Close Brothers
Modern Merchant Banking

Close Brothers Group plc

Preliminary Results 2021

Verbatim transcript

Tuesday 28th September 2021

Adrian Sainsbury, Group Chief Executive Officer

Good morning and welcome to Close Brothers Full Year 2021 results presentation. I'll start with some reflections on the key elements of our performance this year. I'll then hand over to Mike to talk through our financials and I'll come back to give an update on our business and strategy.

You ask a question at the end either via the telephone conference line or alternatively, via the webcast.

Covid-19 continued to present challenges and impact our customers and businesses in the last year. Against this backdrop, we delivered a strong financial and operational performance. Both income and pre-provision profit were up by 10%. Adjusted operating profit increased by 88% and we delivered a strong ROE of 14.5%, up from 8% in the prior year. We delivered growth of 10.9% in our loan book, the fastest rate of growth since 2016, with a strong net interest margin of 7.7%.

Impairment charges were down on the prior year, reflecting a strong underlying credit performance across the Commercial, Retail and Property businesses, as well as a reduction in Covid-19 provisions.

Asset Management achieved good net inflows and grew managed assets and Winterflood delivered an exceptional trading performance, capitalising on the high trading volumes for most of the year. We've maintained a strong capital, funding and liquidity position, which provides us significant flexibility for growth.

The board is recommending a final dividend of 42p which will take our full-year dividend to 60p per share. This reflects the group's strong performance in the year and continued confidence in our business model and financial position.

We continued to be agile in our response to the crisis and maintained the support for our people and customers. Our people are critical to our success and I've been impressed by their hard work and commitment. The strong results in this year's employee opinion survey, recently showcased at our Investor Event, highlight our distinctive culture, which is a key contributor to our success.

We've also supported our customers when they needed us most. We've offered over 130,000 Covid-19 related concessions and lent over £1.1 billion to SMEs under the government support schemes since the beginning of the pandemic. I'm pleased to now see most of these customers moving forward as the economy reopens.

Face-to-face interaction and excellence in customer service remain key features of our model. We remain committed to progressing our model as our people return to the workplace and implement our future ways of working, which will take into account the different needs of customers and our business, to suit the diverse nature of our group.

This year we've also evolved our strategic priorities to protect, grow and sustain our business model. We've made good progress on our multi-year investment programmes, which are crucial to protect and take our model forward. We've also made the most of our current opportunities, as evidenced by our strong performance and loan book growth this year.

Importantly, we're delivering disciplined growth, with a continuous focus on consistent pricing and maintenance of our credit underwriting standards and in line with our "Model Fit Assessment Framework". This is a set of criteria we continuously evaluate our businesses and initiatives against to ensure they are aligned with the key attributes of our model.

This framework was used as a key tool in our strategic review of Novitas, a provider of loans for legal proceedings that we acquired in 2017. This business sits within Commercial and represents around 2% of our total net loan book. We concluded that the overall risk profile of the business is no longer compatible with our long-term strategy and risk appetite and, in July, we decided to permanently stop writing new business in Novitas and to withdraw from the legal services financing market.

On our sustainability agenda, I'm pleased to say that we've achieved good progress this year and continue to assess the opportunities arising in the sustainable finance space.

Throughout the year, our priority has been to ensure the group remained in a strong position, while making the most of the opportunities.

There remains a lot of uncertainty in the trajectory of the economic recovery and whilst we still do not know how the next phase of the cycle will take shape, we operationally and strategically are ready for it.

I'll now handover to Mike for the Financial Update.

Mike Morgan, Group Finance Director

Thank you Adrian, and good morning everyone.

As Adrian said, we have delivered a strong performance in evolving market conditions. Group adjusted operating profit was up 88% to £271 million, returning to pre-pandemic levels. This reflects high new business volumes and significantly lower impairment charges in Banking, good net inflows in Close Brothers Asset Management and strong trading volumes in Winterflood.

Before bad debt provisions, profit increased 10% to £361 million and we delivered a strong return on opening equity of 14.5%.

We maintained a strong capital, funding and liquidity position as our CET1 capital ratio increased to 15.8%, providing significant headroom against minimum regulatory requirements.

And as Adrian mentioned, the board is proposing a 42p final dividend, resulting in a full year dividend of 60p per share.

In Banking, we achieved 10.9% loan book growth and a strong net interest margin of 7.7%, with a bad debt ratio of 1.1%.

In Close Brothers Asset Management, we saw net inflows of 7% and in Winterflood, average daily bargains were 101k over the year.

Looking first at the income statement. Income increased 10% to £953 million with top-line growth across all divisions, driven by high new business volumes and a strong NIM, as well as particularly strong trading income in Winterflood.

