Close Brothers Group plc

Half Year Results 2021 Presentation

Verbatim transcript

Tuesday 16 March 2021

Adrian Sainsbury, Chief Executive

Good morning, and welcome to the presentation of Close Brothers 2021 Half Year Results. I'll start with a brief reflection on the key elements of our performance in the first half, and how I'm planning to take us through the next stage of our strategic development, building on the core strengths of our successful model. Mike will then take you through our financial performance, and then I'll come back to give you an update on our strategy and business performance.

Current circumstances have dictated that this is a pre-recorded presentation, but as usual we'll be happy to take your questions afterwards, both via the telephone conference line and over the webcast, which you can submit either during or after the presentation.

It's been another challenging period, with the impact of COVID-19 and lockdown restrictions continuing to affect our customers and businesses. Our priority has been to successfully navigate this challenging environment while continuing to support our people, customers and clients. Against this backdrop we delivered strong results, and we're pleased with our financial and operational performance in this period, achieving a strong ROE of 13.2%. Income grew across all of our divisions, and adjusting operating profit increased by 2%.

We saw strong new business volumes in the lending business, and delivered growth of 4% in our high quality loan book, while maintaining a net interest margin of 7.7%. Asset management achieved solid net inflows and grew managed assets. And Winterflood delivered a very strong trading performance, capitalising on the significantly higher trading volumes across the equity markets.

We've maintained a strong capital, funding and liquidity position, which provides us flexibility for growth. Following a resilient financial operational performance in the first half, we've declared an interim dividend of 18 pence per share. This reflects the Group's strong performance in the first half, and continued confidence in our business model and financial position.

This remains a highly uncertain environment, and the full impact of COVID-19 is yet to be seen. However, we remain very confident in the quality of our loan book which is predominantly secured and prudently underwritten, and in the expertise of our people. We're

well placed both operationally and financially to navigate this challenging environment and maximise the opportunities available to us.

Our purpose is to help the people and businesses of Britain thrive over the long-term, which is backed up by our strategy, culture and responsibility. Our purpose continues to convey the important role we have to play in supporting small businesses and individuals. Last September I introduced our responsibility as a core component of our model, and as we continue to navigate the impact of COVID-19, our responsibility to help address the social, economic and environmental challenges facing our business, employees, customers and clients, remains more important than ever.

This has been a challenging period for our stakeholders. We continue to support them throughout, with over 120,000 customer payment deferrals and other COVID-19 related concessions offered, and have lent £730m under the Government support schemes for SMEs, as well as expanded our efforts to support charities, helping to address disadvantages in the wake of COVID-19.

As we emerge from the unprecedented circumstance of the past year, I'd like to share with you how we're evolving our strategy and how it will guide us in the future. The fundamental strengths of our business model remain unchanged, and have been evidenced throughout the current crisis. Our strategic approach will therefore focus on three objectives: to protect; grow; and sustain our successful business model. I'll come back after Mike's presentation to talk a little bit more about each of these strategic objectives and how they apply to our business.

To ensure that we're best placed to respond to opportunities and deliver on our strategy, I've made some changes to our Executive Team. These include bringing the leadership of the Motor Finance and Premium Finance's businesses together under our recently appointed Retail CEO, Rebecca McNeil, as well as appointing Neil Davies as our Commercial CEO, with responsibility for Asset Finance and Invoice and Speciality Finance. Rebecca and Neil, along with Frank Pennal, our Property CEO, have joined our Group Executive Committee, with all of our businesses now represented at Group level.

I'd also ask you to save the date for our Investor event on 15 June, when a more detailed presentation on the Group and each of our businesses will be provided, including presentations by each of our business CEOs.

I'll now hand over to Mike for the financial update.

Mike Morgan, Finance Director

Thank you, Adrian, and good morning everyone. As Adrian said, we delivered a strong performance in the current environment as the positive trends seen at the end of the last financial year continued. It is worth highlighting that we are comparing our performance in the first half of '21 to the first half of 2020, which was a pre-COVID-19 period.

Group adjusted operating profit was up 2% to £129m, and pre-provisions' profit increased 12% to £181m, reflecting higher profits in Winterflood and strong new business volumes in banking. Overall, we delivered an adjusted earnings per share of 64 pence, and a strong return on opening equity of 13.2%. We maintained a strong capital, liquidity and funding position, as our CET1 capital ratio increased to 15.3%, providing significant headroom against regulatory requirements. We achieved 4.4% loan book growth, and a net interest margin of 7.7%, reflecting our focus on pricing discipline. And as Adrian mentioned, we have declared an 18 pence interim dividend, reflecting the Group's strong performance in the first half, and continued confidence in our business model and financial position.

