## Close Brothers Group

## Tuesday 25th September 2012

## 2012 Preliminary Results

**Preben Prebensen, Group Chief Executive**

I think we should get started. So can I say good morning to all of you and welcome to this presentation of Close Brothers 2012 full year results. As usual Jonathan will take you through the results in detail and I'll then add my perspective on the strategic and operational position of our businesses. And after the formal presentation we'll be happy to take any questions you may have.

Before I hand over to Jonathan I'd first like to share with you the highlights of this year's performance. We achieved a solid overall performance in the current market environment. Our adjusted operating profit increased 2% to £134 million.

The Banking division achieved another strong performance and we achieved growth of 20% in the loan book and 27% in operating profit.

However performance in Securities was affected by difficult trading conditions across the market, although we've maintained a strong position.

We've made good strategic progress in Asset Management which has substantially completed its restructuring and is now positioned for future profitability.

Crucially we've maintained a strong funding, liquidity and capital position including a core tier 1 capital ratio of 12.8%. And I'm pleased to say that we've increased the full year dividend by 4% to 41.5p.

Now I'll hand over to Jonathan.

**Jonathan Howell, Group Finance Director**

Good morning everyone and thank you, Preben. We're pleased to report a solid overall result in the current market conditions. Overall income reduced 3% to £532 million. While we achieved strong growth of 11% in Banking this was more than offset by lower trading activities in Securities. However, both operating expenses and bad debts also reduced and as a result adjusted operating profits increased 2% to £134 million.

Adjusted earnings per share increased 4% to 67.3 pence for the year and we continue to deliver a solid return on equity of 12.5%. We've increased the final dividend by 1p taking the full year dividend to 41.5 pence, up 4%. This reflects our solid performance in the year and continued confidence in our future prospects.

We've recorded £6 million of exceptional income in the year, principally foreign exchange gains realised on the partial sale of Mako. The prior year exceptional charges reflect an impairment charge on Mako, and restructuring costs in Asset Management. After exceptional items, profit before tax increased significantly to £135 million.

The tax charge for the year was £34 million, corresponding to a tax rate of 25% in line with the UK Corporation Tax rate. After tax, profit increased from 43 to 100 million and basic earnings per share also more than doubled to 69 pence.

Performance varied across the divisions reflecting the different market conditions facing our businesses. The strong performance continued in the Banking division, the loan book increased by 20%, the net interest margin remained strong and bad debts reduced. As a result, adjusted operating profit in Banking increased 27% to £135 million.

Profit in the Securities division reduced to 25 million reflecting the difficult trading conditions.

And in Asset Management we've substantially completed the restructuring and the operating loss reduced to £4 million.

We've continued to improve the quality and efficiency of our balance sheet with a focus on our loan assets and high quality liquidity. During the year total assets increased 4% to £6.4 billion. This was driven by growth in the loan book which increased 20% to £4.1 billion and now represents 65% of total assets. This growth was partly offset by a £350 million reduction in Treasury assets to £1.1 billion. The large majority of our Treasury assets are now in high quality liquid assets which are broadly unchanged year on year.

Securities assets and liabilities also reduced by around £100 million reflecting lower trading activity.

The majority of our liabilities relate to funding for the loan book and for our holding of liquid assets. In the year customer deposits increased to £3.4 billion and wholesale borrowings increased to £1.3 billion as we raised new funding to support loan book growth. Equity also increased £40 million to £770 million at the year end.

Our funding position remains strong with diverse funding sources and a prudent maturity profile. Total funding increased by £450 million to £5.9 billion and covered 142% of the loan book at the balance sheet date. Customer deposits increased around £300 million to £3.4 billion and include both retail and corporate deposits. Wholesale funding increased £100 million to £1.6 billion and includes securitisations, bank facilities and a group bond. We have continued good access to funding and in the year we raised a new £500 million securitisation on the Motor finance loan book and over £300 million of new retail deposits. Our funding has a prudent maturity profile, consistent with our conservative risk appetite. At the year-end we had term funding of £2.8 billion which covered two thirds of the loan book. And the average maturity of this term funding was 27 months, considerably longer than the loan book at 14 months.

Turning now to our Treasury assets where we've maintained a good level of high quality liquidity. Our high quality liquid assets, which include deposits with the Bank of England and gilts, remain stable on the prior year at £800 million. This is comfortably above the FSA's liquidity requirements and our own risk appetite. At the same time we continue to reduce our holding of less liquid debt securities to optimise balance sheet efficiency. As a result total Treasury assets reduced to £1.1 billion.

