion of the impairment charge for the year.

Our approach to provisioning continues to reflect the application of our models overlaid with expert judgement to determine the appropriate allocation of loan book balances between stages, to macroeconomic scenario updates and weightings, and to provision coverage at the individual portfolio level.

We have revised the macroeconomic scenarios and the weightings assigned to them, with the resulting position being 20% upside (of which 10% was moved to the upside at 31 January 2021), 40% baseline, and 40% downside, to reflect a reduced level of economic uncertainty, the Covid-19 vaccination developments and easing of restrictions.

There was a marginal increase in overall provision coverage to 3.2% (31 July 2020: 3.0%) which included reductions in Covid-19 provisions, reflecting improved macroeconomic outlook and encouraging performance of the forborne loan book, more than offset by a significant increase in provisions against the Novitas loan book.

We believe this represents an appropriate level of provision, reflecting an improved but still uncertain economic outlook.

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.

Exceptional and Other Adjusting Items

We have recognised an exceptional gain of £20.8 million reflecting a VAT refund from HMRC in relation to hire purchase agreements in the Motor Finance and Asset Finance businesses. This follows HMRC's new policy framework in respect of the judgment from the Court of Justice of the European Union regarding Volkswagen Financial Services (UK) Ltd and has been agreed with HMRC in respect of 2009 to 2020.

Following the strategic review of Novitas' products and services, the group decided to cease permanently the approval of lending to new customers across all of the products offered by Novitas. As a result of this decision and the impact on the future cash flow profile of the business, we recorded an impairment charge of £12.1 million relating to the full write down of goodwill allocated to Novitas and a £10.1 million impairment charge relating to the remaining value of intangible assets recognised on acquisition. These charges are recognised as other adjusting items in the presentation of the group's adjusted performance.

Tax Expense

The tax expense was £63.1 million (2020: £31.4 million), which corresponds to an effective tax rate of 23.8% (2020: 22.3%). The effective tax rate in the 2021 financial year is above the UK corporation tax rate primarily due to the surcharge applying to most of the group's profits, partly offset by a write-up in deferred tax assets, reflecting an increase in the UK corporation tax rate from 19% to 25% applying from April 2023 passed into law earlier this year.

The government has indicated that it will legislate in Finance Bill 2021-22 to ensure that the combined rate of tax on banks' profits, which comprises the standard corporation tax rate and banking surcharge, does not increase substantially from its current level. This legislation would partially reverse the abovementioned deferred tax asset increase, and income statement benefit, however the precise quantum and timing of such a reversal remains uncertain.

Earnings per Share

Prior to adjusting for exceptional and other items including the impairment of goodwill and intangible assets on acquisition and the VAT refund from HMRC, basic earnings per share ("EPS") increased 85% to 134.8p (2020: 72.8p). After adjusting for these items, adjusted EPS increased 88% to 140.4p (2020: 74.5p).

Dividend

The board is proposing a final dividend of 42.0p per share, resulting in a full-year dividend per share of 60.0p (2020: 40.0p), up 50% on the prior year. This reflects the group's strong performance in the year and continued confidence in our business model and financial position. Subject to approval at the Annual General Meeting, the final dividend will be paid on 23 November 2021 to shareholders on the register at 15 October 2021.

Financial Overview continued

Summary Group Balance Sheet

	31 July 2021 £ million	31 July 2020 £ million
Loans and advances to customers	**8,444.5**	7,616.7
Treasury assets[1]	**1,788.2**	1,733.9
Market-making assets[2]	**801.6**	719.1
Other assets	**1,000.2**	1,001.8
Total assets	**12,034.5**	11,071.5
Deposits by customers	**6,634.8**	5,917.7
Borrowings	**2,600.9**	2,591.2
Market-making liabilities[2]	**690.6**	622.8
Other liabilities	**538.9**	490.2
Total liabilities	**10,465.2**	9,621.9
Equity	**1,569.3**	1,449.6
Total liabilities and equity	**12,034.5**	11,071.5

1 Treasury assets comprise cash and balances at central banks and debt securities held to support the Banking division.
2 Market-making assets and liabilities comprise settlement balances, long and short trading positions and loans to or from money brokers.

Group Capital[1]

	31 July 2021 £ million	31 July 2020 £ million
Common equity tier 1 capital	**1,439.3**	1,254.0
Total capital	**1,662.7**	1,441.0
Risk weighted assets	**9,105.3**	8,863.2
Common equity tier 1 capital ratio	**15.8%**	14.1%
Total capital ratio	**18.3%**	16.3%
Leverage ratio	**11.8%**	11.2%

1 The group's capital, risk weighted assets and ratios are presented on a transitional basis after the application of IFRS 9 transitional arrangements and the Capital Requirements Regulations qualifying own funds arrangements in force at the time. Without their application, and excluding the benefit related to the current treatment of software assets, at 31 July 2021 the CET1 capital ratio would be 14.2% and total capital ratio 16.7% (31 July 2020: CET1 capital ratio 13.1% and total capital ratio 15.1%).