Looking first at the income statement. Income was up 13% to £474m, with top line growth in all divisions and particularly strong trading income in Winterflood. Expenses increased 14% to £293m, driven by higher variable costs in Winterflood, and continued investment across the businesses. Impairment charges rose to £53m, to take into account loan book growth and a review of staging and provision coverage for individual loans and portfolios. And after tax, we delivered £95m of profit attributable to shareholders, stable on the prior year period.

Moving on to the divisional performance. Overall, adjusted operating profit increased 2% to £129m, with lower profits in banking and asset management more than offset by a very strong performance from Winterflood. We saw high new business volumes in the Banking division with strong demand for CBILS, but profit reduced 18% to £95m as modest income growth was offset by higher impairment charges and continued investment.

In Asset Management profit was broadly flat on the prior year period at £12m, as operating income grew despite the impact of COVID-19 on new business activity, and we continue to invest to support the long-term growth potential of the business. Profit in Winterflood increased 223% with a very strong performance, capitalising on the heightened trading volumes.

Now on to our balance sheet. We maintain a strong balance sheet and remain focused on our prudent approach to managing financial resources. Our total funding increased to £11.1bn, well in excess of the loan book. We continue to borrow long and lend short, with the average maturity of allocated funding at 24 months, ahead of the loan book at 16 months. We had £2.2bn of Treasury assets at 31 January 2021, with the majority held with the Bank of England. Our funding base is well diversified, and includes access to retail and non-retail deposits, as well as secured and unsecured wholesale funding. We continue to strengthen our funding base with a £350m 10 year senior unsecured bond issue in December, and our customer deposit platform helped us grow our retail deposits to £2.7bn as we launched cash ISAs and a new Notice Account.

Since the start of the COVID-19 pandemic, we have increased our funding and liquidity levels enabling us to lean into current market opportunities. Liquidity levels increased further in the first half of 2021, reflecting the timing of our new debt issuance. However, we expect these to revert over time as uncertainty related to COVID-19 reduces. Our credit ratings remain strong, with the banking subsidiary rated AA3 by Moody's. We have also continued to optimise our cost of funds through disciplined deposit pricing and the renewal of facilities.

Turning to our capital position. Our CET1 capital ratio increased 120 basis points from the year end position to 15.3%, with significant headroom against minimum regulatory requirements. Our CET1 capital increased to £1.4bn. This was driven by higher profits and a circa 45 basis points' benefit from regulatory changes to the treatment of software assets. The PRA is currently consulting on the potential reversal to the previous treatment, which would result in a future reversal of this benefit.

Risk weighted assets remained broadly flat at £8.8bn despite the loan book growth, as CBILS loans have a lower risk weighting, and the property loan book which has the highest risk weighting in the portfolio, reduced. And our leverage ratio remains strong at 10.8%. We submitted our initial IRB application to the PRA in December, and continue to work with the regulator to support their review. We have a strong capital base with significant headroom to minimum regulatory requirements. This provides flexibility as we lean into current opportunities and take the business forward.

Moving on to the Banking division. We saw 1% growth in income to £309m, driven by strong new business volumes and loan book growth. We maintained our focus on pricing discipline, allowing us to deliver a net interest margin of 7.7%. Expenses increased 4% to £161m, as

costs continue to grow ahead of income in the current phase of investment. BAU costs remain flat, reflecting our strict control and cost discipline. Impairment charges increased, resulting in an annualised bad debt ratio of 1.3%, slightly up year-on-year, but down significantly from 2.3% for the 2020 financial year. In the first half of 2021, impairment provisions increased to take into account loan book growth and a review of staging and provision coverage for individual loans and portfolios. As a result, adjusted operating profit decreased 18% to £95m.

Now on to the loan book, which grew 4% to £8bn as we saw high levels of new business volumes and good opportunities for growth in Motor Finance and Commercial, supported by strong demand on the Government support schemes for SMEs. The Commercial loan book increased 15% overall. We saw strong growth in our asset finance business, driven by demand for loans under CBILS. We also saw growth in invoice finance, reflecting good CBILS demand. However, overall utilisation levels in this business remain subdued versus pre-COVID-19 levels.