We've now substantially completed the run off of our FRN portfolio which has reduced from nearly £800 million three years ago, to just over £100 million today. And we continue to hold a small portfolio of CDs.

The Group has maintained its strong capital position and had a core tier 1 ratio of 12.8% at the year end. The ratio is comfortably above the regulatory requirements and industry benchmarks and will not be materially affected by Basel III. The core tier 1 ratio reduced modestly in the year despite strong loan book growth and reduced profits and securities. This reflects an 8% increase in risk weighted assets driven by loan book growth partly offset by lower debt securities. However the core tier 1 ratio increased from 12.3% at the half year partly reflecting the normal timing of dividend payments in the year. The Group also has a strong leverage ratio of 9.7% which increased from 9.5% last year, and this is a further measure of the strength and quality of our capital base.

Looking first to the Banking division which delivered its third consecutive year of strong performance. Overall operating income increased 11% to £362 million. Adjusted operating expenses were £169 million, an increase of 9% or £14 million in the year. Most of this increase relates to volume related costs as a result of the strong loan book growth and associated increase in headcount particularly in Asset and Motor finance. We also continued to invest in infrastructure to support future growth, particularly in the areas of credit, finance and IT. These projects accounted for about a third of the increase in costs on the prior year. As a result the expense/income ratio remains stable at 47%, slightly below its 10 year average of 49%. Bad debt charges reduced to £58 million reflecting improved credit quality in the loan book. Overall operating profit increased 27% to £135 million and return on equity improved to 22%.

The loan book increased 20% in the year benefitting from strong demand for specialist lending and limited competition in many of our markets. The retail loan book increased 15%. This was driven by good growth from Motor finance, reflecting strong demand and wider geographic coverage. However, growth in Premium finance was limited with demand coming mainly from personal lines.

The Commercial loan book increased 18% reflecting strong growth in Asset finance which benefitted from a significant increase in sales capacity over the last three years. However the smaller Invoice finance loan book was flat in a competitive environment.

After several years of slower growth the Property loan book increased 39% to some £800 million. This is principally short term residential development lending and we continue to lend selectively to maintain strong credit quality. Property continues to account for around 20% of the total loan book.

The return on net loan book after expenses and bad debt has continued to improve to 3.6% in the last financial year. We've maintained a strong net interest margin of 9.4%, however, this is a modest reduction on the particularly strong prior year which partly reflects ongoing change in the mix of growth.

The bad debt ratio has continued to improve to 1.5% from 2.1% in the prior year. This is driven by an improvement in Commercial and Property, while bad debts in Retail remained at low levels.

Now turning to the Securities division: Performance in the year was affected by difficult market conditions which affected both Winterflood and Seydler. As a result, overall income reduced by 36% to £101 million. However, expenses also reduced by 26% to £77 million

reflecting the variable cost base of our businesses. But nonetheless adjusted operating profit more than halved to £25 million.

Looking now at the performance of the three businesses in Securities: Winterflood's operating profit reduced from £43 million in the prior year to a ten year low of £16 million. Seydler's operating profit was substantially lower than the prior year at £1 million, reflecting both low volumes and reduced capital markets activity. Mako contributed £7 million of associate income benefitting from a spike in volatility in the first quarter. In September we agreed the phased sale of our investment in Mako and our holding has since reduced from 49 to 27%.

Turning now to Winterflood: Winterflood's income fell to £73 million in the year as a result of low investor risk appetite and reduced trading activity, particularly in the less liquid AIM and small cap stocks. Although client activity reduced, Winterflood's bargains per day were broadly stable at 47,000. This reflects a market-wide reduction in bargain sizes on the order book, resulting in a higher number of order book trades for Winterflood. However, income per bargain reduced to £6.20 due to the lower client trading activity and a shift in mix to more liquid, lower margin stocks. Winterflood's variable cost structure gives us the flexibility to reduce costs and therefore remain profitable in all trading conditions. In the year Winterflood reduced operating expenses by some £24 million or 30% principally through lower performance related costs.

Looking now at Asset Management which has substantially completed its restructuring to focus on the private client market: As a result we're reporting a revised breakdown of income and AuM between advice and investment management. Income on AuM increased 17% to £69 million as a result of acquisitions in the prior year. And overall income increased 9% to £70 million. Adjusted operating expenses increased slightly to £74 million, this is principally the effect of acquisitions which more than offset lower non-recurring investment spend of £2 million. As a result the divisions overall operating loss reduced to £4 million from £9 million last year.

