Close Brothers Group

Tuesday 27th September 2011

2011 Preliminary Results

Preben Prebensen, Chief Executive

Welcome to today's presentation of our 2011 financial year results. I'm pleased to be sharing with you today a set of results that reflect both good strategic progress and good operational performance in our core businesses. Overall adjusted operating profit increased 13% to £131 million. This was driven by a very good performance from the Banking division where the profit increased 34% on prior year and the loan book grew a further 18% to £3.4 billion. We also achieved a solid performance in the Securities division with a resilient performance from Winterflood, notwithstanding a significant slowdown in market activity towards the end of our financial year. And in Asset Management we've made real progress this year on its restructuring and on growing the Private Client business which nearly doubled to £6.5 billion of client assets largely through acquisitions.

We've also during the year successfully exited a number of non-core businesses, including operations in the UK offshore and Cayman Islands and we recently announced our agreement to sell our minority interest Mako. These exits leave us with a more focused group and allow us to recycle cash and resources into our core businesses.

We've maintained a strong capital position with the core tier 1 ratio of 13.1%. We have continued good access to funding and overall are in a strong position to continue executing our plans for our core businesses.

And finally I'm pleased to announce that the board is recommending a 1p increase in the final dividend, taking the full year dividend to 40p which reflects our confidence in the performance and prospects of our core businesses.

Now I'll hand over to Jonathan who will take you through this year's results in detail and later on I look forward to sharing with you my perspectives on the performance and progress of the group during the year. As usual, after the presentation, we'll be happy to take your questions.

Jonathan Howell, Finance Director

Thank you, Preben, and good morning to everybody. Looking first at the highlights of our income statement, and these numbers relate to our core continuing operations, I'm pleased to report that the group has performed well in the year. We had good income growth of 11% to £549 million. This was driven principally by growth in the Banking division. Adjusted operating profit increased 13% to £131 million and the operating margin improved to 24% reflecting strong growth and a lower bad debt ratio in the Banking division.

Adjusted EPS increased 11% to 64.8p and the group's return on equity increased to 13% and having maintained our dividend throughout the credit crisis I'm pleased to say that this year we're proposing a 1p increase, resulting in a full year dividend of 40p.

During the year we have made significant progress on the restructuring of the group, including a number of acquisitions and disposals. These disposals have resulted in a more focused group with higher quality earnings. This restructuring resulted in exceptional charges in the year of £47 million. These included firstly a £36 million impairment on our investment in Mako following the sale agreement we announced two weeks ago. And secondly a £15 million charge relating to the restructuring of Asset Management including acquisition and disposal costs, severance payments and other restructuring costs. And finally a £5 million investment gain from the sale of our seed investment in Mako's Pelagus Fund. In addition the group recorded a goodwill impairment of £4 million in Asset Management related to institutional business and a £2 million charge for amortisation of intangible assets.

As a result profit before tax on continuing operations, but after exceptionals, reduced from £101 million to £79 million. The tax charge for the year was £35 million and therefore basic EPS from continuing operations, after exceptional items, decreased to 29.6p. We also recorded a loss of £28 million from discontinued operations. These relate to the UK offshore and Cayman business which was sold in the year. And as a result basic EPS from continuing and discontinued operations reduced to 10.1p.

Turning to the performance by division, the Banking division had another year of strong growth. It delivered a 34% increase in adjusted operating profit to £106 million. The Securities division had a solid performance overall although profit reduced to £55 million, relative to a strong prior year. Winterflood had a resilient performance in mixed market conditions and Seydler delivered a strong result whilst Mako's performance was subdued.

The Asset Management division has continued as planned with its investment programme and as expected delivered an operating loss. And finally group net expenses, related to our central functions were stable at £21m.

During the year the group had improved the efficiency of its balance sheet with a shift from lower yielding treasury assets into higher yielding loan book. The loan book increased £500 million to £3.4 billion whilst treasury assets reduced £600 million to £1.4 billion with a focus on higher quality liquid assets. Overall total assets decreased slightly to £6.1 billion. Securities assets and liabilities largely relate to settlement balances and trading positions held by Winterflood and Seydler. These were broadly stable at around £700 million of assets and £600 million of liabilities. Customer deposits increased slightly to £3.2 billion. During the year we had good organic growth in deposits of £400 million and acquired a £300 million book of structured term deposits. This more than offset the sale of the UK offshore and Cayman businesses which had some £600 million of deposits. And finally as a result of a more efficient balance sheet and lower draw downs on our facilities, borrowings reduced £300 million to £1.1 billion.