Expenses were up 10% in line with income to £592 million as we continued to invest across our businesses and saw higher variable costs in Winterflood. And at the pre provision level, we also delivered profit growth of 10%, highlighting our strong performance.

Impairment charges were significantly lower at £90 million reflecting a strong underlying credit performance across Commercial, Retail and Property, as well as a reduction in Covid-19 provisions.

And we achieved an 88% increase in our adjusted EPS to 140.4p, surpassing the level achieved prior to Covid-19.

Looking further at the income statement and touching on the exceptional and other adjusting items we have recognised this year.

As Adrian said, this year, we conducted a strategic review of Novitas and made the decision to permanently cease lending to new customers across all of Novitas' products. As a result of this decision, we have recorded an impairment charge of £12.1 million relating to the write down of all of the goodwill allocated to Novitas, as well as a £10.1 million impairment charge for all of the remaining value of intangible assets recognised on acquisition.

We have also recognised an exceptional gain of £20.8 million reflecting a VAT refund from HMRC. This follows a judgment by the EU Court of Justice and is a one-off cash credit relating to hire purchase agreements in the Motor and Asset Finance businesses from 2009 to 2020.

So including these items, we delivered operating profit before tax of £265 million, which is also up 88% on the prior year, the same growth rate as pre-adjusted items.

Our effective tax rate for the year was 23.8%, which reflects the Banking surcharge applying to most of the group's profits, partly offset by an increase in deferred tax assets.

And after tax, we delivered £202 million of profit attributable to shareholders, an 85% increase on the prior year.

Moving on to the divisional performance. Overall, adjusted operating profit increased 88% to £271 million as we saw growth in income and profits across all our divisions.

In Banking, profit was up 114% to £213 million, reflecting strong income growth and lower impairment charges, partly offset by continued investment in our key strategic programmes. We saw significantly higher profits across Commercial, Retail and Property, and strong loan book growth driven by high new business volumes.

In Asset Management, we saw good net inflows and a 16% increase in profit to £24 million, with the growth in income more than offsetting the cost of new hires to support the long-term growth strategy.

Winterflood delivered an exceptionally strong trading performance, with profit increasing 27% to £61 million.

And now onto our balance sheet. We maintained a strong balance sheet and remain focused on our prudent approach to managing financial resources.

Our total funding increased to £11.1 billion, well in excess of the loan book. We continued to “borrow long and lend short” with the average maturity of allocated funding at 24 months, ahead of the loan book at 17 months.

We manage liquidity conservatively and have maintained elevated levels throughout Covid-19, enabling us to maximise any opportunities available in spite of the uncertainty.

We had £1.8 billion of treasury assets at 31st July 2021, with the majority held with the Bank of England.

Our established presence in all wholesale markets, along with our mix of retail and non-retail deposits, supports our diverse funding base.

During the year, we issued a £350 million, 10-year senior unsecured bond and raised £200 million of subordinated debt in the form of Tier 2, with both transactions significantly oversubscribed.

Our credit ratings remain strong, with the group upgraded to A2/P1 and the banking subsidiary rated Aa3 by Moody’s. Our active management of debt capital markets and strong ratings help support our ongoing issuance plans.

And we reduced our cost of funds during the year, supported by our diversified funding strategy and continued access across wholesale and retail markets.

Our online savings platform continues to support the growth and diversification of our funding base. We now have over 39,000 customers on our online platform.

Turning to our capital position. The prudent management of capital is a core part of our model and has been key in enabling us to continue supporting customers, clients and colleagues, whilst providing flexibility for growth.

Our CET1 capital ratio increased 170bps to 15.8%, with significant headroom against minimum regulatory requirements and reflects strong growth in profits as well as modest growth in risk weighted assets, reflecting the high proportion of CBILS lending, which carries a low risk weighting.

The CET1 ratio includes a circa 50bps benefit from the treatment of software assets, which will reverse on 1st January 2022, as well as 110bps benefit from transitional IFRS 9 arrangements. The underlying CET1 ratio excluding these benefits is 14.2%.

Our leverage ratio remained strong at 11.8%.

And as planned, we submitted our initial IRB application to the PRA in December. The Motor, Property and Energy portfolios were submitted with the initial application, with the other businesses to follow in future years. We are progressing through the first phase of the application process and continue to work with the regulator to support their review.

Moving on to the Banking division, which delivered a strong performance overall.

We saw 8% growth in income to £632 million, driven by strong new business volumes and loan book growth. We maintained our focus on pricing discipline, allowing us to deliver a strong NIM of 7.7%. Expenses increased 8% to £329 million as we continued to invest in strategic programmes to protect, grow and sustain the model, whilst maintaining a rigorous focus on cost management.

Impairment charges decreased significantly, down 51% to £90 million. The bad debt ratio of 1.1%. reflects a significant increase in provisions against the Novitas loan book, while the underlying credit performance of the rest of the portfolio remained strong.

