Close Brothers Group plc

Full Year Results 2022

Edited transcript*

Tuesday 27th September 2022

Adrian Sainsbury, Group Chief Executive Officer

Good morning and welcome to the presentation of Close Brothers' 2022 full-year results. I'll start with some brief reflections on our full year performance. I'll then hand over to Mike, who will take you through our financials. I'll then come back and provide our business and strategy updates. After that, Eddy Reynolds, our CEO of CBAM, will provide some insights on our continued growth aspirations for that business.

You can ask a question at the end of the session, either via the webcast or over the telephone link, and you can provide the questions on the webcast during or after the session.

We're now transitioning to a post-pandemic world and adapting to a more flexible work environment. At the same time, our customers and colleagues are facing an uncertain set of economic circumstances.

Against this backdrop, we've delivered a solid performance overall, with a Return on opening equity of 10.6% and a return on average tangible equity of 12.2%.

The Banking division has performed well, with a strong net interest margin of 7.8% and loan book growth of 5% year-on-year. In the second half, we saw loan book growth of 3% as momentum picked up.

In Asset Management, we generated net inflows of 5% despite volatile market conditions, which benchmarks us above the majority of our peers.

Winterflood's performance has been impacted by cyclicality in the trading business following an exceptionally strong trading performance in 2021.

We've maintained strong capital, funding and liquidity positions, with a CET1 capital ratio of 14.6% at 31 July 2022.

We're also pleased to propose a full year dividend of 66p per share, up 10% on the prior year, returning to the pre-pandemic level.

* This transcript has been edited to correct minor factual inaccuracies.

We've continued to successfully deliver against our strategic priorities to "Protect", "Grow" and "Sustain" our business model. The disciplined application of our prudent underwriting and pricing is key. This is demonstrated by our strong underlying credit performance, as well as our high net interest margin.

The prudent management of the group's financial resources is a core part of our business model. We're considering the further optimisation of our capital structure, including the issuance of debt capital market securities if appropriate, targeting a CET1 capital ratio range of 12 – 13% over the medium term.

We remain committed to investing to protect our business model through the cycle. Our multi-year investment programmes are progressing well and delivering tangible benefits across our businesses.

We remain focused on maximising disciplined growth and have achieved over £400 million of loan book growth in the year, with strong margins in Banking. We've made significant progress in identifying both incremental and new growth areas.

On our sustainability agenda, we've also further developed our climate strategy, which supports our ambition of 'helping people and businesses transition towards a lower carbon future'. We've enhanced our understanding of our impact on the environment, covering not just our operational emissions, but also the implications across our financed activities. I'm pleased to say that we've recently joined as a signatory to the Net Zero Banking Alliance.

I'll now hand on to Mike to talk us through our financial results.

Mike Morgan, Group Finance Director

Thank you Adrian, and good morning everyone.

Looking firstly at the income statement. Income was marginally down at £936 million, with growth across Banking and Asset Management, offset by a reduction in Winterflood.

Expenses were broadly stable at £598 million as lower variable costs in Winterflood were offset by continued investment in Banking and higher staff costs in both the Bank and Asset Management, to reflect the inflationary environment.

Impairment charges increased to £103 million, corresponding to a bad debt ratio of 1.2%, which is broadly in line with our long-term average and the prior year's ratio, and this included the impact of updated assumptions for Novitas.

The effective tax rate increased to 29%, reflecting the impact from revaluations of deferred tax assets, and we achieved adjusted EPS of 112p, down 21% on the prior year.

The board is proposing a 44p final dividend, resulting in a full year dividend of 66p per share. This reflects our solid performance, strong capital position and continued confidence in our business model.

Moving on to the divisional performance. Overall, adjusted operating profit was down 13% at £235 million.

In Banking, profit was up 7% to £227 million, as 10% income growth more than offset the continued investment in our key strategic programmes, higher staff costs and impairment

charges. We saw significantly higher profits in Commercial, which benefited from particularly strong loan book growth, with Retail and Property down year-on-year.

In Asset Management, we generated positive net inflows, although profit reduced 8% to £22 million, as income was impacted by falling markets and staff costs increased as we continue to grow the business.

And Winterflood's performance was impacted by cyclicality, as we saw a 77% reduction in profit to £14 million, following a market wide slowdown in trading activity and falling markets.

Turning to the Banking division. We saw 10% growth in income to £693 million, reflecting good loan book growth and a strong margin. The net interest margin of 7.8% increased marginally on the prior year, primarily driven by the lower cost of funds.

Expenses also rose by 10% to £363 million as we continued to invest in strategic programmes, increased salaries and saw higher performance-driven compensation.

Impairment charges increased to £103 million, which corresponds to a bad debt ratio of 1.2%, broadly in line with our long-term average. This included the impact of updated assumptions for Novitas. Excluding Novitas, the bad debt ratio was 0.5%, reflecting the release of Covid-19 provisions and the ongoing review of provisions and coverage across our loan portfolios.