The group has maintained a strong capital position and at the year end had a core tier 1 ratio of 13.1% and a total capital ratio of 14.9%. These ratios reduced year on year as the group employed capital for loan book growth in the Banking division and focused acquisitions in Asset Management. The disposals made during the year did not materially impact capital and although retained earnings reduced this was largely offset by lower deductions for intangibles. As a result core tier 1 capital reduced slightly to £589 million.

Risk weighted assets increased 4% to £4.5 billion. Strong growth in the loan book was partly offset by lower holdings of debt securities and a lower assessment of operational risk, reflecting improvements in the group's risk framework.

The group remains above the new minimum requirements under Basle III but we will continue to monitor any changes to capital requirements by the regulators.

The group has a strong funding position with total available funding of £5.4 billion, some 1.6 times the loan book. And we have further improved the diversity and maturity of our funding during the year. At 31 July the group had £1.5 billion of wholesale funding. During the year we raised around £1 billion through our securitisation of the premium finance loan book, a syndicated facility and repo agreement. And since the year end we've raised a further £250 million of committed funding through a securitisation of the Motor Finance loan book.

We also strengthened the maturity of our £3.2 billion of customer deposit base and term deposits, with a remaining maturity of over one year, increased from £200 million to £1 billion.

Overall our total term funding increased from £1.6 billion to £2.5 billion covering 72% of the loan book. This term funding had an average maturity of 36 months, well ahead of the 13 month average for the loan book. Overall this strong funding position and access to diverse funding sources gives us the flexibility we need to execute our growth strategy.

The focus of the group's treasury function is on funding the loan book efficiently whilst holding a sound level of high quality liquidity and during the year the group's overall holding of treasury assets reduced £600 million to £1.4 billion as funds were redeployed into the loan book. In particular the group is actively managing down its portfolio of FRNs which halved to £300 million. At the same time the group's high quality liquid assets, which include deposits with the Bank of England and Gilts, increased slightly to £800 million. And the group continues to hold additional liquidity in the form of around £300 million of CDs and has a further £400 million of undrawn facilities.

Now looking at the divisions in more detail starting with banking. The division's income increased 20% or £54 million, principally reflecting good loan book growth and maintained strong margins. Expenses increased £25 million, also 20% year on year, to £155 million. To support its growth the division is making significant investment in both its frontline origination and sales capacity and in enhanced operations and infrastructure including Finance, Credit and IT. This investment accounted for over half the cost increase in the year and as a result the expense income ratio remains stable.

Bad debt ratio reduced to 2.1% and as a result adjusted operating profit increased 34% to £106 million. Return on equity increased to 21% reflecting the good profitability of the group's high margin, prudent, lending model.

The division's net interest and fee income increased 22% overall to £312 million reflecting strong growth across its businesses in Retail, Commercial and Property. This was driven by growth in the average loan book of 20% whilst maintaining a strong net interest margin of 9.8%.

Treasury and other income declined in the year to £14 million reflecting the group's reduced holdings of treasury assets. The loan book increased 18% in the year to £3.4 billion. This was delivered through double digit growth across Retail and Commercial. The retail loan book increased 23% reflecting good growth in premium finance, particularly in personal lines and strong growth in Motor Finance which benefited from several new branches and increased penetration of larger dealerships and franchises.

The commercial loan book increased 20% to £1.4 billion. Asset finance continued to see strong demand across asset classes and invoice finance achieved good growth notwithstanding a competitive market.

The loan book in property increased 3% to £600 million. Although there was strong growth in shorter term lending this was partly offset by the repayment of older loans.

Looking now at some of the key ratios in the division. Bad debt ratio reduced to 2.1% largely driven by an improvement in commercial. Bad debts in retail have remained low whilst property remained higher as it continues to manage down it's older dated loans. The net interest margin remains strong at the top end of its historical range at 9.8% and as a result the return on our loan book increased to 3.3%.