As a result, adjusted operating profit increased 114% to £213 million.

Moving onto the loan book, which saw strong growth of 10.9% to £8.4 billion, and representing the highest absolute growth since 2016. The growth was broad-based, coming in particular from the Commercial business, where the loan book was up 30% overall, reflecting strong demand supported by CBILS in Asset Finance and improving utilisation in Invoice Finance. We also saw 10% growth in the Motor Finance business which delivered record new business volumes.

However, both the Premium and Property books declined over the year, with customer behaviour in the Premium business impacted by Covid-19 restrictions and Property seeing high levels of repayments driven by strong unit sales.

Now onto our net interest margin. Our business model is built on pricing discipline, supporting a consistently strong net interest margin compared to our sector. We reported a NIM of 7.7%, a pick-up from the 7.5% seen in the 2020 financial year, as we maintained our pricing discipline and benefited from a continuing reduction in our cost of funds. And given our specialist, relationship-driven model and consistent, disciplined pricing, we are well positioned to maintain a strong NIM going forward.

Moving onto costs, there was an 8% overall increase, reflecting the cost of continued investment in our strategic programmes.

We maintained our focus on cost discipline to create investment capacity, with Business-as-Usual costs up 3%, reflecting an increase in performance-related compensation.

Investment costs increased to £74 million as we focus on protecting, growing and sustaining the model, and Adrian will touch more on how we are doing this through our strategic investment programmes shortly. As previously indicated, we expect spend on investment programmes to stabilise over the next financial years, although the P&L cost will continue to rise as related depreciation flows through.

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

We experienced strong underlying credit performance across Commercial, Retail and Property. We believe this represents an appropriate level of provision, reflecting the improved but continued uncertain external environment.

We remain confident in our loan book, which is predominantly secured or structurally protected, prudently underwritten, diverse and supported by the deep expertise of our people.

Moving on to Asset Management. We delivered good net inflows of 7%, reflecting continued demand for our integrated wealth and investment management services and good inflows from our recent portfolio manager hires.

Managed assets increased 24% to £15.6 billion, driven by positive market movements and net inflows. Total client assets were also up 24% to £17.0 billion, including the benefit of a small acquisition.

Adjusted operating profit increased 16% to £24 million as 9% growth in operating income more than offset an 8% increase in expenses, mainly reflecting the investment in new hires in line with our growth strategy.

The revenue margin decreased to 91bps, as we saw lower advice and dealing fees and a higher levels of flows into our lower margin products, with the operating margin up slightly to 17%.

And now turning to Winterflood, where Philip and the team have done an impressive job in the last year. The business has delivered an exceptionally strong trading performance, with income up 20% to £182 million, the highest total revenue in the last 20 years, although activity has slowed over recent months. Expenses increased 17% to £121 million, driven by higher variable compensation and settlement costs as a result of increased trading activity.

As a result, operating profit increased 27% to £61 million, the highest level since 2000. And the expertise and experience of our traders meant they were able to successfully manage risk, with only one loss day in the year despite significant market volatility.

So, as you can see, we delivered a strong financial performance and made the most of the opportunities arising as the economy recovers from the Covid-19 crisis.

I will now hand over to Adrian. Thank you very much.

Adrian Sainsbury

Thanks, Mike.

Our strategy, our culture and our responsibility are the foundations for our long-term track record and I spoke of these at length at our recent investor event. They enable us to deliver on our purpose: to help the people and businesses of Britain thrive over the long term.

Also at our recent Investor Event, I talked in detail about what differentiates us and puts us in a very strong place 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 portfolios of businesses, with specialist expertise and focus on service and relationships in each of the sectors we operate in.

We've a distinctive culture at Close Brothers, a relentless customer focus and 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 strong performance this year, enabling us to maintain our strong track record of excellence in customer service, loan book growth, profitability and dividend progression.

It's essential that we continue to protect our model to ensure its core, differentiating strengths aren't compromised.

This year, we maintained our agile response to Covid-19 and continued to benefit from playbooks and simulations run in prior years.

As demonstrated by our strong balance sheet, liquidity and funding position, we remain committed to preserving our financial strength and resources to fund our strategy.

And we continued to invest to protect our business model, enhancing our operational and financial resilience. We've made good progress on our multi-year investment programmes, which included the submission of our initial IRB application to the PRA in December. Our Motor and Asset Finance transformation programmes, as well as the technology projects in Asset Management, have also helped us strengthen our customer proposition and drive operational efficiency in those businesses.

We've a strong track record of progressive lending throughout the cycle and as evidenced by our strong performance this year, we're focused on maximising the growth opportunities in each of our businesses, while maintaining the discipline of our model.