Turning now to Assets under Management: Our strategy is focused on private clients which now represent the vast majority of total AuM of £8.3 billion. Total AuM reduced £1.3 billion in the year reflecting our exit from the institutional business. This includes £1.3 billion of client redemptions and closure of non-core funds and the sale of a property fund management business with around £350 million of AuM. Private clients continue to increase with good organic growth of close to £300 million, as well as acquisitions of a further £300 million. And finally, market movements reduced AuM by around £200 million.

Looking now at the drivers of income per division; Assets under Management and revenue margin: We have two principal types of assets, firstly, advised AuM which was £4.6 billion. This is where we provide financial planning advice or self directed services and includes both our original affluent business and the assets we've acquired in the last two years. Secondly, managed AuM, which was £5.3 billion. This includes assets invested in our own funds or managed on a discretionary basis. These numbers include £1.7 billion of assets which are both advised and managed by us. These assets have come principally from our original affluent business, and for disclosure purposes, they're included in both advised and managed AuM.

Our AuM therefore generates two types of income; income from advice and other services which is generated from our advised AuM. This was £31 million at a margin of 68 basis points, advice revenues were up 75% on the prior year as a result of acquisitions. And Investment Management income which is generated from our managed AuM, this was £38 million at a margin of 62 basis points. These revenues reduced 7% on the prior year due to

the decline in institutional AuM. The £1.7 billion assets which are both advised and managed generate both types of income. Therefore the margin on these assets is higher at well over 100 basis points. As a result the total revenue margin on all assets was 77 basis points. As we migrate clients to our new proposition and increase the assets which are both managed and advised we expect this revenue margin to rise.

Thank you very much. I'll now pass back to Preben.

**Preben Prebensen**

Thank you, Jonathan. During the year we've continued to deliver on the strategic priorities for each of our businesses. In the Banking division we've continued capturing growth opportunities while maintaining our prudent and distinctive business model. In Securities we've maintained our leading market positions and maximised the revenue opportunity in a difficult market. In Asset Management we've now substantially completed our restructuring. And we've continued to manage our financial resources prudently which leaves us well positioned with strong capital, funding and liquidity. During the year our businesses have continued to demonstrate the strength of their business models and their ability to manage and make the most of the current market environment.

Turning first to our largest division, Banking. Our strategic priority for the division remains to capture sustainable growth opportunities while maintaining the distinctive, specialist lending model that supports our long track record of solid returns. We're doing this by firstly expanding our client franchise, growing our loan book while building strong relationships with clients and intermediaries. We achieved a further 20% loan book growth this year with stable or rising market shares across our businesses.

Secondly, maintaining a consistent approach to lending and loan book quality. As I'll shortly demonstrate our key credit metrics and performance ratios have remained solid and consistent despite strong growth in the last three years. And finally, managing our resources for growth. As Jonathan has said this includes ensuring that we have the infrastructure to support growth and maximise long term efficiency. Over the last three years we've strengthened both front office and support resources and infrastructure across the division. This includes a new credit management information system which allows us to more efficiently monitor credit metrics at division, business or individual loan level.

We've also upgraded and consolidated our IT infrastructure and rolled out a single finance system across the division. At the same time we're maintaining the local expertise and integrated model which are central to our customer proposition and business model.

Our conservative risk appetite is unchanged and we're focused on maintaining the key characteristics of our lending as we grow. The overwhelming majority of our loans are secured with prudent loan to value ratios. Our loans are diverse across clients, asset types and sectors, and individual loan sizes are small, with 80% of our loan book less than £1 million. Lending is short term with an average maturity of just over one year.

We refer a lot to the model. This is a picture of the model. Despite strong growth over the past three years the composition of our loan book is broadly unchanged with around 40% coming from Retail, 40% Commercial and 20% Property. And substantially all of our lending is within the UK.

Next I'd like to turn to a slide which again demonstrates the consistency and strength of our performance over the long term. The dislocation in credit markets over the last three years have resulted in strong demand from both businesses and individuals for alternative forms of

financing as well as limited supply of such financing. During this period we've grown our loan book by an average of 20% per annum and also strengthened the client franchises that support this growth. Our business is built on relationships with small businesses, either lending directly to them, for example in Asset Finance where we have relationships with over 20,000 customers, or lending through them as distributors, such as in Motor finance where we work with around 9,000 dealers, an increase from 6,000 three years ago.

Our business continues to generate high levels of repeat business, demonstrating the importance of the long term relationships we build with clients and intermediaries. And history has shown that these relationships benefit us when market conditions change. This is demonstrated by the fact that even over a ten year period our compound average loan growth rate is 11%, which includes the easy credit years.