As a result, adjusted operating profit increased 7% to £227 million.

Moving onto the loan book, which reached £9.1 billion, as we continued to see good demand across our businesses. The 2% growth we saw in the first half was supplemented by 3% in H2 as momentum picked up.

Our Commercial book saw growth of 9% overall, reflecting strong new business volumes in Asset Finance, as well as increased utilisation in Invoice Finance, with our core Invoice Finance book up 29%.

Motor Finance increased by 7%, with high new business levels reflecting continued demand for used cars and supported by benefits from our investment in the business.

The Premium book declined as we saw lower demand for the funding of insurance policies from consumers.

Property also contracted overall, despite growing in the second half of the year, as high repayments more than offset drawdowns, driven by the buoyant UK housing market.

We are actively working to identify incremental and new opportunities in both our existing and adjacent markets. We are confident in the outlook for the loan book over both the short and medium term and remain well positioned to deliver disciplined growth.

Now onto our net interest margin. Our specialist, relationship-driven model and focus on pricing over volume growth support our strong net interest margin.

We reported a NIM of 7.8%, a marginal increase on the prior year, primarily reflecting a reduction in our cost of funds to 1.3%. And with the UK base rate now above 1%, no further impact is expected from the Property floors in respect of future rate rises.

Looking forward, we are well positioned to maintain a strong net interest margin, although the trajectory of our NIM will depend on our ability to pass on further rate increases to our customers. We also expect our cost of funds to continue to rise in light of the increasing cost of customer deposits to reflect higher interest rates.

Moving onto costs in the Bank. There was a 10% increase overall, as we continued to progress our investment programmes to support our strategic objectives to protect, grow and sustain our business model.

Business-as-Usual costs were up 7%, driven by higher staff costs as we increased wages in light of the inflationary environment and reflecting performance-driven compensation.

Investment costs increased 22% to £84 million as we progressed our strategic programmes and incurred related depreciation. And Adrian will talk more about these programmes shortly.

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

Turning now to our credit performance. The bad debt ratio of 1.2% was broadly in line with our long-term average and included the impact of updated assumptions for Novitas.

Excluding Novitas, the bad debt ratio was 0.5% and this reflected the release of Covid-19 provisions and the ongoing review of provisions and coverage across our portfolios, as well as higher provisions to take into account the outlook.

Our provision coverage ratio excluding Novitas was slightly down at 1.9%.

Whilst we are not yet seeing a significant impact from rising inflation and interest rates on customers' credit performance, we are alert to the highly uncertain external environment. Nevertheless, we remain confident in our loan book, which is predominantly secured or structurally protected, prudently underwritten and diverse.

Moving on to Asset Management. Operating income increased 6% to £148 million, reflecting positive net inflows and market performance in the first half of the year, despite falling markets and its impact on wider sentiment in the second half.

The revenue margin decreased to 87bps, as we saw a higher proportion of flows into our lower margin products.

Expenses rose 9% to £126 million, reflecting higher staff costs and new hires to support our growth strategy.

As a result, adjusted operating profit decreased 8% to £22 million and the operating margin decreased to 15%.

Over the year, we continued to attract client assets, generating net inflows of 5%, despite volatile market conditions. Managed assets decreased 2% to £15.3 billion, as negative market movements more than offset net inflows. Total client assets were down 3% to £16.6 billion.

Now turning to Winterflood, where cyclicality in the trading business negatively impacted performance. Income was down 48% to £95 million, reflecting a market wide slowdown in trading activity and a change in the mix of trading volumes, which has been exacerbated by falling markets.

WBS delivered another strong performance, with income up 12% to £10 million.

Expenses reduced significantly by 33% to £81 million, reflecting lower variable compensation following reduced activity.

And as a result, operating profit declined 77% to £14 million, following the exceptional highs of the prior year.

We also navigated the market volatility well, benefiting from the expertise of traders and their strong focus on risk management, which resulted in eight loss days for the year, seven of which were in the second half.

Building on this market volatility, we saw the AIM Index down 24% this year and the worst period for US stocks in more than 50 years. This exacerbated the decline in monthly operating income seen over the last year, which was also driven in part by the market wide slowdown in retail trading activity.

Trading volumes have reduced since the highs experienced during the pandemic, but remain ahead of pre-Covid levels. However, total bargains in our higher margin markets of AIM and Small Cap remain down significantly on the prior year, reflecting the change in mix in our trading volumes.

Nevertheless, Winterflood is well placed to continue trading profitably and take advantage of returning investor appetite.

Moving now onto our balance sheet. We maintained a strong balance sheet and continued to adopt our prudent approach to managing financial resources.