Turning now to the Securities division which delivered a solid performance for the year. Whilst market conditions for our businesses were good for most of the year a weaker trading environment in the final quarter impacted the overall result. Income for the year reduced 2% to £159 million plus operating expenses were broadly stable. As a result adjusted operating profit reduced 8% to £55 million compared to a strong prior year.

Winterflood had a resilient performance and delivered £43 million of operating profit. Seydler achieved a strong result with £9 million profit whilst the contribution from Mako reduced to £3 million. The division continued to deliver a strong ROE of 39% and an operating margin of 33%.

Looking first at Winterflood which had income of £125 million down 5%. Trading conditions for Winterflood were mixed. They had a strong performance in the second and third quarters driven by high levels of aimed trading followed by a slower fourth quarter as retail trading activity reduced. Overall bargains per day increased slightly to 48,000 although income per bargain reduced to £10.40 reflecting weaker trading conditions at the end of the year. Despite variable market conditions Winterflood demonstrated its resilience with only one lost day in 251 trading days, Seydler's income increased 27% to £32 million reflecting an increase in debt capital markets' activity. And Mako had a subdued performance contributing associate income of only £3 million.

And finally looking at the Asset Management division which is making good progress on its restructuring. Income in the division increased 5% to £64 million with a £9 million increase in management fees partly offset by lower other income. Expenses increased £10 million to £72 million including £7 million in respect of the partial year cost base of businesses acquired in the period. Expenses also include £8 million of non-recurring investment in the Private Client proposition and platform.

As set out this time last year, we expect to spend a total of £18 - £20 million on this initiative and have spent £15 million of this to date. Overall the division made a loss as expected of £9 million.

Overall income in Asset Management increased 5% to £64 million. Management fees on AuM which is the recurring income generated by the division's client assets increased 19% to £57 million. This reflects 24% growth in average AuM largely driven by acquisitions. The overall revenue margin remained broadly stable at 70 basis points and the underlying revenue margin on our Private Client assets, including businesses acquired in the year was

93 basis points. Other income reduced to £7 million. This reflects income from our residual interest in the private equity business which we sold in 2009.

We have significantly increased our Private Client assets in the year. Overall AuM increased 39% to £9.6 billion but Private Clients AuM nearly doubled to £6.5 billion. This was partly offset by a £500 million reduction in institutional to £3 billion reflecting the sale of the property funds business. The asset growth in Private Clients was achieved through acquisitions of £2.6 billion and positive net new funds of some £250 million or 8% of opening AuM. It also benefited from positive market movements of £290 million. As a result Private Clients now represent around 70% of the total and we remain focused on growing this business.

In the first half of this current financial year we expect a further reduction in institutional AuM reflecting the sale of a property investment business and the planned redemption of a large institutional mandate. Adjusting for these movements total AuM would be £8.2 billion of which 80% would be Private Client assets.

Finally, turning to the outlook for the 2012 financial year, we remain focused on growing and developing our core businesses in Banking, Securities and Asset Management. We continue to see good opportunities for growth in the Banking division. The Securities division is experiencing difficult market conditions but remains well positioned and the Asset Management division is entering the final stage of its restructuring and is expected to deliver a small loss in 2012.

Overall economic and market conditions are uncertain but we have a strong financial position and are well placed to deliver solid results. Thank you.

Preben Prebensen

Thank you Jonathan. The focus during the last year has very much been on implementing and executing the strategic priorities which we set out this time last year. We have a clear strategy focusing on developing and growing our core businesses in Banking, Securities and Asset Management. These are all businesses where we see good long term prospects and which have the capacity to deliver high quality, sustainable earnings. Our priorities for the group as a whole and for each of these divisions are unchanged. In the Banking division we want to grow the business while maintaining our predominantly secured, high margin, specialist lending model. In Securities we want to maintain our leading market positions while selectively exploring any opportunities for growth. And in Asset Management we're transforming the business to become a leader in Wealth and Asset Management in the UK.

Our primary focus today is on executing our plans for each of these divisions. At the same time we also had a number of businesses in the group that did not fit with our wider strategic objectives and which did not have the same capacity to deliver sustainable and growing earnings. This was something we needed to address and in the last year we successfully exited a number of non-core businesses. Within the Asset Management division we've sold our UK offshore and Cayman businesses which both completed in June and we also sold our Property Funds Management business earlier in the year. More recently we announced an agreement to sell our 49.9% investment in Mako to the management team.