The Retail loan book remained flat. The Motor Finance loan book grew 4%, as we saw record new business volumes driven by pent-up demand and an increase in used car finance, as well as benefits from our Motor Finance Transformation Programme. The Premium Finance loan book declined 6%, reflecting the impact of COVID-19 restrictions, exacerbated by January seasonality. And the Property loan book decreased by 8%. This reflects lower drawdowns and higher repayment levels, reflecting delays in completion of developments due to COVID-19 restrictions and strong unit sales.

Turning now to our net interest margin. Our specialist and relationship driven model is built on pricing discipline, supporting a consistently strong net interest margin compared to our sector. The chart on the right shows the trajectory of NIM over the last year, excluding the impacts of certain items such as modification gains and losses, and for day count. From this you can see our underlying net interest margin stabilised at around 7.5% in the period. This reflects an improvement in fee income, higher levels of customer activity during the period, and a reduction in our cost of funds.

Moving on to costs. There was a 4% overall increase as we continued to invest in our strategic programmes. We continued to focus on cost discipline, and BAU costs remained flat, despite an increase in variable compensation.

Investment costs increased £7m to £32m as our strategic initiatives progress, and we incur related depreciation charges. As this investment continues costs are expected to grow ahead of income for the remainder of the year.

Investing through the cycle remains a key strategic priority, with a number of our ongoing investment programmes delivering benefits. This investment has enabled us to adapt our business in response to changing conditions and evolving customer behaviour, such as with the launch of our cash ISA product.

Impairment charges increased to £53m, up from £37m in the pre-COVID-19 comparative period. We have revised the macroeconomic scenario weightings, with a 40% weighting remaining to the base line and 10% moved to the upside scenario to reflect reduced Brexit uncertainty and the COVID-19 vaccination developments.

The modelled impact of these changes in weightings has been mainly offset by judgemental management overlays, to reflect the continued uncertainty in the UK economic outlook.

Impairment provisions increased on the comparative period to take into account loan book growth and performance and a review of provision coverage for individual loans and portfolios.

These factors resulted in an overall increase in provision coverage to 3.3%. We believe this represents an appropriate level of provision reflecting the highly uncertain external environment and the fact that the full impact of COVID-19 has yet to be reflected on credit performance.

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

Since this time last year we have offered a range of COVID-19 concessions to our customers, and these loans have been classified as forborne. Looking at the forborne loan book the overall performance remains encouraging. Considering each book in turn:

In Commercial 20% of the loan book was classified as forborne and subject to COVID-19 forbearance measures at 31st January 2021. This is down from 26% of the book at the year end. And of this 20%, 87% of customers by value had resumed payments at 31st January.

In Retail 6% of the loan book was classified as forborne and subject to COVID-19 forbearance measures at 31st January, down from 9% of the book at the end of the year. And of this 6%, 79% of those customers by value had resumed payments at 31st January.

And then in Property COVID-19 forbearance takes the form of extensions where we waive the fee, and is not triggered by a sign of financial stress, and so we remain confident in the quality of these loans. This represented 13% of the loan book at 31st January, down from 18% at the year end.

Overall we remain confident in the credit quality of our loan book and the underlying security we hold.

Moving on to Asset Management. We delivered solid net inflows of 4%, reflecting continued demand for our integrated wealth management and investment management services, and good inflows from recent portfolio manager hires. Managed assets increased 10% to £13.8bn, and total client assets increased 9% to £14.9bn, driven by positive market movements and net inflows.

Adjusted operating profit was broadly flat at £12m, as we saw a 2% increase in operating income, despite COVID-19 restricting face-to-face meetings.

The revenue margin remained broadly stable at 94 basis points.

The 3% increase in expenses was driven by new hires and technology spend, reflecting our commitment to invest in the long-term growth potential of this business.

And onto Winterflood, which delivered a very strong performance and continued to demonstrate its ability to lean into significant trading volumes.

The business delivered a 223% increase in operating profit to £34m. Income increased 105% to £98m, reflecting a very strong trading performance and continued elevated market activity. Expenses increased 71% to £64m, reflecting higher variable compensation and settlement costs as a result of increased trading activity.

The expertise and experience of our traders meant they were able to successfully manage risk with no loss days in the period. All of this contributed to Winterflood delivering its best start to the financial year in the last decade.