Our total funding increased to £11.6 billion and is well in excess of the loan book. We continued to "borrow long and lend short" with the average maturity of allocated funding at 21 months, ahead of the loan book at 17 months.

We manage liquidity conservatively, with our Liquidity Coverage Ratio at 924%.

We had £1.9 billion of treasury assets at 31st July, with the majority held with the Bank of England.

Our established presence across wholesale markets, along with our mix of retail and non-retail deposits, supports our diverse funding base. And our credit ratings remain strong, helping support our ongoing issuance plans.

We reduced our cost of funds, down around 10bps on last year, but an increase on the half year position as the cost of customer deposits has increased.

Our deposit platform continues to support the growth and diversification of our funding base. We have grown retail deposits by 16% year-on-year and now have approximately £350 million in Fixed Rate ISAs.

Looking now at our strong capital position, where we have significant headroom above the minimum requirements.

Our transitional CET1 capital ratio was 14.6%, down from 15.8% at 31 July 2021. The movement mainly reflected a 75bps reduction relating to regulatory impacts, and an increase in RWAs due to loan book growth. And this was partly offset by retained profit.

Our leverage ratio remained strong at 12.0%.

And following the submission of our initial IRB application in December 2020, we have transitioned to Phase 2 of the process. The next phase commences in October, although the timing remains under the direction of the PRA.

And finally turning to our capital framework. The prudent management of our financial resources is a core part of our business model.

Our primary objective is to deploy capital and to support disciplined loan book growth in Banking, and to make the most of strategic growth opportunities.

The board remains committed to our dividend policy, which aims to provide sustainable dividend growth year-on-year, while maintaining a prudent level of dividend cover.

Further capital distributions to shareholders will be considered depending on future opportunities.

We are considering the further optimisation of our capital structure, including the issuance of debt capital market securities if appropriate, and are targeting a CET1 capital ratio range of 12% to 13% over the medium term.

However, in the short term, we would expect to operate above this target range in light of the heightened macroeconomic uncertainty and potential growth opportunities available to us.

So thank you, and I will now hand back over to Adrian.

Adrian Sainsbury

Thank you, Mike.

Our proven and resilient business model differentiates us and puts us in a very strong position to continue to deliver on our long-term track record. Our performance is supported by our consistent pricing and underwriting criteria, by the prudent management of our financial resources, and by our diversified portfolio of businesses, with specialist expertise and focus on service and relationships.

We've a distinctive culture at Close Brothers. A relentless customer focus and a long-term approach to everything we do are embedded throughout our organisation. And I truly believe that this is one of the most important strengths of our model.

Once again, these strengths have supported our solid performance against a backdrop of continued market uncertainty.

The proposed full-year dividend of 66p marks a return to the pre-pandemic level.

We see it as essential to invest through-the-cycle, to protect our model and enhance its strengths. And we're seeing our multi-year investment programmes deliver tangible benefits across the organisation.

We view these programmes through two lenses: first, those focused on maximising our income generation. For example, in Motor Finance, our investment in digital and technology has allowed us to make the most of opportunities in the second hand car market. We've launched a unique proposition in partnership with AutoTrader and have developed APIs to provide our finance offering at various points of the customer journey.

Our Asset Finance transformation programme enabled us to build, test and launch our CBILS portal within 10 days and we're developing a new customer portal.

In Asset Management, our improved client portal and mobile app have enhanced client experience, driving a substantial reduction in the amount of paper we use.

Similarly, our customer deposit platform has enabled us to broaden our Savings product offering, driving significant growth in our Retail deposits and supporting lower cost of funds, whilst also delivering excellent service for our customers.

Our second investment lens focuses on resilience and efficiency.

In Asset Management, we've automated a number of key processes, improving capacity and scalability, whilst also reducing risk.

In Asset Finance, we're developing a solution which enables integration directly into service providers, such as credit reference agencies.

Our investment in IRB will help further enhance our credit risk management and governance and will also optimise our capital efficiency, helping to provide strategic flexibility in the longer term.

Finally, our investments in cyber and data centres are part of a programme to continually enhance our business and operational resilience.

We remain focused on maximising disciplined growth in our existing and adjacent markets. This year, we've conducted a further review of potential growth opportunities and have a strong pipeline of identified target areas that are aligned and fit well with our business model.

In Banking, we recognise the significant opportunity in broadening our sustainable finance offering as the UK heads towards a net zero carbon economy, building on the success of the renewables finance team we established in 2014. In particular, we're seeing growth across a range of battery electric vehicles, predominantly through our Commercial business, as the UK's economy moves to electrify all forms of transport. We've set ourselves an initial green finance ambition to provide £1 billion of funding for battery electric vehicles over the next five years.