While these disposals have impacted the accounts for the year they had no impact on the group's capital and they allow us to recycle cash and focus our internal resources on growing and developing our core businesses.

Turning now to some of the more interesting developments in each of our divisions. In Banking our priority remains to grow the business while sticking closely to our specialist, predominantly secured, high margin lending model. We continue to see significant opportunities to grow in our core markets and this is borne out by 18% organic loan book growth in the year to £3.4 billion with double digit growth across both commercial and retail divisions. It's clearly a good time to grow. The supply of credit to individuals and small businesses is limited and there's strong demand for specialist lending as an alternative to traditional sources of finance like credit cards and overdrafts. And as Jonathan has set out today we have the funding, the capital resources and business model in place to do this.

As we set out last year we've made significant improvements to our sales and distribution capacity over the last two years in order to make the most of the current market opportunity. We've increased our number of frontline, revenue-generating staff by over 20% in the last two years to around 450 today out of our total of 1,600 people in the Bank. And we've opened a number of new branches and offices including a new Motor Finance branch, opened earlier this month in Kent and this has led to higher market shares in several of our businesses, notably in Motor Finance we've increased the number of dealers who intermediate our lending by nearly 30% to 7,300 in the last 12 months and over the same period our share of the used car financing market has increased from 9% to 11%. We have a tried and tested lending model which is based on specialist lending, predominantly short term and secured on conservative loan to values and which delivers high margins and good returns through the economic cycle and as we grow we are not changing this model.

We are however looking at ways to extend it into adjacent markets which fit very closely with our existing activities. For example, in Motor Finance the key accounts team which we established last year to deal directly with larger accounts and franchises has brought in over £50 million of new lending this year. In Invoice Finance we're increasingly targeting larger ticket sizes through a dedicated sales team. In Asset Finance we've introduced some interesting new asset classes ranging from forklift trucks to green energy and we're also for the first time looking across both Invoice and Asset Finance for opportunities to cross-sell between the two client bases.

Overall the growth outlook for the division remains strong and as we grow we also have to invest in our central functions and infrastructure to be able to support a larger business. During the last year we've added significantly to our resources in Finance, IT, Credit, Legal and Compliance and we have a number of projects underway to upgrade our central infrastructure and at the same time increase integration and streamline processes to increase scalability and operational efficiency over time. However, at the same time we will maintain our local expertise-based model which is critical to our customer relationships and our ability to price and manage risk in a wide range of specialised markets.

Finally we remain focused on ensuring that we do not compromise credit quality as we grow. Our people have significant underwriting expertise and experience with a proven track record of managing credit risk through the cycle and during the year we've commenced work on a new management information system for credit risk. Overall this will ensure that as we grow we can continue to effectively monitor the credit metrics that underpin our lending decisions and our financial performance through the economic cycle.

I'd now like to share with you a slide that many of you have seen before which we think is very useful for an historical perspective on the Banking division's performance.

Firstly this chart really illustrates the progress we've made. This is the second consecutive year of strong loan book growth. The loan book has increased 45% in the last two years and at the same time profit has nearly doubled. Having fluctuated between £70 - £75 million during the years of easy credit and then reduced to £55 million in 2009, our profit has broken out of its historical range at over £100 million this year. Even more importantly as you look at this chart you can see that historically this business has growth through a range of economic conditions. The ten year compound annual growth rate of the loan book is 11% and this includes the easy credit years when we faced significant competition both within our markets and from other forms of cheap, readily available, finance and aside from a small reduction in 2006 the loan book has never gone backwards. What this shows is that once we win business we tend to keep it through strong customer relationships and high levels of service with over half of our lending coming from repeat business.

We continue to see good opportunities to grow and are very focused on making the most of this opportunity. Conditions are undoubtedly in our favour at the moment and we're confident that the growth we're capturing today is indeed sustainable.

Our Securities division consists of Winterflood, Seydler and our investment in Mako. Our primary focus for Winterflood, in particular, is to maintain its leading market position in the UK and to continue delivering results in a range of market conditions. During the year market conditions have been mixed, ranging from strong in the second and third quarters to much weaker in the fourth quarter as retail investors risk appetite reduced. And Winterflood has continued to generate consistent profitability throughout that period with only one lost day out of 251 trading days in the last year. Its average volumes traded actually increased slightly to 48,000 bargains a day although income per bargain reduced relative to the strong prior year. And it’s maintained its market position as the leading market maker to retail brokers in the UK, ranking first by volume and value across each of the main UK indices. In fact Winterflood is around twice the size of its nearest competitor in its market.