Our business model has a long term track record of solid returns through the cycle, as demonstrated by both the strength and consistency of our key performance ratios. This includes a ten year average return on the net loan book of 3.6% and a return on equity which has averaged 19% over ten years, and was 12% even in the 2009 downturn.

Over the last three years of strong growth we've continued to lend selectively, with a focus on protecting our model. We do not know how long current conditions will continue, but we do know that we have a model that can withstand changes in the external environment. Regardless of market conditions our priority will be continuing to protect our model.

Turning now to Securities, where we've continued to focus on our strategic priorities despite the difficult market conditions of the last 12 months. Firstly, to maximise revenue opportunities in all market conditions. Second, to manage costs and maximise profitability. And finally to maintain leadership through the cycle. Winterflood's primary focus has remained on managing its core UK market making business through the recent difficult market conditions. It also continues to selectively explore opportunities to increase trading flow, including through its office in the US and through Winterflood Business Services, which offers outsourced execution and custody. Seydler's performance has been affected by difficult conditions in the German market, but remains well positioned for any recovery.

Turning now to look in more detail at Winterflood. Performance has been affected by a difficult trading environment throughout this period. This includes significant economic uncertainty, a market-wide reduction in retail risk appetite, with retail volumes down 25% year on year overall, and an industry-wide reduction in primary activity. As the largest market maker to the UK retail broker market, Winterflood's performance is sensitive to market conditions and to retail trading activity in particular. However its resilient business model has enabled it to manage the impact of the current external market relatively well, particularly through, first, the ability to trade profitably in all market conditions. This reflects the experience of our people with around 100 skilled traders, as well as our conservative risk appetite and tight trading limits, and is demonstrated by only 13 loss days for the year as a whole out of 253 trading days.

Second, its leadership position in the UK and relationships with over 300 stockbrokers, and the diversity of its product and market coverage which means we'll benefit from any increase in retail trading activity regardless of what part of the market it occurs.

And third the flexibility of its cost base. Winterflood's primary focus is on market making and we do not carry the fixed costs associated with primary activity. The cost base is tied to trading revenue, through settlement costs, and variable compensation, and, as Jonathan said, in the last year costs reduced 30% while we maintained our capacity and leading market position.

The strength of Winterflood's model is demonstrated by the long term history of its performance shown on this slide. Winterflood's performance in the 2012 financial year is comparable to the previous low in 2002, and its number of loss days is lower than 2002 but comparable to both 2003 and 2008. Going forward we'll continue to maximise profits in all market conditions. Although we have yet to see any signs of a sustainable increase in market activity, we're confident that the business remains well placed to benefit from any future recovery.

Finally turning to Asset Management where we've substantially completed our restructuring. As you know the change in this division over the last three years has been significant as we've reshaped it to focus on the private client market and build an integrated business combining advice and investment management. We've sold non-core businesses, we've bought private client businesses, and we've launched new client propositions and a new technology platform to support them. We've also significantly strengthened our distribution capacity and support functions to manage a growing business.

The last financial year marked the final step in building this single business. We launched our advice proposition and our new technology platform for advised and self-directed clients. We also completed our range of investment management products, which now constitutes one of the most comprehensive propositions in the private client market. We now offer a full range of directly invested, multi-manager, and passive funds, separately managed accounts and bespoke portfolio management, all leveraging the same institutional quality investment process. Fund performance since launch has been strong. All five of our direct funds have achieved a first or second quartile performance in the year to 30th June and over half our high net worth portfolios have achieved a first quartile performance over the same period. We've completed our investment in the business, including the planned non-recurring investment of 20 million over three years in the new client propositions and platform technology.

And we're also seeing good initial signs that the business model is working. In the last financial year we had net inflows of nearly 300 million in the private client business, an increase on last year. And this growth came both from our own advisers and from sales of our investment products through third party IFAs. Both of these distribution channels are areas we've focused on and invested in, including expanding our national adviser base to nearly 130 advisers today. And most importantly the feedback on our new integrated advice proposition has been strong from both our advisers and clients, and the pipeline of new advised business is growing day by day.

We're also gaining an increasing level of external endorsement, including several awards in the last year such as the PAM Award for high net worth service quality.

So with our business model, proposition, and technology in place we're now positioned to return to profitability. We set out on the slide some high level performance metrics which demonstrate our clear path to profitability over the next few years. Firstly we expect the overall revenue margin to rise from 77 basis points today to around 100 basis points by the 2015 financial year.