We're exploring a number of incremental and adjacent growth opportunities across our Banking businesses. For example, in Property, we're piloting a specialist buy-to-let extension to our existing Property bridging finance customers. And have extended our sector coverage in Asset Finance with the addition of specialist materials handling and agricultural equipment teams. In Invoice Finance, we continue to grow in the Asset Based Lending space, including identifying syndication opportunities and partnering with other lenders.

In Asset Management, we're well aligned with the long-term trends in the wealth management space and we'll continue to invest to support its growth potential. We remain committed to building on our excellent track record of increasing client assets organically, through our successful hiring strategy, as well as through in-fill acquisitions.

We also see significant growth potential in WBS, a business built on our award-winning and highly scalable proprietary technology. We've a solid pipeline of clients to support continued growth in income and assets under administration in this business.

Our responsibility is fundamental to our purpose, strategy and culture. We've an important role to play in helping people and businesses transition to a lower carbon future. And I'm particularly pleased with the significant progress we've made this year in developing our climate strategy.

We've carried out a comprehensive assessment of our indirect Scope 3 emissions across all categories of operational emissions, as well as an initial assessment of financed emissions, focusing on our loan book.

As highlighted previously, we're supportive of the goals of the Paris Agreement to achieve net zero by 2050 and we've set ourselves ambitious targets for our operational emissions. We're now setting ourselves a wider and longer-term ambition to align our operational and attributable greenhouse gas emissions from our lending and investment portfolios with pathways to net zero by 2050.

I'm pleased to say that we've recently joined 116 banks globally as a signatory to the Net Zero Banking Alliance.

We've also made excellent progress in CBAM, having recently become a signatory to the UK Stewardship Code. CBAM will also be making a commitment to join the Net Zero Asset Managers initiative soon.

I'll now take you through an update on each of our banking businesses and how they're maximising current market opportunities.

We've achieved industry leading growth rates in both Asset and Invoice Finance, naturally at our price point and underwriting standards. I'm pleased to say that our Asset Finance business recently won the annual Asset Finance Connect Award for the 'Strongest loan book growth in one year'. In addition, our Invoice Finance business won a Business Moneyfacts Award for the ninth consecutive year.

In Asset Finance, we've continued to see strong new business volumes, particularly in Transport, Broker, Contract Hire and Energy. Our Asset Finance business is well positioned to capitalise on continued demand for asset finance. We've recently expanded our coverage with the hiring of expert agricultural and materials handling teams and are increasing our focus on financing green and transition assets, such as the battery energy storage system pictured on this slide.

In Invoice Finance, we've seen high sales volumes and improved utilisation, with SME customer numbers increasing, supporting strong loan book growth in the core Invoice Finance business, as well as record profit years delivered by our Irish Commercial Finance business and Brewery Rentals. Invoice Finance utilisation has improved but remains slightly below those levels seen prior to Covid-19. We expect growth in this business to closely follow economic conditions.

In Motor Finance, high new business volumes have continued, reflecting ongoing demand in the used car market, as well as the benefits from our investment in the sales capability. The Motor Finance transformation programme has enabled us to broaden our offering as I mentioned previously. Our award-winning forecourt insights proposition provides dealers with real-time data and market insights, in partnership with AutoTrader. And we've developed APIs that connect us with strategic partners including iVendi and AutoTrader, so that we can provide our finance offering at various points in the customer's journey.

We also continue to explore opportunities for growth through the shift to Alternatively Fuelled Vehicles as they become more prevalent over time, although penetration of AFVs currently remains low in the second hand car market.

In Premium Finance, we've seen lower demand for the funding of insurance policies from consumers, although new business volumes have been strong from commercial customers. We've launched new insight tools in the Premium business, which have enhanced our offering for brokers and helped support their decision-making. We expect demand for the funding for insurance policies to increase given the current macroeconomic environment.

In Property, the UK market remains buoyant, with strong house sales volumes leading to high repayments by our customers. Despite strong new business levels, drawdowns were more than offset by high levels of repayments.

Our undrawn pipeline is strong at over £1 billion and we've continued to see good demand in the regions outside of London and the South East. We've made good progress building out our bridging finance offering and have partnered with Travis Perkins to establish a facility allowing SMEs to access supplies and materials directly. And we're also piloting a specialist buy-to-let extension for our existing Property bridging finance customers, which is a natural evolution of our expertise in the Property Finance space and well aligned with our Banking business model and risk appetite.

Winterflood continues to diversify its revenue streams, balancing the volatility seen in the trading business.

WBS, our in-house developed business, has delivered another strong performance, generating £10.2 million of income and growing its assets under administration to £7.2 billion, with impressive net inflows of £1.3 billion. Our award-winning proprietary technology is highly scalable and we see significant growth potential in WBS. We've a solid pipeline of clients expected to increase assets under administration to in excess of £10 billion in the 2023 financial year.