We also continue to explore opportunities to increase Winterflood's flow. During the year Winterflood has established a new company which has applied for broker dealer status in the US which will allow it to access order flow in UK and European shares directly from US institutions and broker dealers.

It has also established a new business unit in the UK, Winterflood Business Services, in order to satisfy increasing demand from a range of institutions for outsourced execution and custody services. In the last year Winterflood Business Services has signed up nine clients one of which is our Asset Management division where Winterflood provide the execution capability for equities on the new technology platform. While not expected to make a material contribution in the near future these are both interesting opportunities which should provide incremental flow in the longer term.

Our smaller securities business, Seydler, also had a strong performance and increased profit significantly with a very good performance from its capital markets businesses in particular. And it has a very good franchise here which we're looking to build on.

Two weeks ago we entered into an agreement with the management team of Mako to sell our 49.9% interest. Given the nature of its business, derivatives market-making, and the fact that it was a minority investment the sale of Mako is consistent with our focus on developing our core businesses where we have full control.

Now turning back to Winterflood I just wanted to spend a few minutes on its performance from an historical perspective with a slide that some of you will recognise from our presentation on Securities early last year.

This slide really demonstrates what we mean by sustainable earnings. Over the last ten years, which cover a wide range of market conditions, Winterflood's average profits were

£35 million and over the last five years they were £41 million. And its return on equity has been consistently strong between 40% and 50% for most years. And this really demonstrates the resilience of Winterflood's model and its ability to make the most of any market conditions regardless of whether investors are buying or selling shares. And this continues to be true in the current difficult market conditions.

The Asset Management division is undergoing a significant transformation and restructuring with the objective of becoming a leading provider of wealth and asset management services in the UK. As many of you will know we held a detailed presentation in May where we set out our Private Client's strategy and our propositions. We're now into the final year of what we regard as a three year transformation process and we've made significant progress over the past two years. Firstly, we've increased the focus on our core activities which directly relate to UK based wealth and asset management and which are consistent with a scalable high growth, high quality earnings business model we're building. During the year we've made a number of disposals of businesses in the division which did not fit this description. This includes the UK offshore and Cayman Islands businesses which were in markets and geographies outside our core areas. These disposals have realised around £45 million of cash which we've been able to invest in developing our business model and in acquisitions.

At the same time we've made significant progress in building scale and extending reach in the private client side of the business. Over the past year our private client assets have nearly doubled to £6.5 billion. Most of this increase came through three acquisitions made during the year: Chartwell, Allenbridge and Cavanagh. These acquisitions have added £2.6 billion of additional private client assets, and increased our total number of active private clients from just over 20,000 to around 65,000. They've also significantly extended our distribution capacity by adding further geographic hubs in Bristol, Scotland and the Southeast and have more than doubled our base of financial advisers from 50 to over 120. These businesses will be fully integrated and branded Close Brothers and the integration is being overseen by an integration board led by Andy Fay, the former CEO of Cavanagh.

We continue to see interesting acquisitions opportunities and as we set out in May would expect to acquire between £1 billion and £2 billion of additional client assets during the course of the current financial year. In broad terms we expect the acquisition stage of our growth to be completed by the end of this financial year and thereafter the primary focus will be on organic growth. This year we achieved 7.5% net new funds growth in the private client business which largely came through the high net worth side. Over time as we begin to leverage the additional distribution capacity in our adviser network we would expect to improve this growth.

The third element of our strategic transformation relates to the development and roll out of our client proposition and the underlying technology platform, and this is an area where we've made significant progress. We've clearly defined our core propositions for advice, execution only and investment management, which I'll come back to on the next slide. And we are developing a new technology platform together with a leading industry partner which will support our client propositions for both advice and execution only clients. The development of this technology platform is on track and on budget and the execution only application is currently undergoing user testing in a live environment. In November we're due to commence the commercial roll out of the advice application to new clients. At the same time we'll begin the phased roll out of the execution only application with additional content added to the service early in the New Year. So we're now entering the final stage of this transformation which leaves us with the building blocks for a high growth and profitable business in the longer term.