In Banking, our Commercial businesses are well positioned to capitalise on continued demand for asset financing. And we expect the growth trajectory in Invoice Finance to follow the economic recovery. In Motor Finance, the fundamentals in the second-hand car market remain strong and we are exploring opportunities for growth through the shift to Alternatively Fuelled Vehicles. Following the removal of Covid-19 restrictions, we would expect demand for the funding of motor insurance policies to recover in Premium Finance. And finally in Property, our pipeline of undrawn commitments remains solid and the loan book trajectory will continue to reflect the rate of repayments, as well as new business volumes.

We continue to build on our growth track record and take our business forward. In the last year we have, for example, extended the product offering in our Savings franchise, launching a 35 Day Retail Notice Account and Fixed Rate Cash ISA products. These new products supported an increase in customer deposits of 12% in the year.

In Asset Management, we've completed the acquisition a small IFA business with circa £300m of client assets.

Winterflood Business Services has continued to grow its assets under administration.

And across all our businesses, we will look to further penetrate our existing market niches and we'll also continue to assess opportunities for potential new initiatives.

These opportunities are assessed against our 'Model Fit Assessment Framework'. We look for businesses with attributes such as a strong margin, long-term prospects, and the same expert, relationship-based and specialist traits which define our model. We also look for cultural fit, as it's important that we keep intact our responsible way of doing business.

As previously mentioned, during the year, we also took the decision to withdraw from the legal services market following a strategic review of the Novitas business. We've concluded that recent credit performance and the overall risk profile of Novitas no longer fits the Close Brothers model.

It's important that we maintain this disciplined approach to reviewing our businesses and opportunities as it will ensure we preserve the attributes that will continue to generate value for our shareholders.

Our long-term approach defines the way we do business. It's reflected in how we invest for growth and also in how we operate our business and engage with all of our stakeholders.

We recognise that to help the people and businesses of Britain thrive over the long term, we've a responsibility to help address the social, economic and environmental challenges facing our business, employees and customers, now and into the future. And we've made good progress on helping address these issues this year. We announced several new sustainable objectives and I'm encouraged by our progress so far.

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

Within Commercial, we've seen strong new business volumes, supported by good demand under CBILS, particularly in Asset Finance. The chart on the left shows how strong those volumes have been, with record levels achieved during the year as the business leans into the current demand from SMEs.

As at 31st July 2021, we had lent over £1 billion across approximately 6,000 loans, predominantly under CBILS, with minimal amounts lent under the Bounce Back Loan Scheme. We made a strategic decision to focus on CBILS over Bounce Back, as it enabled us to apply normal underwriting and pricing discipline and focus on supporting our existing customers.

The Asset Finance Transformation programme continues to progress well and to deliver tangible benefits. This included, for example, an agile response during the pandemic as we were able to build, test and launch our CBILS portal within 10 days.

In Invoice Finance, we've seen good new business volumes, although utilisation levels remain below those seen prior to Covid. As the economy recovers, we expect growth in this business to closely follow the economic activity.

In Motor, we've seen strong new business volumes reflecting pent up demand, an increasing use of finance in the second hand car market and also the benefits from our own investment in sales capability. This investment allowed our sales teams to adapt and become more agile. It maximised our remote lending capability so we could continue supporting motor dealers during lockdown, in a period of strong demand for second hand car financing.

As illustrated on the chart, new business volumes have remained high, and above the pre-Covid average. We've outperformed the market since restrictions began easing and have achieved record volumes in the year. We continue to see strong fundamentals and opportunities in the second-hand car market.

In Premium Finance, we've seen reduced demand for car insurance policies as Covid-19 restrictions led to the suspension of driving tests and a decline in the new car market. We therefore expect demand for the funding of motor policies to recover as restrictions are removed.

In Property, we saw strong unit sales following the easing of the first lockdown restrictions, heightened by the stamp duty temporary reduced rates and Help to Buy incentives. This has led to higher repayments by our house builder customers. We've seen an uptick in the level of drawdowns, particularly in the second half of the year, and have a solid undrawn pipeline at over £900 million, as we look to capture the strong demand that remains throughout the residential construction sector.

The loan book trajectory in this business will continue to reflect the rate of repayments, as well as new business volumes.

We focus on residential developments of family housing, where there's strong structural demand and continue to see good demand in the regions outside of London and the South East, with the regional book now making up over 50% of our development portfolio. As highlighted at our Investor Event, we remain focused on identifying and capturing the next generation of developers.

The Asset Management division has maintained excellent client service during challenging market conditions. The division has achieved strong net inflow rates over several years. In the 2021 financial year, net inflows accelerated from 4% at the half-year to 7% for the full-year. This is reflected in the continued demand for our integrated advice and investment management services, despite the reduced face-to-face client interaction due to Covid-19 restrictions.