Balance Sheet

The group maintained a strong balance sheet and remains focused on its prudent approach to managing financial resources.

The fundamental structure of the balance sheet remains unchanged, with most of the assets and liabilities relating to our Banking activities. Loans and advances make up the majority of assets. Other items on the balance sheet include treasury assets held for liquidity purposes, and settlement balances in Winterflood. Intangibles, property, plant and equipment, and prepayments are included as other assets. Liabilities are predominantly made up of customer deposits and both secured and unsecured borrowings to fund the loan book.

Total assets increased 9% to £12.0 billion (31 July 2020: £11.1 billion), but decreased marginally on the half year 2021 position (31 January 2021: £12.3 billion). This increase in total assets mainly reflected the strong loan book growth. Total liabilities were up 9% to £10.5 billion (31 July 2020: £9.6 billion) mainly driven by higher customer deposits. Both market-making assets and liabilities were up due to increased settlement balances reflecting the higher trading activity in Winterflood.

Total equity increased by 8% to £1.6 billion (31 July 2020: £1.4 billion), primarily reflecting the profit in the year, partially offset by dividend payments of £86.6 million (2020: £65.8 million). The group's return on assets increased to 1.7%, reflecting higher profitability in the year (2020: 1.0%).

Group Capital

The prudent management of capital is a core part of our business model and has been a key focus in the evolving environment so that the group can continue to support customers, clients and colleagues.

Common equity tier 1 ("CET1") capital increased 15% to £1,439.3 million (31 July 2020: £1,254.0 million) reflecting strong capital generation through £202.1 million of profit, a £50.2 million benefit from regulatory changes in the treatment of software assets and a £17.5 million transitional IFRS 9 capital add-back. This was partially offset by the regulatory deduction of dividends paid and foreseen of £89.5 million.

Risk weighted assets ("RWAs") increased modestly by 3% to £9.1 billion (31 July 2020: £8.9 billion) notwithstanding the 10.9% growth in the loan book, given the significant portion of government guaranteed loans under Coronavirus Business Interruption Loan Scheme ("CBILS") which attract a lower risk weighting and a reduction in the Property loan book due to high levels of repayments.

The CET1 capital ratio increased to 15.8% (31 July 2020: 14.1%), primarily due to higher profits and the benefit from regulatory changes to the treatment of software assets, partly offset by the increase in RWAs. The total capital ratio increased to 18.3% (31 July 2020: 16.3%), which also reflected our £200 million subordinated debt raised in the form of Tier 2 notes, replacing and concurrently repurchasing most of the outstanding securities.

At 31 July 2021, the applicable minimum CET1 and total capital ratio requirements, excluding any applicable PRA buffer, were 7.6% and 11.5%, respectively. Accordingly, we continue to have significant headroom of 820bps in the CET1 capital ratio, and 680bps in the total capital ratio, leaving us well placed to continue to help our customers and clients and in a position of strength to make the most of the opportunities in the current environment.

In line with the amended CRR ("CRR II"), effective on 23 December 2020, the CET1 capital ratio at 31 July 2021 includes a c.50bps benefit related to software assets which are exempt from the deduction requirement for intangible assets from CET1. The PRA published PS17/21 "Implementation of Basel standards" on 9 July 2021, confirming the reversal to the earlier position. This will result in the reversal of this benefit and reduction of the CET1 capital ratio upon implementation on 1 January 2022.

The group applies IFRS 9 regulatory transitional arrangements which allows banks to add back to their capital base a proportion of the IFRS 9 impairment charges during the transitional period. Our capital ratios are presented on a transitional basis after the

Group Funding[1]

	31 July 2021 £ million	31 July 2020 £ million
Customer deposits	**6,634.8**	5,917.7
Secured funding	**1,333.7**	1,418.2
Unsecured funding[2]	**1,539.5**	1,460.1
Equity	**1,569.3**	1,449.6
Total available funding	**11,077.3**	10,245.6
Total funding as % of loan book	**131%**	135%
Average maturity of funding allocated to loan book[3]	**24 months**	18 months

1 Numbers relate to core funding and exclude working capital facilities at the business level.
2 Unsecured funding excludes £22.7 million (31 July 2020: £7.9 million) of non-facility overdrafts included in borrowings and includes £295.0 million (31 July 2020: £295.0 million) of undrawn facilities.
3 Average maturity of total funding excluding equity and funding held for liquidity purposes.

Group Liquidity

	31 July 2021 £ million	31 July 2020 £ million
Cash and balances at central banks	**1,331.0**	1,375.8
Sovereign and central bank debt[1]	**192.5**	72.2
Certificates of deposit	**264.7**	285.9
Treasury assets	**1,788.2**	1,733.9

1 Included in sovereign and central bank debt is £90.2 million encumbered UK Gilts (31 July 2020: £nil).

application of these arrangements. Without their application, and excluding the benefit related to the current treatment of software assets, the CET1 and total capital ratios would be 14.2% and 16.7% respectively.