The next slide summarises at a high level what our new proposition for private clients looks like. Our aim is to provide private clients with an integrated range of services incorporating advice, investment management and execution only. Not only will this allow us to serve a wide range of clients but importantly our research indicates that a large number of individuals are looking for a combination of services. On the advice side we'll provide a nationally branded consistent advice offering covering goal based financial planning, tax planning and investment advice. This will be supported by our locally based financial advisers. We currently have 122 advisers but expect to increase this number to between 150 and 200 by the end of this financial year. The service is available now and will be rolled out to both new and existing clients over the next 12 months.

On the execution only side we'll offer self directed clients the opportunity to transact across a wide range of investments including Close Brothers own savings and investment products via our new technology platform. This will include access to a variety of wrappers and a consolidated view of all assets. The first stage will be rolled out starting in November and the full offering including fund research will be available early in the New Year.

On the Investment Management side we have an award winning multi asset class investment capability with around 50 investment professionals. We're building on this capability to offer a range of consistent investment management propositions serving a wide range of client types and account sizes. This includes a range of collective funds, separately managed accounts and for high net worth clients we offer fully bespoke portfolio management. All these are underpinned by a central research and asset allocation strategy led by our experienced investment management team.

We believe this combination of services gives us the ability to serve a wide range of clients and indeed the ability to continue serving the same clients as their needs change which is a key differentiator of our model.

So to sum up today's presentation. We've made good strategic and operational progress during the year and remain focused on implementing our strategy for Banking, Securities and Asset Management. In the Banking division we see good prospects to continue growing while maintaining our distinctive model. In Securities we've maintained a strong position and are well placed to perform in a range of market conditions. And in Asset Management we're now entering the final stages of our transformation into a growing, profitable business.

Thank you very much and we now look forward to answering any questions you may have. As well as Jonathan and myself, the heads of our three divisions, Stephen Hodges, Julian Palfreyman and Martin Andrew are here and also available to answer any questions. Please can I remind you to state your name and company before asking your question.

Question and Answer Session

<u>**Question 1**</u>

Arnaud Giblat - UBS

I've got three questions on the Bank. First of all core tier 1 ratio at 13.1% if we look at a few years what level are you targeting or comfortable with?

And I suppose it's another way of asking the same question but over the next few years what sort of growth levels at the Bank should we be looking for bearing in mind the core tier 1?

And third, given the current or possible deterioration in the macro environment what's the outlook on bad debt? Thank you.

Answer: Preben Prebensen

Let me take the bad debt question and maybe Jonathan you can take the capital question. On the bad debts I think the historical perspective on this is interesting, which is if you look over a 25 year period where we've had a very consistent business model focusing on high margin secured niche banking, and we're not changing that, our bad debts have peaked twice in the early '90s and in 2009 at around 2.5% / 2.6%. So that gives you perspective over a long period of time. Since the last peak we've seen a trend down in bad debts and so we saw that move from 2.4% to 2.1% for this year and I think again what's happening within that is that Retail moved quite quickly down, that's a shorter dated book, and so the rotation takes place more quickly. We've seen Commercial now starting to trend down. Again a longer dated book within our context but that's now rotated. And Property is the one which has remained at the higher levels and as Jonathan mentioned that's as we're basically still continuing to manage out the legacy part of that book. So bear in mind the 25 year perspective and bear in mind the trend that we've seen and the fact that we have a high margin secured lending model with conservative loan to values and we can recalibrate asset values and so on as we rotate that position, and I think that gives you a sense of the direction, notwithstanding the external environment. So we don't think that we're going to be very significantly buffeted unless things get an awful lot worse from where they are today. But if we continue to kind of go along where we are now. Do you want to take the capital question?

Answer: Jonathan Howell

Yes just in terms of the capital if you cast your mind about three years ago, I think we've discussed it before, there was surplus capital on our balance sheet and that had been identified by investors, by analysts and by ourselves about three years ago. We were very clear at that stage that we were not contemplating a return of capital because we knew that during periods of pressure and stress on the rest of the banking community historically those have been opportunities for Close Brothers and the Close Bank in particular to grow disproportionately. And that's very much what's happened over the last two to three years. We had a loan book growth two years ago of 23%, this year it's 18% and as we sit here now just very early into the New Year there is strong growth continuing.