I'd also like to welcome Bradley Dyer as our recently appointed chief executive of Winterflood. Bradley joined Winterflood in 2004, is highly experienced and has outstanding knowledge of the business. He's well placed to lead Winterflood in the next phase of its growth and development. I'd like to also thank Phil Yarrow for his significant contribution to the group and Winterflood, following his decision to retire after 22 years at Winterflood.

Close Brothers Asset Management is an example of the high-quality expertise of our people and their specialist fields, which underpins our success in wealth management. We see significant potential to continue CBAM's growth development, which further supports the group's resilience and growth over the longer term.

I'd now like to introduce you to Eddy Reynolds, CBAM's chief executive. Eddy took over the leadership of our Asset Management division from Martin Andrew in March and brings with him outstanding experience and knowledge to lead our talented team at CBAM. He'll now take you through how we're planning to build on the strong track record of growth of our wealth management business.

Eddy Reynolds, CBAM Chief Executive Officer

Thank you Adrian, and good morning everyone.

It has now been six months since I took over the leadership of this fantastic business, and I have been extremely impressed by the talented team here. And having completed a strategic review, I am very optimistic regarding CBAM's growth potential.

Our strategy isn't changing, but we will be more tightly focussed on those key activities that move our strategy forward, drive growth and add value.

We have three drivers of growth: underlying organic growth, the purchase of Financial Advice businesses, and the hiring of established Bespoke Investment Managers. These drivers add up to deliver our net inflows target, which we expect to be between six and 10%. They also provide diversification of flows, adding resilience.

Over the past year, and despite the significant impact of exceptionally volatile markets upon investor sentiment, we continued to attract new clients and new assets. Net inflows of 5% placed us ahead of our peers' average.

Looking at our inorganic growth drivers, one part of CBAM that has particularly impressed me is our Bespoke Investment Management service. Against a background where many of our competitors continue to change their operating models in ways that alienated their investment managers, for example by centralising and commoditising portfolio construction, CBAM continues to manage its client portfolios locally.

Most importantly, our managers act as both investment manager and relationship manager for their clients, a model which is greatly valued by both manager and client. This makes CBAM an obvious and extremely alternative home for Bespoke Investment Managers who are being disrupted at their current employment. We intend to fully capitalise upon this, and plan to accelerate the rate of hiring of quality Bespoke Investment Management accordingly.

Our other inorganic growth driver is the purchase of Financial Advice businesses and we offer a great home for talented Financial Advisers and their clients, in part because we manage one of the broadest ranges of investment solutions for advised clients, from managed and passive fund-of-funds, to IHT-efficient portfolios of AIM shares, to our locally managed bespoke portfolios.

This allows our Financial Advisers to meet more of the varied needs of our clients without going outside the group. We can therefore deliver both excellent client outcomes and a higher revenue yield for the business.

Despite having successfully bought and integrated several Adviser businesses in the past, we have been relatively quiet with regards to acquisitions recently, while we have focused on upgrading our technology and business processes. Now that we have completed much of this work, and our Adviser systems are operating effectively and are scalable, we are now accelerating our efforts to identify and acquire more Financial Advice businesses.

Taking these plans together, it is fair to say that we intend the next period of CBAM's story to be a growth story.

At the same time, costs will continue to be tightly managed while we continue to improve our operating environment. Some of the resources that were aligned to upgrading our technical foundations have now been realigned to supporting our growth plan. We will further increase efficiency, enhance functionality and improve the client experience to ensure that we can capitalise on the opportunities that are in front of us.

Before concluding, I would also like to mention sustainability. We continue to broaden our range of sustainable investment propositions, with our sustainable funds gaining further traction. We have mobilised a Sustainability Programme with dedicated initiatives to embed the Principles for Responsible Investment and stewardship across all areas of our business. And we have recently become a signatory to the UK Stewardship Code.

I firmly believe that the asset management industry can play an important role in facilitating the transition to a low carbon economy. And CBAM will therefore also be committing to the Net Zero Asset Managers initiative.

The structural shift in the UK from corporate to personal balance sheets, as defined benefit pensions and annuities are replaced by individually managed savings, provides huge opportunities for the Wealth Management industry. With our hiring and business purchase strategies, we are extremely well positioned to grow, and to grow faster than the market.

Thank you.

Adrian Sainsbury, Group Chief Executive Officer

Thank you, Eddy.

We've delivered a solid performance this year and we start the 2023 financial year with confidence, whilst recognising the highly uncertain external environment.

Although we're alert to the impact of rising inflation and interest rates on our customers and the wider financial market conditions, we remain well placed to continue delivering on our long track record of profitability and disciplined growth.

Thank you, and we will now be happy to take any questions you may have.

Q&A session

Question 1

Benjamin Toms, RBC

Good morning, thank you for taking my questions.