So, as you can see, we are pleased with the strong financial performance delivered in the current market conditions, and I will now hand over to Adrian. Thank you.

Adrian Sainsbury

Thanks Mike. A key point of difference at Close Brothers is our long-term approach, and the rigorous discipline behind our proven and resilient business model which supports our long-term track record of growth, profitability and dividend progression over the years.

Our success is supported by our consistent pricing and underwriting criteria, by the prudent management of our financial resources, and by the diversification of our businesses, with specialist expertise in each of the sectors we operate in.

These are the fundamental strengths of our model, and my responsibility is to ensure we continue to protect them whilst taking the business forward.

I mentioned at the start how we are evolving our strategy to protect, grow, sustain. I will now talk through each of these strategic objectives and how they position us well for long-term success.

Our first strategic objective is to keep our business safe by maintaining and enhancing our model's key strengths. This will allow us to continue to deliver for all our stakeholders in a wide range of market conditions.

We will remain focused on the prudent management of our financial resources, and on the disciplined application of our underwriting and pricing criteria.

And to protect the key attributes of our high-touch relationship model it's essential that we continue to invest in our businesses. We've maintained this discipline throughout this challenging period which has helped us navigate this environment and emerge in the strongest possible shape.

Another important strategic objective for us is disciplined growth. And we'll deliver disciplined growth by leaning into the current environment and by maximising future opportunities. Importantly, this doesn't mean we'll achieve growth at any cost, as loan book growth in the lending businesses will absolutely continue to be an output of our business model.

Our immediate priority is to continue to successfully navigate this challenging environment and to make the most of the opportunities as the economy starts to recover.

Looking ahead, we'll proactively assess any incremental growth opportunities that fit with our successful model across our businesses in existing and new markets. And to do this we'll continue to evolve our offering as well as improving our operational and digital capabilities.

Market conditions have continued to be dominated by COVID-19. We benefited from implementing the playbooks we developed in 2019 in preparation for a downturn. And our immediate priority is to be ready to maximise the opportunities available if and when a credit event happens.

At our full year 2020 results back in September I said this credit event had not yet happened. Since then we've entered another national lockdown and the government has extended the support schemes for consumers and SMEs, which has helped to delay increases in company insolvencies and unemployment.

There remains a lot of uncertainty. And while we still can't know how the next phase of the cycle will play out, we do know that we're in a strong position to make the most of any opportunity it presents.

Finally, our third strategic objective, sustain. Our long-term approach is genuinely embedded in everything we do and is a key differentiator of Close Brothers. That's why it's important that we secure the future of our business, customers and the world that we operate in, and that we do it responsibly. We'll achieve this by focusing on the needs of our customers, our people, our community and the environment by evolving our business to recognise and support the priorities of each of these groups.

I'll now take you through an update on the activities seen by the various segments of the Bank, and how each of our businesses are maximising the current market opportunities.

Within Commercial we've seen good demands under CBILS, particularly in Asset Finance. The chart on the right shows how strong levels of both CBILS and non-CBILS lending have contributed to the record period of new business volumes in Asset Finance as the business leans into the current demand from SMEs.

As at 31st January 2021 we'd lent £730m across 3,418 loans, predominantly under CBILS, with minimal amounts lent under the bounce-back loan scheme.

In Invoice Finance utilisation levels remain subdued and continue to track below those seen prior to COVID, as lockdown restrictions impact customer activity and sales volumes. Most importantly, the Commercial business remains well-positioned to support customers as they emerge from the crisis.

In Motor we've seen strong new business volumes, reflecting pent-up demand and increasing use of finance in the second-hand car market, and also benefits from our investment in sales capability.

This investment allowed our sales teams to adapt and become more agile during this challenging period. It maximised our remote lending capability so we could continue supporting motor dealers during lockdown, capitalising on the strong demand for second-hand car financing.

As illustrated on the chart, new business volumes have remained resilient throughout the November and January lockdowns, notably ahead of the volumes seen in lockdown one in March 2020.

In Premium Finance we've seen reduced demand for car insurance policies as COVID-19 restrictions have led to the suspension of driving tests and a decline in the new car market.

In Premium Finance's commercial market we've seen an increase in deal size as customers look to ease their cash flow.

Both Retail businesses continue to support customers as their needs change and evolve throughout the crisis.