That has meant that we have used capital, we have grown into that capital base and are therefore now beginning to run a level of capital that we still think is very safe and very prudent, we're at 13.1% core tier 1; 14.9% total capital ratio. But as we continue to grow we do expect that to moderate. There have been two principal uses of capital during the course of the year: one is the loan book £500 million increase in the loan book to £3.4 billion, so that has been a source of utilisation of capital; the other utilisation has been in the acquisitions in the Asset Management division where we generated another £58 million of goodwill or intangible assets which included deductibles from capital in buying that 2.6 billion of AuM in the Private Client business.

Looking forward those two principal parts of the business that have been utilising capital will be utilising it on a slightly more aggressive level than we've seen in the past. Why is that? The Bank now is at an absolute level of profits and a level of profitability in terms of return of capital employed, return on equity at 21% and return on loan book which has gone from 3% to 3.3%. So both in absolute terms and in levels of profitability the Bank is improving and therefore its use of capital as it grows would begin to ameliorate. And similarly in terms of the Asset Management division, in the Asset Management Seminar we said that having made

£2.6 billion of acquisitions of AuM during the course of this last financial year we would anticipate that over time we would do another one to two billion but that very much was at the sort of upper edge of our expectations of what would be short term acquisition growth in Asset Management. And as that's coming to an end and this big period of transformation and turnaround in the Asset Management division is coming to its end and as the Bank is becoming more profitable we still expect to utilise more capital during the course of the next 12 months but that will begin to ameliorate and over time when we plan it and when we forecast it and when we measure it we can see that actually that trend will start to reverse. But we're not quite at that stage.

Just to reiterate at 13% where we are for core tier 1 we're easily in excess of any Basle III requirement at seven and a half percent and whilst Vickers is still in a state of discussion and not yet, in terms of legislation or regulation, we are confident that there is nothing in the whole of Vickers that would disrupt any of our capital planning at this stage.

And in terms of growth, the last question in terms of growth, 23% two years ago, 18% this year that we've just reported on, good prospects for growth in this current year. I think in terms of if you go back ten or 15 years the sort of aggregate, you know compound annual growth of the loan book has been about 10% through the cycle, peaking in years just the last two that we've seen, and falling to a slightly lower level during times of easy credit and banking expansion for the rest of the banking industry. So that has been a long term trend, but at the moment, as you can see, we've been performing significantly above that trend. And there's nothing immediately that can see us sort of moving very rapidly back towards that 10%.

<u>Question 2</u>

Tom Mills - KBW

Just on the £1b to £2 billion of acquisitions in the Asset Management side of AuM. Can we expect those to be in the form of IFA businesses similar to those that you've made before?

Answer: Jonathan Howell

Yes that would be entirely consistent. I think what we're looking for is just to put the last building blocks in place in terms of regional reach, presence and client assets and clients and then drive it organically from there. But it would most likely be in a form of IFAs.

<u>Question 3</u>

Nitin Arora - HSBC

A few questions: firstly on Banking; given that you're talking about still rate of growth in the loan book is going to be pretty good what are your thoughts about growing the front staff either sales force or the expansion of the investment within the front staff?

Secondly, looking at the margins, net interest margins have fallen from 10% in H1 to 9.6% in H2 what is the key driver there, is it only the mix or is it also an increase in the cost of financing within the loan book?

And then on Asset Management, firstly on the institutional business after losing the institutional mandate I guess the two and a half billion of assets are I presume roughly £10 million of revenues. Is it a profitable business as a standalone entity or do you think does it make sense to run that business or focus entirely on the Private Client management side?

And the second on Asset Management is regarding the acquisitions do you think you can get or acquire new IFAs or the target IFAs that are cheaper valuation than what you paid for Cavanagh?

Answer: Preben Prebensen

Lots of questions. Let me take them in reverse order mostly because I've remembered those. In terms of the acquisition costs of the IFAs we bought those IFAs if you look at all three of them at I think around 2% of assets, that's there or thereabouts, that's a reasonable kind of yardstick. It isn't a driving yardstick in terms of what we go out to do each of these is negotiated heavily. Each depends on what we get in terms of people, infrastructure, how far along the process they are in terms of converting towards a much more modern business model - all of those things to into how attractive we find the business, and therefore what determines price. But I think in terms of the materiality of your question you could use that aggregated benchmark of £50 million spent on £2.6 billion of three acquisitions as a kind of yardstick for the future. But beyond that it will be negotiated very specifically on a case by case basis.