This will initially be driven principally by sales of the new proposition to our existing advised clients, particularly those that we've acquired, to capture investment management as well as advice income from these clients. As Jonathan said we have 1.7 billion of AuM which are both managed and advised, and own a revenue margin well over 100 basis points, and which principally relate to our original affluent business. We also have around three billion of AuM which are advised but not managed, and principally come from the businesses we've acquired in the last two years. Over the next few years we expect to migrate a portion of

these assets into the new proposition, making them both advised and managed, and therefore earning a higher revenue margin. Over time we'll also increase sales of our new proposition to new clients. This will further increase the share of assets which are both managed and advised, and also benefit the margin through a higher level of initial advice fees. As a result from the 2014 financial year we expect new business flows to accelerate as we increasingly focus on new clients. And finally we expect the operating margin to increase with a combination of revenue growth and by stabilising the fixed cost base.

We're confident that this business is now positioned to return to profitability and we only need a relatively small increase in revenue to get there. However by the 2015 financial year, with a revenue margin of 100 basis points we currently expect to achieve an operating margin of at least 15%, which is comfortably within the industry range. And we expect this margin to continue to rise thereafter as we add further scale.

These are our current expectations and they're clearly subject to market conditions. We look forward to updating you on our progress over the next few years.

Now concluding with the outlook. We remain confident in the business model and position of each of our businesses. In the Banking division we continue to see prospects for loan book and profit growth. In Securities difficult trading conditions have continued since the year end but we remain well positioned. And in Asset Management we're now positioned to move into profitability during the current financial year. Overall the Group is well positioned for the year.

Thank you very much for listening, we now look forward to answering any questions that you may have. As well as Jonathan and myself we have with us in the front row the heads of our businesses; Stephen Hodges, Julian Palfreyman and Martin Andrew, who are also happy to take questions. Can I just remind you to state your name and company before asking a question.

**Questions and Answer session**

**Question 1**

**Arnaud Giblat – UBS**

Two questions on the Bank. With regards to growth and the prospects of growth, I understand that most of the growth this year has come from taking market share. Is there still scope to take further market share and continue growing the book at double digits or are you seeing any other areas for growth, that there may be new products?

And the second question is on the cost base. Are you mostly done with expanding your infrastructure and your front office staff, or are there further plans to continue that?

**Answer: Preben Prebensen**

Let me start on the market share one and I can hand over to Stephen if there are any supplementary questions on that. And then Jonathan perhaps you could address the cost base issue.

In terms of market share, we have continued to increase our market share. If you look at the Motor finance book in the last year our market share of point of sale used car financing went from 11% to 13%, and that's grown quite consistently over the last three years. In Asset

finance it ticked up a bit from around 6% to around 7%. And in the other areas, Property we have less than 1% of the market for the nation, if you like, but we are a very specialised property lender and so we have a significant position in the residential property development area, but it's hard to measure in terms of national market share. Will we continue to increase share or will we see growth from other sources? I think there is scope to increase share a bit, certainly in Asset finance, possibly in Motor. Property will continue to grow where share is not really relevant but growth prospects are good actually, for us, so I think those three areas are clearly noteworthy. They have been the growth engine in the last year and I think they'll probably continue.

And in terms of new products we do add new specialist niche lending products when we develop them and they're appropriate and they fit with our model. Do you want to add anything to that, Stephen?

**Answer: Stephen Hodges, CEO Banking**

No, I think that summarises it well. The only point I would make is that we remain a relatively small player in a very large, deep market. We have plenty of room in most of our specialist niche areas to continue to grow market share, and we see good prospects for continued growth.

**Answer: Preben Prebensen**

Jonathan, do you want to address the Bank cost and how long that's going to be what it is.

**Answer: Jonathan Howell**

Yes Arnaud, in terms of the bank costs, we saw a 14 million increase during the year, so just looking at what's happened over the last 12 months, then we'll just look forward subsequently.

As we've discussed before, and as you know, we have a high level of variable costs in our Bank. That's driven by a high local presence that we have in our banking model, the high level of staff experience and skill which we have out at the customer interface. And the generally high touch in most of our lending book. What does that do for us? It means that we are very vigilant on the quality of the assets, on the LTVs that we achieve, and very importantly on the NIM, so that helps drive the banking model. And that will continue, that high variable volume related cost element will continue to grow as the Bank grows.

Over the last 12 months of that £14 million increase, about two thirds of it, just under 10 million, came from those volume related costs, that was a head count increase, in particular in Motor and Asset, the two quickest growing parts of the Bank, head count increase of about 150 people. The remainder, about five million of the costs, related to this ongoing investment in infrastructure. There's been a bit of catch-up over the last two to three years. There's been a building of best of breed and scalability for growth going forward. And we anticipate that that element of the cost increase will probably continue for this current year that we are in, but thereafter we'd hope that that would begin to come to an end and, on the assumption of continued loan book growth, the opportunity to sort of stabilise or improve the cost income ratio from about 12 to 18 months out.