In Property we saw a rebound in sales activity following the easing of first lockdown restrictions, heightened by the stamp duty holiday. We focus on residential developments of family housing, where the strong structural demand is reflected in the mix of our property loan book. We continue to see good demand in the regions outside of London and the southeast.

The strong sales activity we've seen by new house builders has led to higher repayments. And we've also seen lower drawdowns in the Property book as development completions have taken longer due to COVID-19 restrictions. We're now seeing an uptick in drawdowns and have a solid undrawn pipeline of more than £1bn as we look to capture the strong demand that remains through the residential construction sector.

The Asset Management division has maintained excellent client service during challenging market conditions, reflected in continued demand for our integrated advice and investment management services.

We have an attractive, vertically integrated and multichannel distribution model which underpins our success. This leaves us well positioned to benefit from the proven ongoing demand for our services, and the structural long-term growth opportunity in the wealth management industry.

The division has achieved good net inflow rates over several years, and in the first half delivered solid annualised net inflows up 4%, a slowdown in flows compared to the prior period due to the impact of COVID-19 on client interactions.

We've seen net inflows from our advisors, third 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 advisors and fund managers, while remaining open to selective incremental acquisitions to aid long-term growth.

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

And finally Winterflood, which once again delivered a very strong trading performance and demonstrated its ability to lean into the significance market activity.

The continued extraordinary market conditions saw Winterflood record its highest ever daily bargains in November. 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 no lost days in the first half. 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 also continues to make good progress in expanding its relationships with institutional clients and continues to grow its presence in the US market. And Winterflood Business Services which provides outsource dealing and custody services for asset managers has continued to grow its client base, with assets under administration at £5bn, up 21% in the first half. Overall, the Group is navigating this unprecedented environment well, and our model is performing as we'd expect at this stage of the cycle.

Despite the national lockdown restrictions and volatile macroeconomic environment our credit performance has remained stable, reflecting the quality of our loan book and the ongoing government support schemes for consumers and SMEs. However, the full impact of COVID-19 still remains highly uncertain. Against this backdrop we're committed to maintaining the discipline of our business model and our readiness to respond to opportunities and changes in market conditions.

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

I look forward to seeing you at our investor event on 15th June. Thank you, and we'll now be happy to take any questions you may have.

Question and Answer

Question 1

Benjamin Toms, RBC Capital Markets

Good morning both, and thank you for taking my questions. Two please. How should we think about the dividend announced today and how it relates to your potential full year '21 dividend? Does the one third, two thirds rule still apply in the current environment?

And then secondly, you printed a CET1 ratio today on a fully loaded basis and excluding Software Assets of about 13.6%. That's about 600 bps ahead of your regulatory requirement. How much of that 600 bps does management see as excess, and how do you see it being allocated between growth, investment and the potential to be returned to shareholders in the future? Thank you.

Adrian Sainsbury

Thanks, Benjamin. On your first question on the dividend you rightly point out that historically we've had a progressive dividend policy, that has been in place for the 34 years since Close Brothers has been quoted. It progressed all the way up until April last year when we withdrew our 22.7p dividend that we announced for half one '20 on COVID happening. So that's when the dividend fell away, and then we reintroduced a final dividend, for the full year period of '20 at 40 pence. We've had a strong performance, as we've described it in the results today, and management and the Board see that a dividend of 18p is reflective of that performance.

Looking forward, there is still a high amount of uncertainty as we say in the RNS and as Mike and I highlight in the announcement this morning, so we will take account of the second half performance, we will take account of the outlook at that time, and that's when the Board will make the decision on the dividend. So we're not making any statement on whether it's a one third, two third, going forward. As I said in 2020 in September, the dividend is a very important part of our investment thesis and we will look to make the right payment at the full year.

If I move on to the CET1 position and the fully loaded position, as you said, so the whole CET1 at 15.3% is broadly double the regulatory minimum, and the deductions you've made to take it down to the 13.6% still leave very comfortable headroom. It is right in the current environment that we maintain a significant amount of headroom. The best use of our capital is growing our loan book at our very strong NIM, reported at 7.7%, and you'll have seen the slide underlying

at 7.5%. That is the best use of our capital to identify ways that we can sensibly grow the balance sheet in line with that NIM.

We're going through the IRB process, that will take a while for accreditation, probably two years, that again will have an impact on our CET1, and we're still in the middle of investment programmes that we highlighted, notably in Motor and Asset Finance, as well as the IRB programme itself.