On the institutional question I think the strategy that we have is to focus on the UK, so onshore Private Client and Wealth Management business. And that is a continuum it isn't really compartmentalised. What we really mean by that is we have a continuum in the Private Client side which really goes from about say a hundred thousand of investible assets right up to high net worth of £5 million or £10 million of investible assets. And then there are institutions, if you want to call them that, that fit with that continuum, so they would be charities, endowments, small funds things like that where the application of our model makes a lot of sense. I think where you may see us de-emphasising is a large institutional target client which is more like the mandate that we're giving up right now. So that's how I would characterise that distinction.

Further question

So when you say you are using the same infrastructure for both Institutional and the Private Clients?

Answer: Preben Prebensen

We will be using the same infrastructure, same investment process for all of those clients yes. And that extends from the affluent to the high net worth to the charities, endowments and small institutions.

On the net interest margin question the change between H1 and H2 is it mix or is it a change in what we're seeing? I think that... do you want to take that?

Answer: Jonathan Howell

Just very, very simply it's principally mix. If you look at the growth in the loan book during the course of the year the highest growth part of the loan book was the Retail division in at 23% and that is at a slightly lower level of net interest margin than the Commercial part of the book. And so that is really being driven by mix. In terms of funding costs we haven't in recent months yet seen an increase in funding costs, but critically importantly over the last two to three years we've demonstrated the ability to pass on any increase in funding costs through to the borrower, and have actually increased our net interest margins during the course of the last two to three years as opposed to going the other way. So it's principally what you've seen in the last 12 months is mix and I wouldn't read too much into the sort of short term fluctuations or trends. We are historically have always operated at a net interest margin of between eight and a half percent and 10% and what we've been saying for the last 12 months is look just don't get too carried away, it's not going to break out above that 10% but equally we can't see it rapidly falling back towards the eight and a half percent.

Answer: Preben Prebensen

We track our new business written to try and get away from mix issues and the new business written is staying at these kind of levels, it isn't changing very much.

Answer: Jonathan Howell

And then lastly I think it was on investment was it in the...

Answer: Preben Prebensen

Front end investment like sales force.

Answer: Jonathan Howell

Over the last two years we've invested heavily in the front end, that's headcount and distribution capability. The cost increase coming through in the Bank today was down to investment in heads and new infrastructure. In terms of the front office sales capability we added 30 new heads in the Bank over the last 12 months. We also saw coming through a full year run rate of the 60 to 70 heads that we'd added in the front office in the previous year. We also have opened or seen the full year run rate effect of two to three additional branches opened in the motor division.

And in addition to that sort of front office we have also invested in Central Bank infrastructure and that's in IT, Credit, Compliance and Finance to make sure that we have got the absolute best control measurement, management, compliance capability around this Bank which is growing by any measure at fast rates. That meant that the cost/income ratio remained about flat for the last 12 months. That level of investment in IT capability and projects to maintain this growth is going to continue into the next 12 months and so we will continue to see costs increase but not at the rates that we've seen over the last 12 months.

Further question

In terms of front office staff you're saying that you're mostly done, it's only the IT and...

Answer: Jonathan Howell

I think at this stage in terms of what we can definitely see for this year and the year after it's doing these major IT, Compliance, Risk infrastructure projects. There will be some additional front office sales going in as well but at this stage it's too hard to predict depending upon which parts of the loan book are growing fastest.

Answer: Stephen Hodges

Clearly if we open a new branch we need new sales people, that's sort of clear. And also if we come across good people in the marketplace we would like them to join us. But we've made a sizeable increase, as Jonathan and Preben have said, of nearly 100 front office sales staff over the last couple of years and that puts us in a very good position to maintain the rate of growth.

Answer: Preben Prebensen

I think there is a difference between the gearing up that we needed to do in response to the much more interesting conditions for us that came out of the credit crisis and then the incremental amounts that you might need to add thereafter. So there's a kind of gap up and then a smoother path thereafter.

I think we're done. Thank you very much indeed.