The leverage ratio, which is a transparent measure of capital strength, not affected by risk weightings, remains strong at 11.8% (31 July 2020: 11.2%). The leverage ratio increased on the position at the end of the 2020 financial year, reflecting the strong capital generation during the period.

We continue to make good progress on our preparations for a transition to the IRB approach and, as planned, the initial application to the PRA was submitted in December 2020. We are progressing through the first phase of the PRA application process and continue to work with the regulator to support their review. Our Motor Finance, Property Finance and Energy portfolios, where the use of models is most mature, have been submitted with our initial application, with other businesses to follow in future years.

Group Funding

The primary purpose of our treasury function is to manage funding and liquidity to support the Banking businesses and manage interest rate risk. Our conservative approach to funding is based on the principle of "borrow long, lend short", with a spread of maturities over the medium and longer term, comfortably ahead of a shorter average loan book maturity. It is also diverse, drawing on a wide range of wholesale and deposit markets including several public debt securities at both group and operating company level as well as a number of securitisations.

We increased total funding in the year to £11.1 billion (31 July 2020: £10.2 billion) which accounted for 131% (31 July 2020: 135%) of the loan book at 31 July 2021. The average cost of funding reduced to 1.4% (2020: 1.7%) largely driven by lower market rates, re-pricing of deposits and wholesale borrowings.

Customer deposits increased 12% overall to £6.6 billion (31 July 2020: £5.9 billion) with non-retail deposits increasing by 19% to £3.9 billion (31 July 2020: £3.3 billion) and retail deposits increasing by 3% to £2.7 billion (31 July 2020: £2.6 billion).

This has been another successful year for our online savings portal. The 35 Day Retail Notice Account and Fixed Rate Cash ISA were both launched this financial year, with c.39,000 customers, 40% of our retail customer base, registered for online banking. The online portal has proven a particularly valuable channel during Covid-19, mitigating the challenges of a postal offering whilst working remotely. We are focused on continuing to extend the product range, which will support us in growing and diversifying our retail deposit base and further optimise our cost of funding and maturity profile.

Secured funding reduced marginally to £1.3 billion (31 July 2020: £1.4 billion). Our range of secured funding facilities include securitisations of our Premium and Motor Finance loan books, and during the year we renewed our £500 million Premium Warehouse securitisation. We transitioned £262 million of drawings previously under the Bank of England's Term Funding Scheme ("TFS") to the Term Funding Scheme with additional incentives for SMEs ("TFSME") in October 2020, taking the total drawings under TFSME to £490 million, and no longer have any drawings under the TFS.

Unsecured funding, which includes senior unsecured bonds and undrawn facilities, remained broadly stable at £1.5 billion (31 July 2020: £1.5 billion). This was driven by the successful issuance of a £350 million, 10-year senior unsecured bond in December 2020 and the maturity of a £300 million unsecured bond in June 2021, as well as the renewal of our revolving credit facilities and issuing several private placements. We also successfully raised £200 million of Tier 2 debt capital in June 2021, replacing and concurrently repurchasing most of the outstanding securities via a liability management exercise.

We have maintained a prudent maturity profile. The average maturity of funding allocated to the loan book remained ahead of the loan book at 24 months (31 July 2020: 18 months), with the average loan book maturity at 17 months (31 July 2020: 15 months), in line with our "borrow long, lend short" principle.

Our strong credit ratings have been upgraded by Moody's Investors Services ("Moody's") and affirmed by Fitch Ratings ("Fitch") during the year. Moody's rates Close Brothers Group "A2/P1" and Close Brothers Limited "Aa3/P1" with a "negative" outlook. Fitch rates both Close Brothers Group and Close Brothers Limited "A-/F2", and has upgraded the outlook for both issuers to "stable", from "negative". This reflects the group's profitability, capital position, diversified business model and consistent risk appetite.

Group Liquidity

The group continues to adopt a conservative stance on liquidity, ensuring it is comfortably ahead of both internal risk appetite and regulatory requirements.

Against a backdrop of an improving but uncertain UK economic outlook, the group continued to deliberately maintain higher liquidity relative to historical levels, to provide additional flexibility as uncertainty persists whilst enabling us to maximise any opportunities available. Over the year, treasury assets increased 3% to £1.8 billion (31 July 2020: £1.7 billion) and were predominantly held on deposit with the Bank of England. The proceeds from the senior unsecured bond issued in December 2020, which contributed to further elevate the liquidity levels at the end of the first half, were deployed to repay the £300 million senior unsecured bond which matured in June 2021.

We regularly assess and stress test the group's liquidity requirements and continue to comfortably meet the liquidity coverage ratio ("LCR") regulatory requirements, with a 12-month average to 31 July 2021 LCR of 1,003% (2020: 823%).