We see the level of capital that we have as very sensible and prudent. It is not our plan as we stand today with the level of uncertainty in the market to consider any paybacks to shareholders as we speak.

Mike Morgan

I think that's fine, Adrian, you're absolutely right, the best use of the capital is to deploy it to the loan book. We also have made some small acquisitions in the past in the Asset Management business, so that might be something that we could use it for, but overall it's really to support the growth of the business.

Question 2

Robert Sage, Peel Hunt

Yes, thank you. I have two questions as well actually, the first of which is, in terms of the outlook for the bad debts, I know this is extremely difficult given uncertainties, but when a lot of the large quoted clearing banks were reporting their full year results for 2020 pretty much all of them were saying they were expecting a very substantial reduction in bad debts in 2021 relative to 2020, and some of them even suggesting that the bad debt rate ratio was going to fall down to normalised levels. And I was wondering whether, when you look ahead into calendar 2021 whether you would particularly agree or disagree, for whatever reasons, with this prognosis.

And the second unrelated question is that I was quite interested in seeing that you're bringing two of your divisions under a single management, i.e. Motor Finance and Premium Finance, and I was just wondering whether you could touch a little bit on the thinking behind this. Is this just a matter of convenience? Might there be synergies? Might there be cost savings, or how should we think about this?

Adrian Sainsbury

Thanks Robert. Firstly on the bad debt, one of the first things to note of course is our different timing of our year end relative to the banks that have a December calendar year end. So to interpret our bad debt progression I think it's worth looking at it half-on-half. So half one '20 we had 0.9% and the full year for '20 we reported as 2.3%, hence half two '20 was 3.7%. So the progression is 0.9% half one '20, 3.7% half two '20, and then we've reported 1.3% today, so a significant fall in the bad debt from the half two last year.

As we've said in the presentation, we've done a full, as we always do, review at the portfolio and individual large loan level. We've looked at the macroeconomic overlay, and then we have management expertise judgment overlay as well. We see the level of provision as very prudent as we stand today, very sensible, and the coverage level we have is at 3.3%, which, if you compare to the other banks you mention, is probably on the slightly higher side as well.

We see that as a very sensible level of provision. We're not giving guidance on what the half two numbers should be. We've highlighted a range of uncertainty; the lockdown, how that will play out; how unemployment will progress after the Job Support Scheme ends, insolvency after the Loan Support Schemes end as well. So there's so much uncertainty that it is right that we maintain a sensible level of provision on the balance sheet, which is what we're doing.

You ask an interesting question on the organisational change. If I answer that in a wider context first, what I wanted to do was to bring the customer closer to the Group Executive, so I've elevated customer facing CEOs, namely Frank Pennal, Neil Davies and Rebecca McNeil, onto the Group Exco. That helps decision making and obviously had some immediate efficiency benefit at a senior level.

In terms of putting the business together, they're both consumer businesses, they both have CCA interaction, so that's important. We broadly have 2.2 million consumers in the Premium business, and about 250,000 in Motor. So there are some common issues there. We are sensibly looking at the back offices of both businesses, and where there are future chances to see optimisation we would look at those as well. Thanks, Robert.

Question 3

Jens Ehrenberg, Citi

I just had a very quick question on Winterflood really. So I think the average bargains per day for the half year stood at 97,000 and I think if I remember for the first quarter they were a little bit lower at 83,000 I was just wondering can you give any indication how you see that going in the second quarter and if you still see elevated bargains per day towards the end of the quarter we are now in? Any colour there will be appreciated thanks.

Adrian Sainsbury

Thanks Jens if I answer that question on a little bit of a wider context, so if you look at the half-on-half bargains for Winterflood you'll see that in the seven or eight quarters pre-COVID we were doing towards 54 – 73,000 bargains a day. That spiked quite significantly after COVID and the first half after COVID i.e. our second half last year, at 108,000 bargains a day, and as you rightly say it's moved back slightly it was 97,000 in the first half '21.

Now you may remember how the market's performed during that period. In October there was quite a fall in equity markets generally and then in November there was quite a spike, and the day we quote 9th November was the day that the Pfizer vaccine was shown to have 90% effectiveness and that's when we had the truly exceptional day of 227,000 trades. So that's the strength that we saw in the final quarter.