We've seen net inflows from our advisers, 3rd party IFAs and our own portfolio managers, with strong contributions from our investment in new hires over recent years.

Ongoing investment in systems and technology continues to enhance our operating efficiency and increase the scalability of our back and middle office functions. We also continue to hire additional advisers and fund managers, while remaining open to selective incremental acquisitions.

In line with our plans to maximise long-term growth potential in our Asset Management business, towards the end of the financial year, we completed the acquisition of a small IFA business with circa £300m of clients assets.

Sustainable investment management strategies remain a key area of focus across the industry and our socially responsible proposition continues to be well received, with two new sustainable funds launched.

We've an attractive, vertically integrated and multi-channel distribution model which underpins our success and positions us well to benefit from structural growth trends in the Wealth Management industry.

And finally, Winterflood, which delivered an exceptionally strong trading performance and demonstrated its ability to lean into the significant market activity. Although activity has slowed over the last few months of the financial year, Winterflood recorded its highest ever daily bargains in November 2020, with average bargains of 101k in the year. Winterflood's operational responsiveness allowed it to maintain uninterrupted trading throughout the period of elevated trading volumes.

The experience and expertise of our traders, and their ability to manage risk, enabled them to deliver a very strong trading performance in extremely challenging market conditions, with only one loss day.

Winterflood remains a long-established leading UK market maker for retail stockbrokers and institutions and is well positioned to continue to maximise daily trading opportunities and provide continuous liquidity in all market conditions.

Winterflood Business Services, which provides outsourced dealing and custody services for asset managers, has continued to grow its client base with assets under administration at £6.2 billion, up over 50% on the prior year. We continue to add high quality clients and expect AUA to continue growing in the medium term.

Looking ahead, we are encouraged by the improvement in the economic outlook, although the trajectory remains uncertain. Against this backdrop, we're committed to maintaining the discipline of our business model and are ready to respond to opportunities and changes in market conditions.

Our proven and resilient model and strong balance sheet, combined with our deep experience in navigating a wide range of economic conditions, leave us well placed to continue supporting our colleagues, customers and clients over the long term.

Thank you. And we'll now be happy to take any questions you may have.

Q&A session

Question 1

Benjamin Toms, RBC Capital Markets

Good morning both. Thank you for taking my questions. The first is on dividends and the second is on loan growth. On the dividend, how should we think about the dividend of 60p? Does this constitute a rebasing of the progressive dividend or should we think of Full Year 2021 as still being extraordinary? Is the base of progressive dividends going forward still being the 66p in FY19?

And loan growth. The loan growth in 2021 was around 11%. Consensus expectations for the next couple of years, last time I looked were around 7%. Government loan schemes have had an impact on the numbers this year for sure but in the context of loan growth in the first couple of months of this year, is FY22 more likely to be in line with FY21 or more in line with consensus expectations?

Adrian Sainsbury

Thanks, Benjamin. I'll take both of those. On the dividend, you're quite right. The full year at 60p is a little below the pre-Covid level that we had at 66p. It is up 50% on Full Year 2020 where we did the full year and final at 40p. It's worth noting that we had an interim dividend of 18p. Historically, we've done a one third, two thirds interim and final and clearly we've done 18p, 42p. So in line with my statement at the Half Year, the increased confidence we have led to us paying more than 36p as the final, we paid 42p.

We've considered a wide range of variables and considerations in the dividend decision with the Board. Key, I would say, is the confidence in the future and sustainability of the dividend for the future. We're highly confident that we can progress the dividend from this position of 60p. The difference between 60p now and 66p in Full Year 2019, I'd say a little bit is on the certainty in the economy as well.

If I look back to two years ago when we were completely pre-Covid, we were in a pretty stable environment at that stage. There clearly is considerable uncertainty in the markets as we stand today. So, for example, the furlough scheme and the Stamp Duty concessions end imminently in September, companies are falling due to pay their CBILS loan schemes etc., and VAT deferrals are now falling due for payment as well. So given that uncertainty, we see 60p as a good number to reflect the performance of the company, which as I said in my opening remarks, is strong and our confidence in the future and the ability we see to progress the dividend from here.

Moving on to your second question on loan book growth. Absolutely correct, the loan book growth was 11% in 2021 and I'm aware that the market consensus at the moment is just below 7% I believe.

I think it's worth me answering this question by talking through each of the loan books and what we see and what's different. So as Mike said, in the Commercial business, the loan book grew 30% in Full Year 2021. That's strong growth, and as you correctly say, CBILS was a significant part of that. Our total CBILS lending now, or all the government schemes, is around £1.1 billion. And the final draw date for all of the CBILS lending is around the end of November for asset finance products. We have a remaining pipeline of around £140 million still to draw in Asset Finance before that November date.