Firstly, on costs in the Banking division. There was an increase there of about 10% year-on-year. Is the 10% growth for this year a good benchmark for 2023 or FY23? And how should we think about weighing up the fact that you expect investment programmes to stabilise vs. wage inflation pressure, which is presumably higher than 2022, where you only saw a 3% average increase in salaries?

And then secondly, on the investment management margin, that's reduced in your Asset Management division with flows including a high proportion of lower margin products. Can you give any more colour on this dynamic – is competition impacting pricing, is there any J-curve effects with more pain up front and should margins see a recovery from here? Thank you.

Adrian Sainsbury

Thanks, Benjamin.

Firstly, on the cost side. You're right, the Bank costs did increase 10% year-on-year. I think that's worth noting, the income was strong at 10% as well, so we did achieve neutral leverage in the Bank this year. And the BAU costs in the Bank broadly 7% on the year, whilst investment went higher as Mike said. You're quite correct, the investment programmes that I touched on, they're delivering various income benefits and resilience benefits and they've been delivering that strong NIM and the 10% top line growth. As Mike said, the cost of those programmes is broadly stabilising, but depreciation will still come through.

You mentioned the wage inflation was 3% in 2022. It was actually higher than that – what we announced was, for the first time, we did a mid-year rise, which for us is January 22, broadly 3% in the Bank for Bank and Group individuals, members, employees, apart from senior staff who didn't receive that increase. And then we did our normal salary rise in July 22 as well. So clearly those will work through.

There's undoubtedly a lot of uncertainty, of course, as we've highlighted in the external environment and there's still high inflation in the environment and that's feeding through to employment markets as we see. As Mike touched on, we've got significant discipline on BAU cost management and we see the delivery of operational leverage, positive operational leverage, as important to us over the medium term.

In investment management, you commented on the margin, the operating margin falling down a bit or reducing this year. That's in part, of course, because of the falling markets that have hit the income line slightly, as we highlighted. There is a mix part of this as well, as you rightly point out. So if we have the advice as well as the investment services, clearly we get a bigger return there than if we just do the investment on its own. And clearly on some of the infill acquisitions we've had, we bought some advisory businesses where we can add on the investment services afterwards, and that works well for us.

It is a competitive market and we'll have all seen some of the passive players who are clearly charging, let's say, less than 30 basis points for their services. We're providing a high value service, as Eddy commented, we get very good customer scores here, very good NPS scores, that show our customers value that full service. And Eddy explained the whole value of the proposition. I fully expect the operating margin to improve as we move to more stable markets.

Question 2

Ed Firth, KBW

Morning everybody. I have two questions, if I may.

The first one was just about the broader market environment, in that we're seeing a lot of the big players making a lot of money on the funding side of the balance sheet by effectively not passing on really any of the rate rises at all. And I assume that gives them quite a competitive advantage when it comes to pricing of assets. So, I guess my first question is, how are you seeing the environment for pricing of assets? Are we seeing the pass throughs coming through, are you able to reprice and how confident are you that you can maintain that competitive position at an acceptable price going forward? If that question makes sense, I hope.

Adrian Sainsbury

OK, thanks Ed. I thought you mentioned there were two questions, so I'll answer this one and then if you got a second one, please do follow up.

Clearly we are in a market of sustained interest rate rises, so broadly in the last ten months we've gone from 10 basis points to 225 basis points. And you rightly point out, the major banks have the benefit of non-interest bearing current accounts. We provide specialist products, not undifferentiated products like current accounts, so we don't have that benefit of the interest rate rises not being passed on to current account customers.

I'd start with where our NIM is as we stand today, Mike showed it at 7.8%. The UK banking market average is less than 3% and the slide we put up also shows what we've seen in recent years as the interest rates have started to come through - Full Year 20, 7.5%, Full Year 21 NIM of 7.7 and last year 7.8. Our market is wholly focussed or our approach is

wholly focussed, our model, on maintaining pricing discipline and maintaining credit quality, and the volume is an output of that.

Now the volume output of that at 5% in Full Year 22, I see as a wholly reasonable loan book output. And what we will see next year will largely depend on the competitive environment and how our expert teams compete in that competitive environment. We will be looking to pass on the interest rate rises that the market is expecting to happen over the coming months and year, perhaps, up towards whether it's four or 5% the market is looking at the moment. We'll look at look to pass that on and we've had success of that at previous times.

Some of our business, some of our loan books are variable rate and therefore the rate rise passes on immediately, whereas some of our books also are at fixed rates. Those books are all fully hedged, match funded, etc. So our back book of £9.1 billion is protected on the price effectively, and we pass on the price rises as they happen in the market as we go forward. There can be some time lag in passing on those price rises in Motor and Asset Finance. But as I mentioned, our whole approach is to pass those rises on into the market.