**Question 2**

**Robin Savage – Canaccord**

Following on from that question, if you look at the first half/second half split of costs in the Banking division, I think the first half of last year, 2011, was 73 million, then 82, 85, then 84. So in other words it looks like the expenses have been pretty flat first half/second half. I assume that looking forward you are looking at an increase in costs, but what sort of level of costs ought we to be looking at going forward?

**Answer: Jonathan Howell**

In terms of going forward, some of it is growth dependent, those volume costs, and depending upon the rate of growth, and you can look back over the last two to three years, that element could not be too dissimilar from what we've seen. But as I say, in terms of the investment spend that we're making, much of which is being expensed, some of which is being capitalised but it's on a very short amortisation term, you will see that running through in the next 18 months or so we begin to see that to reduce.

**Further question**

Okay, and could I ask a question on the Asset Management side? I understand from Rathbones that letters have been sent to clients of Cavanagh, who Rathbone were managing the money and they were being advised by Cavanagh, that letters had been sent to them. I wonder whether you can update us as to the progress, how many of those clients have actually decided to move their money and how many of them have not?

**Answer: Preben Prebensen**

Well a sure answer is that we're right in the middle of that process but Martin do you want to elaborate on that?

**Answer: Martin Andrew, CEO Asset Management**

Only to the extent that we have served notice on our relationship with Rathbones, that's in the public domain. We are in the process of communicating with our clients at the moment, that process is ongoing, and that's all I can tell you at the moment. We're looking to talk to those clients to advise them as appropriate on whether they're interested in moving to Close Brothers Asset Management or staying with Rathbones, or moving elsewhere.

**Preben Prebensen**

This was always going to be part of the process after the purchase of Cavanagh, it's being done absolutely on the timing and being done appropriately with a mind to treating them well and being mindful of all of the issues around that but it's marching according to the plans that we had and have had since we bought Cavanagh.

**Question 3**

**Gary Greenwood – Shore Capital**

I just had a couple of questions around the balance sheet on the Banking business and the one thing that struck me was the core tier 1 ratio in the full year was much stronger than

certainly I expected and that was mainly due to the fact that risk weighted assets only increased by about 2% in the second half of the year, versus loan book increase of about 10% so firstly I was just wondering if you could explain why that had happened.

**Preben Prebensen**

Good question.

**Answer: Jonathan Howell**

Yeah good question. I mean first of all just taking year end to year end before I get on to your particular question Gary. We've just reported a core tier 1 ratio of 12.8% and that's just slightly down on the 13.1% at the previous year end and that was as a result of a net increase in risk weighted assets of 8% during the year and there are two components to that. One is a £700m increase in the loan book and that's at a risk weighting of 80 to 90%, offset in part by a reduction in some of the Treasury assets that we're holding. We're maintaining a high level of high quality liquid assets but we have been running off over the last three years, as I highlighted in my speech, the FRNs and CDs and so we saw those reduce by about £300m or £400m during the course of the year, and that's at a risk weighting of 30 to 40%.

So if you take those two movements plus a slight reduction in op risk in Winterfloods which is just based on a three year average of top line income, that gives you that slight reduction year on year. Now to get to your point, there was an increase from the first half result to the full year result and that's driven by a number of factors which are cyclical on an annual basis and is what we've seen happen over the last three years to varying degrees. And the elements of difference are that the largest difference is created by the dividend payment. So in the first half of the year you're paying the previous year's final dividend and in the second half of the year you're paying your interim dividend. And if you take our last year that was £38m of dividend payments in the first half and £20m of dividend payments in the second half, and so that sort of reduces your capital ratio at the half year when looked at against the full year.

The second key element is, in an environment where the loan book is growing all things being equal, loan book, growth rate, NIM and bad debts, if all those things are equal you will have a higher level of profitability in the second half than you will in the first half because that's off a higher starting base in terms of loan book.

So those are the two normal factors which means that actually the half year level is sometimes about the same or slightly down on the year end level of capital. That's had a slightly bigger effect this year as a result of the op risk in Winterfloods, which is only calculated on an annual basis and hence at the year end, and also the change in Treasury assets that I referred to earlier on and much of that happened in the second half rather than in the first half.

So if you take those four factors that will indicate roughly what's happened over the last 12 months. And yes we expect the same type of effect to happen, certainly the first two elements of that to happen, in the year in the year coming forward, so the dividend effect will be there and the loan book growth effect will be there with the impact on profitability.