And then I would say that markets will return to more normal. Clearly, it has been quite a market distortion, the government supported lending and indeed furlough has distorted the consumer markets as well.

When we look at the impact of CBILS lending in Full Year 2021, we have had record new business volumes in both the Asset Finance and indeed the Motor Finance business. In Asset Finance, of that record performance, broadly on a monthly basis, 60% of the volume was on standard Asset Finance business and 40% monthly was on the CBILS scheme. And we estimate that we would have written about 50% of that 40% if the CBILS scheme had never been in existence. So broadly, there's a 20% impact there.

Now, replacing the CBILS scheme, the government has announced the Recovery Loan Scheme. We're approved for £300 million there. We expect demand to be significantly lower on the Recovery Loan Scheme than CBILS, not least because there isn't the interest free period for the first year for the SME. So in summary, in the Asset Finance business, what I would expect to see is demand returning more to normal levels as the funding distortion is removed from the market, and then we will go back to the strengths of our model of the expert relationship sales force that we have that serves that market very well.

If I move on to Invoice Finance, you'll have seen that the Invoice Finance loan book bounced as well very nicely in 2021, reflecting the uptick in trading of our SME client base. Mike commented that utilisation of our clients or utilisation of the facilities is still below pre-Covid levels, so there's an opportunity for that to increase the utilisation level and the loan book increase as trading of our SMEs improves.

If I move on to the Retail side of the loan book. Premium Finance, as we said, has gone back 3% or £35 million in the year, largely in the motor policies. And as we said, that's largely because test centres were closed for a period and some people have retired their car, not needing it anymore in lockdown. And the new market, where policies are needed, has actually clearly fallen quite significantly. We'd expect that to return to more standard levels as lockdown lifts further.

The Motor Finance UK book has clearly seen record new business volumes and the loan book has rebounded very well. Our investment in the business there, Motor 2020 we call it, has worked very well for us, improved the proposition. A lot will depend on how demand for used cars progresses from the very strong levels we're seeing here. We've been growing share in recent times and it will depend on how the market progresses.

And in Property, that's the loan book we saw go backwards most significantly, just over £200 million in Full Year 2021. That's largely because there's been a significant number of house sales, unit sales, that equates to repayments for our borrowers. And it would be fair to say that some of our developers will have rephased their developments to have a lot of finished stock so that units can be sold quickly. So I would expect that to unwind as the Stamp Duty holiday unpicks and the £900 million pipeline that we've got is available to draw.

In summary Ben, 2021, 11%. What does all that mean for 2022? Well there's clearly a lot of uncertainty as I still said. I would expect that the market would be in the range of where you've seen consensus, but probably softer than the 11% we've seen this year. That's how I see it.

<u>Question 2</u>

Ed Firth, KBW

Good morning everybody. I just have two questions. One was, have you got any update you can give us in terms of the IRB or any of numbers that we could start to think about putting around some of the savings that potentially may come through? I know there's uncertainty, but I guess you must have done some benchmarking, etc. So that would be question number one.

The second question is, there's obviously a lot of talk about interest rates at the moment, that seems to be a big theme. I think, in the past you’re negatively correlated to rising rates if that makes sense, so you’re the reverse of everybody else. Could you perhaps give us some sort of numbers again around that? What the sort of sensitivity may be a 50bps rise, something like that? Thank you very much.

Adrian Sainsbury

Thank you. On the IRB, as Mike said, our application is progressing well. We submitted the application in December 2020 and we're in positive dialogue with the PRA. And we move through the process, which we said before, typically can take 18 months to two years. We're not providing guidance or disclosing what the capital benefit may be. That's largely because that's in the PRA’s gift as part of the application process that we go for. We have said before that one of the reasons that we've looked at it is, of course, the increase in the standardised rate on property lending that the ECB Directive increased to 150% maybe four or five years ago and there could be some benefit of that, because clearly we have an attractively secured business there. But very clearly, we're not giving any guidance at this stage.

Moving on to the interest rates, you're correct that in the generalised trend that we have relative to other banks. We don't have current accounts, so we don't have interest free balances on those that would benefit as interest rates rose. The broad impact that you can see of a 50bps rise, would it be a profit impact of about £10 million. Similarly, if there were a reduction in rates, we would see some benefit there.

<u>Question 3</u>

Philip Middleton, BAML

How much of your loan growth has been due to CBILS and what will happen as this runs off?