Your wider question as well talks about the competition and we'll have to wait and see whether all competitors pass on or don't pass on or partially pass on. Our model, as I say, is to pass on those rises. Ed, I'm not sure if you had a second question or not, you mentioned.

Ed Firth, KBW

Yes, I did. I did have another question. But just to be clear, so you say volume is an output. I mean, as of today, you're comfortable the momentum of the business is still on, is still, you know, where you saw it at the end of last year?

Adrian Sainsbury

Absolutely. So, as we mentioned, the loan book growth in Half One of 22 was 1.9 and it was 3% in Half Two. If you look at that acceleration, in Half One when we got the 1.9, we still had the benefit of the CBILS scheme that has supported our SME growth during lockdown. That fell away and effectively our loan book accelerated in Half Two.

As Mike highlighted, our Property business returned to growth in the loan book for the first time in a couple of years. So four of our five loan books grew. The Motor and Asset Finance businesses, 7% last year both of them, and Invoice Finance 29%. If you compare those to our peers in those markets, that's pretty good growth. And yes, I'm comfortable with the growth opportunities we have in each business that we've touched on, and I'm happy to go through in more detail if that's helpful.

Ed Firth, KBW

No, no, that's great. And so my second question was, we've obviously seen this huge shift in interest rate expectations even just over the last two or three days. I mean, do you have a sense internally at how much your customers can take in terms of interest rate rises? And at what stage should we be starting to worry about their ability to pay these higher rates?

Adrian Sainsbury

So I'd answer that in a couple of ways because some of the products we have can be substitutional to help consumers. So for example, in our Premium Finance business, we

mentioned that the number of personal customers taking out the insurance product has dropped a little in the last year. That may be because consumers have done relatively well in lockdown, they may have built up a savings balance. So when their household insurance comes for the year, let's say for £600, they paid it on the credit card and then have paid it straight off from their savings. My point is, in this environment, it may be an economic decision for them to move back to spreading the cost of their insurance policy over ten months.

Our Motor Finance product can be a substitution. We're all aware of the supply challenges in the new car market and the boom that's effectively happened in used car volumes over, since lockdown started really. And our price point there is a used car typically £7,000 at three years old, and it may be that a customer is coming off their PCP deal, they can't source a new car, they might think it's too expensive for them with the cost of living impact, so they might switch on to our product. So, I would say it's a wider question than just the rate.

But yes, we've had rates above these levels before. If you look back all the way to the pre-GFC, at that time our NIM was around 9%. That was the last time that base rates really went up, 2006, 2007. If you look back at that time in 2007, our year there, the base rate went from 4.5 to 5.75%, we maintained our NIM at 9%. We'll be looking to use our expertise, how we work in each of our markets, the experts we have working with customers, to show the value of our offering. And that's how I believe that we will still provide the volume that I've just alluded to. But absolutely, the volume is an output of the credit quality and the price that we'll sustain.

Mike Morgan

Just one thing I would add there is that in a number of books, the repayments are fixed, so the increase in interest rates doesn't increase the repayment that you would say, make in our Motor business or in our Asset Finance business. But nevertheless, increasing interest rates will put pressure on consumers and other lending relationships that they may have. So it may not be our lending per say, but other things that are going on in their lives.

Question 3

Jason Napier, UBS

Good morning. Thank you for taking my questions. I'm sure we'll get on to other questions around credit quality, so I wanted to ask two around capital if I could.

The first of which is, the 60% payout ratio in 2022 was a touch higher than the market had expected and you've reiterated plans to grow the dividend into a year that many of us would regard as a fairly uncertain one. So, I'm just wondering what the sort of puts and takes there might be. Would you be content paying a much higher proportion of earnings out as dividend in 2023 if necessary?

And then secondly, on the new capital target, the 12 to 13% CET1 target, there is reference there in the text to the return of that capital being subject to, sort of opportunities. My guess would be that that would be around the velocity of loan growth, but I wonder whether you could expand on what opportunities you'd be referring to in that area. Thanks very much.

Adrian Sainsbury

Thanks, Jason. So I'll start with the dividend one first. And you're quite right, the 60% payout, a 1.7 times dividend cover. If you look back over our history, our progressive dividend policy has been highly important to us and also to our shareholders. And we've seen cover fluctuate between 1.5 and 2.3 times. As I mention in the outlook statement at the end, we're confident where we are. I've just mentioned, I'm also confident in our loan book position and the outlook there as well. So, we're confident in our progressive dividend strategy for next year. And the range I've talked about, the 1.5 and 2.3, I think is a useful guide there.

If I look at the CET1 and the new guidance that we're giving on the CET1 range of 12 to 13%, really our allocation strategy is really threefold. Number one, we see the best use of our capital investing in our loan book for loan book growth. We've said previously that around 7% loan book growth, all other things being equal, that's broadly capital neutral at our NIM.