**Further question**

**Gary Greenwood**

Okay thanks. Second question was just regarding funding and the loan to deposit ratios obviously rising, total funding to lending is reducing, I'm just trying to get a feel for what sort of capacity you've got to keep growing the loan book, clearly you've got the capital there but in terms of the funding at what point do you get uncomfortable with those ratios? Do you target a loan to deposit ratio as such? How do you think about that?

**Answer: Jonathan Howell**

First of all the funding situation is very strong for us at the moment, it's probably the strongest it's been since I've been at Close Brothers which is now over four years. During the course of the year our aggregate funding increased by £500 million up to £5.9 billion and the key elements of that as I set out was the £500 million increase in securitisation that we did during the course of the year, £300 million net increase in deposits, moved to £3.4 billion and in addition to that another £300 million or £400 million of wholesale facilities, that we were able to renew or replace during the course of the year. So we've got a broad funding capability, securitisation, bond and deposits and that we see continuing at the moment.

In terms of how best to look at it the measure of loan to deposit ratio is not necessarily so relevant to us because we are the inverse of a normal bank and so therefore our normal model is to borrow long and lend short. And so I think the critical measure for us is looking at the amount of term funding that we have compared to the average term of the loan book. And in that case you'll see during the course of the last 12 months you'll see that our term funding, that is funding with an average term of more than 12 months left on it at the balance sheet date, that's gone from £2.5 billion to £2.8 billion during the course of the year and that has meant that our loan book in terms of term funding is covered by about two thirds, about 67% to be precise. That compares to 72% at the previous year end and that is the type of level that we think is appropriate. And that's the type of level we think is sustainable and appropriate for our model. And when then you just dig the layer beneath that and you look at the average term on that funding against the average term on the loan book that's 27 months in terms of funding compared to 14 months on the loan book.

And there will be a slight fluctuation and variation around those terms or around that percentage that I've given you just depending upon when our funding falls due and when and how we replace it. So for instance you'll have seen us reduce the average term on that funding, principally because we took out a £500 million securitisation with a term of just over 12 months and that pulled us down to 27 months from over 30 months previously.

So you will continue to see that fluctuation but that the key measure is to keep just looking at that term funding as a proportion to the loan book.

**Further question**

**Gary Greenwood**

Okay so I just have one last question just on the margin. I think you said the reduction in margin was partly due to mix, I was just wondering what the other part was?

**Answer: Jonathan Howell**

Yes I mean just to put margin in context as we've said previously if you go back over the previous ten years the margin has varied in a window between 8½ and 10% and so when you go back two years when we reported 9.8%, I remember saying at the time I think in this meeting, look it will start coming down from here and it has and we're down to 9.4%. The average net interest margin for the ten years is 9.2%, so we're still above that ten year average.

The margin reduced over the last 12 months partly from the change and mix. So we saw faster growth in those parts of the loan book with a slightly lower net interest margin and that's principally Property and Motor. But also just at the margins you can be affected by the cost of funds or alternatively just selective bits of competition that we see around the loan book which will change that mix and our ability to pass on any margin increase.

Now going forwards there are three factors. One is the mix of growth which is the one we've just talked about. I think the other factor that we need to take into account is that over the last two to three months we've just seen the cost of funding increase slightly and therefore to what extent we're able to pass that on or not. And that's the difference between LIBOR +250 to LIBOR +280 and that's come in over the last three to four months. And then lastly, and probably the most difficult to predict and probably potentially the one that we need to keep looking at over the longer term, is competition.

Now if you take the net of all of those three variable factors we would say that the risk on net interest margin in the forthcoming period is on the down side, very much on the downside. Those three factors all potentially which will be a slight headwind that we're running into in net interest margin.

**Question 4**

**Robin Savage – Canaccord**

Following on from that last question, looking at the analysis in Note 2 in the Banking division other income seems to have fallen from £96 million to £90 million and I wonder whether you can just comment on that?

**Answer: Jonathan Howell**

Yes a very good question. The whole drive in our Treasury activities over the last three years really has been to do two things. One is to provide the appropriate level, the appropriate term and the appropriate cost of funding to the loan book and to provide funding for the high quality liquid assets. Those are the assets that the FSA recognise as proper liquidity requirements and those are the assets that we, in our own planning and targeting and risk appetite assessment, target. And those assets were about £800 million which were gilts and deposits with the Bank of England.

The reduction in Treasury income therefore is completely compatible with that and is the run off in CDs and FRNs. And I said in my speech you'll see that over the last three years we've seen our FRN balance come down from I think about £700 million or £800 million and that type of range down to £100m, and similarly we've seen the CD balance come down from over £600 million. The FRN portfolio we will continue to run off. Going forward we will continue to hold a bit of surplus liquidity in CDs. But that drop in income is very much down to that fundamental shift, to just holding the high quality liquidity, lower yielding, lower income liquidity, in Treasury.