Adrian Sainsbury

Thanks Phillip, that's partly the answer I gave before. So the total lending we've done across Full Year 2020 and Full Year 2021 on CBILS is about £1.1 billion, and we did less than £3 million on Bounce Back. Just to be clear, we selected CBILS strategically because it has a pricing benefit. We can price more to our normal NIM, whereas the Bounce Back lending had a mandated yield of 2.5%, which would be a NIM for us of sort of 1.1%, 1.2%. And we were able to do our full credit underwriting as well. So the answer is, it's a significant part of our lending in Asset Finance. We did do some CBILS lending to a lower extent in Invoice Finance and a much lower extent, there was a small number of deals in Property. And as I explained before, broadly, we think we'd have written half of that business, half of that CBILS business if the scheme had never existed.

<u>Question 4</u>

Jason Napier, UBS

On your Banking loan growth, investors are concerned about potentially soft UK business loan demand. Close Brothers loan book growth is also impacted by discipline in only writing business at adequate ROEs. So firstly, what is roughly expected loan growth for the bank's loan markets? And secondly, what are you seeing on spreads in the market? Is pricing a tailwind (i.e. more loans are meeting return requirements) or a headwind (so spreads coming down, smaller share of the market meeting requirements) so at present than, say, six months ago?

Adrian Sainsbury

Thanks, Jason. So the UK demand will depend, I think, from SMEs a little bit on what happens on investment. And clearly that's closely correlated with business confidence. And maybe there will be some opportunities with demand for headcount in SMEs. They may need to invest in equipment, let's say, because the headcount isn't there. We are closely correlated with that investment demand that [inaudible] we get on to our very strong proposition in the market that I alluded to earlier. Discipline on ROE is absolutely key to us and as Mike showed on the chart, the NIM has moved from 7.9% in 2019 to 7.5% in 2020 and then back up to 7.7%. That 20bps increase is due to a wide range of factors: there's a bit of mix, there's a bit of improved cost of funding benefit, and also there's a little bit of the forbearance impact where we offered facilities fee-free falling off. I think that 7.7% is a good guide. I don't see a trend of 7.7%, 7.5%, 7.7% and moving up from there. I think that's a good guide for what we're seeing in the market there and I don't apologise for this, we will religiously stick to our pricing discipline and our credit underwriting discipline, and the loan book will be an output of that.

The guide I gave earlier of probably somewhere below consensus at 7% and what we saw at 11% is probably the best guide I can give. And I see it softer than 11% as a result of that. A large part will also play on how the uncertainty I described actually plays out. There are a number of factors still to play out in the market. There will be some SME sectors that are more impacted than others as they move to have to pay their CBILS; the HMRC; have to pay more staff as furlough falls off, so there's a range of impacts still to come. We still remain very strong on our model though.

Question 5

Jason Napier, UBS

On the Asset Management side, so you saw strong growth in the second half, presumably driven by organic performance and build outs. What thoughts, please, on outlook for cost growth in the year ahead, assuming a flat year for equity markets overall?

Adrian Sainsbury

So thank you, Mike you might build on this answer I'm going to give. The cost growth in the asset management business is largely a result of two things. We've been investing in our transformation programme for a number of years. That will come to a conclusion broadly in calendar 2022 and that will have some scale advantages at that time. Clearly, also, we had a performance improvement in Full Year 2021 over Full Year 2020 too, so there is some performance improvement as well that's reflected in the cost base. Mike, would you build on that?

Mike Morgan

I think also we've had a lot of success in hiring portfolio managers to come across and naturally when they come in, they bring an upfront cost, which comes through. We're keen to continue that, we seem to be a good home for them and we will continue that as these people become available.

Question 6

Gary Greenwood, Shore Capital

Can you expand on the reasons for closing Novitas? When did it start to go wrong and what caused this? And are there any other portfolios that are under review?

Adrian Sainsbury

Thanks, Gary. So importantly, we review all of our businesses on an ongoing basis and to do that, we showed at the Investor Day, the ‘Model Fit Assessment Framework’ that really brings out the magic of Close Brothers. The Novitas business we bought in 2017 and what has transpired in the recent period is the assumptions that we have for the business haven't played out as we expected, largely as a result of cases taking longer to come to fruition and the failure rate on cases to be higher than we expected, and the recoverability under the insurance to be lower than we expected.

So putting all those things together and when we looked at the ‘Model Fit Assessment Framework’ for Novitas, it didn't fit our risk appetite. There's broadly three main things on the ‘Model Fit Assessment Framework’ there. The long-term track record, as I said, it's taken longer and it hasn't proceeded as we expected. The secured lending nature of the business that we like; we like businesses to be predominantly secured, the Bank’s loan book is 90% secured or structurally secured, it hasn't played out that way so far with Novitas. And on the expertise side, a lot of the expertise is with the intermediaries as well.

The other thing that has changed, I would say, since we launched the business, regulation has tightened in a range of areas, notably on vulnerable customers and quite rightly here. On vulnerable customers, the nature of the Novitas business, funding on litigation cases and for divorces, is strong there. So we've used the model, we've assessed the business and decided it is the right thing to stop lending.