Now, the environment is highly, highly discontinuity at the moment. It's uncertain. There could be opportunity for us in this as interest rates rise quite clearly. In previous periods of discontinuity, after the GFC in 2009, after the dot.com bust in 2001, the early property crash in the 90s, that's where Close Brothers and it's model of pricing, underwriting quality, has stood out and we saw growth periods there of towards 20% plus, at our margins and our credit quality. Now quite clearly our loan book is dramatically bigger than it was before before the GFC, we're at £9.1 billion now, at the time of the GFC it was broadly £2 billion. So we have a bigger hamster wheel to grow. So I don't see a 20% opportunity coming, but there could be a better opportunity than we saw last year, quite clearly. So best use of our capital, number one. And that's the purpose of this capital strategy as well, is first of all, to look at loan book growth.

After that are the strategic opportunities. And you're quite right, one of those will be, if there is a credit downturn, being able to support our customers at the right time, lean into the opportunity in line with the playbooks that we've talked about and use our capital there. We also have some other growth opportunities that we've talked about. Eddy talked about infill acquisitions that we've seen in CBAM. If they have a premium, there's a small cost to CET1 of that type of acquisition. And clearly in this sort of environment where we are seeing more market stress, more funding dislocation, there could be some players in the market that find that more difficult for their funding, particularly if they don't have retail deposits. That could provide us with some interesting extension opportunities, depending on how that plays out. So, I think having the powder available for that, keeping our powder dry, could be important.

And then number three is if those two aren't required, if we continue at, let's say, the 5% loan book growth we saw last year, we continue to accrete capital, and therefore, if we issue the capital instrument we talked about, we would have surplus capital and we'd need to consider how we use that at that time. That isn't a decision we've made today. My preference is quite clearly, number one, grow the loan book at our NIM, and number two, some of the strategic opportunities.

Question 4

Gary Greenwood, Shore Capital

Three questions here. The first question is you mentioned plans to pilot a specialist buy-to-let product. Can you talk a bit more about your thinking behind that? Will this become a crowded market given HSBC and Barclays also appear to be moving into this space?

Second question, are you surprised that Premium Finance hasn't bounced back following the lifting of Covid restrictions?

And the third question, what sort of operating margin does WBS make, i.e. how much is it contributing to divisional profit?

Adrian Sainsbury

Thanks, Gary. So on the specialist buy-to-let, you may remember at our Investor Day in June 21, it's on the webcast, we put up our ''Model Fit Assessment Framework. It had broadly eight criteria of the magic of Close Brothers, the Close Brothers model. We've done some growth work, as I mentioned in my piece, and we've identified the specialist buy-to-let market as a potential opportunity for us. I say specialist because I think when you refer to Barclays and HSBC, that would be more the wider buy-to-let market, more the undifferentiated. So, we see that could be a good opportunity for us. It fits with a number of the criteria on our Model Fit Assessment Framework. Although it would be at lower margin, clearly we think the cost of risk across the cycle would also be lower than we experience, typically at 1.1%.

We're doing it as a pilot or a test within our Property Finance business, our bridging finance business, Commercial Acceptances, where we have clients already, experts in the property market who've traded with us for a long time, but we only offer the product for a certain period, let's say five years, and we might be able to extend that product by using this buy-to-let offering. So we're looking to grow our expertise there, using the property expertise we already have, in a test and learn type of strategy.

Your second question on Premium Finance. I would say I was a little bit surprised with what happened in lockdown, but I'd say, to be honest, I was surprised with a number of things that happened with our books on lockdown. I wouldn't have expected Invoice to go back, let's say 40% in April and May 2020, and then, as I said, it's bounced quite quickly. What happened that was a surprise to me with Premium was a lot of consumers benefited perhaps from the furlough scheme, not having to go to work at that stage, working from home, and therefore saw their savings balance accrete. And as I touched on earlier, that's led to a number of consumers not renewing with us at that time and actually choosing to pay up front, maybe on a credit card and then clearing it with their savings account. My contention is, though, that in this more cost of living crisis, when those bills arrive for consumers, their car insurance, £600, their home insurance, £700, they might now need to spread the cost of that more than paying it upfront. And I think that's where the opportunity and my expectation, we should see more a positive trend in that loan book going forward.

And lastly on WBS, we're not disclosing the operating margin on that business, but what I would say, is it's highly scalable, it's more a platform business, whereas the other Winterflood business is more trading. So it's more endowment-like. So the AuA we've grown, the plus 16% to £7.2 billion in the latest year, and the guidance we've given that we're confident with the client pipeline we have, the AUA will go through £10 billion in Full Year 23.

It's a highly scalable business, so our margin will accrete, although that's not a number we're disclosing.

Thank you for your questions and your time this morning. We're now out of time for the webcast. I look forward to us being face-to-face in future. Many thanks and good day.