**Preben Prebensen**

And indeed the role of treasury is now very clearly twofold, to fund the loan book and to maintain high quality liquidity and not beyond that.

**Question 5**

**Philip Middleton – Merrill Lynch**

I just wonder could you say a little bit please about how Winterflood has shaped up post the period end, because within that you've had a difficult August and potentially some livelier moments as well? Obviously you can't call a turn on the basis of a couple of good days but I just wondered if you could give some narrative around your experience post Draghi?

**Answer: Preben Prebensen**

Yeah let me try and do that and Julian can certainly pitch in. I think August absolutely quiet, pretty unremarkable other than the fact that it was quiet, and it was quiet for all the reasons that we can all cite. So it was very much a continuation of that trend. And in September I think we did have some livelier days and a lively week. I think the middle week of September immediately after some of those policy initiatives were announced was quite a bit livelier. Since then it's gotten a little bit quieter again. So I think most importantly we can't call any kind of trend on this. In the first seven weeks it's not really breaking out from the pattern of the last however many months. Julian, anything to add to that?

**Julian Palfreyman, CEO Winterflood Securities**

Not really. Obviously August was influenced as well by the Olympics, traditionally a quiet month anyway, apart from last year when it was a very volatile August. But it is too early to call a change in the trend I think at the moment.

**Preben Prebensen**

I think the only other thing I would say which you often say is that it can change very quickly. So last year, also as a result of LTRO and other things like that, we saw an increase in risk appetite so we had a livelier February and March. We had a lively week in September. These things happen quite quickly when they happen.

**Question 6**

**Nitin Arora – HSBC**

A couple of questions. Firstly on Banking, you talked about net interest margins it's still above your long term average and more likely to go down from here than up. Similarly if you were to look at the bad debts they are now slightly below the long term average so how would you see the trend there, stabilising or going up from there?

And separately on Asset Management there's a nice take up in margins from 71 to 77 bps, I was wondering in the managed and advised portion which is £1.7 billion, how has that changed over the last one year if you could give some break up there?

**Answer: Preben Prebensen**

Okay do we want to start with Asset Management and then get back to the Bank just in terms of the margin change the 71 to 77 or whether or not that's inside the managed and advised?

**Martin Andrew**

The change in the margin so far is primarily business mix change and a little bit of the early days of increased growth of that integrated proposition. So I mean when we look at the 1.7 the bulk of that is, either Preben or Jonathan, one of them said, I forget which one, the bulk of that is our original affluent business and rounding I would say around 0.1 of that is the early sales of our new integrated proposition which we expect to grow over time. So the margin growth you've seen so far is not really driven, thus far, by the sales of the integrated proposition.

**Preben Prebensen**

But that's where we expect it to come going forward.

**Martin Andrew**

Going forwards yeah.

**Preben Prebensen**

Can I just address your bad debt question in terms of where we go from here? So we're at 1.5% and the ten year average is 1.6%. I think the only comment we can make is that if you look at the three principal parts of the Bank; Retail, Commercial and Property, Retail was quick to move down and is at very low levels at the moment. So we don't really see that it's going to get better from here because it's just at such low levels. Commercial was the next to move down and I think that's moving predictably at this point in the cycle and so we could see that kind of perform as should be expected and there's still a little bit of momentum there. And Property was very late to move down. It's the kind of long late cycle business that we have and so we still see momentum in property in terms of bad debts.

**Jonathan Howell**

But if I could add to that it's just far too early at this stage to sort of call for the year and if anything if you look and you just take what Preben has said if you just look at the retail part of the book that has been at all-time record lows now for two years and if anything the risk on that is for bad debts to be on the up side. But equally on the other end of the scale property we've seen that come down, that is at the back end of the cycle and if anything there's potentially opportunities for that to improve.

So you take the whole picture overall and it's quite difficult to give any clear direction or say. And the only reason I talk about retail potentially, you know, risk of that going up it's just like two years ago when the NIM was up at 9.8% or 10% for a half year and I said, look on the law of averages that's got to come down.

**Preben Prebensen**

And that's why we give the ten year average for bad debts it's so important to know that that is actually at 1.6. That's the best reference points we have. We haven't changed the model. We haven't changed the broad composition. We haven't changed the nature of what we do and we have a ten year average to look at in terms of trying to see what the predictable trend would be.

Any other questions? Thank you very much.