We had actually slowed down lending on the litigation cases quite a while ago and we wanted to see how it's going and we decided in July to cease all lending. In concept, it is only 2% of the net loan book, so I'd ask you to bear that in mind, and we believe the level of provisioning we have is well considered and proportional.

Question 7

Gary Greenwood, Shore Capital

In Asset Management, your operating margin is below quoted peers due to investment. Is there a point at which you back-off on investment and we see the margin start to evolve more positively?

Adrian Sainsbury

As I said, Gary, I will hand on to Martin Andrew briefly here to provide more detail. We've been undertaking an Asset Management transformation for a number of years that's involved us moving all of our systems onto the same platform and has provided a better proposition for our customers and potential scalability benefits as well. We see that as an opportunity for more cost efficiency from when the programme ends in calendar 2022. And as Mike said, we've also been investing in new high net worth individuals that have been successful in bringing funds in. Martin, would you build on that?

Martin Andrew, Close Brothers Asset Management Chief Executive Officer

I would say that the hires that we've made so far do mature in terms of profitability over time, so as the years roll by, they will become more profitable. I don't think we want to hold back on any growth opportunities we see in the marketplace. So we can't guarantee that we find hires to make, but if we do, I think we definitely want to continue pursuing those. And as Adrian has already said, by the end of 2022, we would expect the bulk of the more significant technology investments to come to an end.

<u>Question 8</u>

Investor

Can you give more detail on the decision to exit legal lending? Was there a problem with your analysis of the business prior to entering?

Adrian Sainsbury

Thank you and I build on the answer I just gave. So we do detailed due diligence and we did do detailed due diligence in this case. The real reason for the exit of the business and ceasing writing new business is, as I said before, the assumptions that we originally had at acquisition haven't proved to be the case. The business took longer to season than we'd expected, and this business does not have any traits reflective in the other businesses that we have.

<u>Question 9</u>

Investor

Given the inflated used car prices in the market now, are you adjusting your underwriting in Motor as regards residual value assumptions?

Adrian Sainsbury

So a couple of points on this one. The used cars, we'll have all seen the unusual trends reported in the media that immediately off the forecourt, a car is more valuable and actually prices are higher than they have been on used cars at the same age point. That's good news for us on the back book quite clearly, where we lent at an LTV against a valuation that has now increased in the market, so that's useful.

On new origination, that is quite correct as well, that we now have a higher start point that we're lending against. So we're cautious on that, but we do maintain our lending criteria along the way and we have very clear levels of risk appetite. It's worth also noting that we only have 12% of our book in PCP. PCP has a residual value position at the end; against a Hire Purchase, the other 88% of our book, where we have full payout and therefore no residual risk at payout. The market average on used car finance for PCP is much higher than our 12%.

So in summary, I remain confident in our credit profile in the Motor book.

Question 10

Investor

Would the Board consider share buybacks given the strength of your capital position and that the company remains persistently undervalued, with the market effectively attributing a valuation on the Banking business of 1.5x tangible equity, too cheap given the strength of the Banking franchises and the return through the cycle.

Adrian Sainsbury

So, as Mike mentioned, we have a very strong CET1 position at 15.8%. And as Mike also identified, there's adjustments there: the software intangibles, 50 basis points and the IFRS 9 transitional relief, 120 basis points, which gets you to 14.2%. That's still a significant headroom over the regulatory minimum that we have. Now as I said before, the best use of our capital is growing our loan book in line with our NIM of 7.7% at the ROE's that that's achieved.

Also, you'll have seen the very strong ROE's that we have in the most recent year with Asset Management at over 30% and Winterflood at over 60%. So we have a very strong portfolio of businesses that have good ROE's. Investing in our business for the future, whether it's the investment programmes, whether it's new hires into Asset Management, small acquisitions is, in my view, the best use of capital for the business.

We also need to remain flexible. I mentioned there's a significant amount of economic uncertainty, the furlough scheme, Stamp Duty coming unwinding, SMEs having to pay for their CBILS lending pretty much from now as well. So we want to be ready for whenever the environment throws up and be ready to grow the loan book in the right way in line with our model to support growth.

We've increased the dividend clearly 50% on the prior year, which is a significant return to shareholders. But you're also right and of course I'm aware that other banks have announced significant share buyback programmes. Our valuation, as you say, at broadly 1.5 book value compares very differently to some of the other banks that are below that multiple. And there were clearly different views on the attractiveness of share buybacks at different bank multiples. We will keep this under review with our board. There are no plans as we speak for share buybacks or return of funds to shareholders other than the dividend we've announced. But I'm not dogmatic on this view, and a lot will depend on how the environment moves forward from here.

And that brings to a close all of the questions. Thank you for your time this morning and have a good day. Thank you.