I am willing to say that what we've seen since the reporting date at 31st January is broadly the same sort of trading levels in Winterflood. If I look at the wider picture there I gave the trend over a long period, I was asked a question back in September when we did the full year, is this a structural change or is it cyclical? And I said at the time it was too early to be structural.

Well now we've seen 11 months or so of very strong volumes in Winterflood, it's still too early to call that a full trend but realistically I don't think the volumes will fall all the way back to that level I quoted, the sort of 55 – 75,000 a day. You may have seen from AJ Bell's and Hargreaves Lansdown's results the big uptick in retail traders, not just customer numbers but also a younger demographic, some of those traders will go back to work and not trade, some of them won't, some of them will continue trading. So there's probably some structural bit there. Clearly it's been a largely cyclical piece still though with the volatility in the market as well.

Question 4

Freddie Sleiffer, KBW

Hi and thanks for taking my question, just following on from that previous question on Winterflood my question on income was answered but what should we see as the normalised cost to income ratio that you'd expect over the long-term to that business since it has fluctuated a bit?

And then secondly I think you mentioned you expect your IRB accreditation process to take about two years, are you able to give an indication as to the expected impact and is this only for one portion of your loan book to begin with?

Adrian Sainsbury

Okay thanks Freddie. On Winterflood first, sorry what was the first one again?

Mike Morgan

The first one was about the ratio on Winterflood and really of course the structure there is very much based on variable pay so the E/I ratio will not move significantly as we write more or reduce less. Clearly there are some fixed costs so that will have an impact but effectively the E/I ratio will stay broadly where it is at the moment.

Adrian Sainsbury

Thank you. So as you rightly say Mike the income went up broadly £50m and the costs went up broadly 26% on Winterflood in the half so it is a fairly direct correlation there.

On IRB, we put in the initial application around Christmas time, the timescale I gave is based on other banks that have been through IRB and clearly we're reliant on the PRA who we're working very well with and they have or course their own pressures with COVID. So it's hard to be exact. We have submitted initial portfolios that you allude to, so we will look at initial portfolios to start with and that's where we will see the benefit initially.

As I said the likely timeframe is about two years and the benefit will come through after that. So we're not guiding on the capital benefits, that is within the PRA's gift to decide on the models we have, the level of conservatism they have, so that will be something that we will be finding out as we go through the process with the PRA.

There are clearly other benefits in terms of risk management, in terms of assessing our books correctly given the level of security that we have on our books. Those are other spin-off benefits that we will get from IRB as well. We'll be talking more about IRB as we go through the process.

Mike Morgan

I think the only point I would add just on the benefits is it clearly depends where you are in the cycle and as you move into a downturn the benefits you would think would be slightly less than they would be as you might be in an upturn situation compared to a standardised approach. So I think it's important that that is borne in mind as well.

Freddie Sleiffer

Great thanks. And sorry can I just ask one more on the NIM quickly, I know you previously guided 7.5% for the full year, is that still where you expect NIM to come out in the second half, or do you have a greater ability to lower cost of funds still?

Mike Morgan

So the chart is on slide 15 Freddie, I think that gives a very clear indication of the underlying NIM of 7.5%, so even though we reported 7.7% for the half there are some one-offs in there. So 7.5% I think from that trend I think is a useful progression to look into half 2.

Question 5

Raul Sinha, J P Morgan

Could you discuss what you are seeing in terms of loan demand across your customer base currently in light of the dip in January with the lockdown? Do you see increasing opportunities to grow your lending with competitors receding in certain areas?

Adrian Sainsbury

Thanks Raul, that's quite an extensive question let me look at that in a range of ways. The diversity of our businesses is very important, we talked about before how we have 17 businesses, that's a plus and they're all in different markets and they will all have different opportunities as we come out of lockdown. I'll briefly talk through the five loan books that we report in and talk about how they performed in the most recent lockdown and the visibility that we have for them.

So if I start with Motor there's a useful slide that shows the Motor volumes. After the first lockdown in March last year the volumes fell quite significantly as that chart showed. It's performed better in the most recent lockdown. The motor dealers who offer our finance have adapted very well and are now doing click and collect on used cars etc. so the volumes have been good and in fact we had record volumes after the lockdown lifted last summer as well.

So I would expect on Motor when lockdown lifts again that we would see some accretion in volumes as car dealers open again. And of course the used car market that our business is based in has performed better than new car registrations, significantly. So I see Motor as performing well and our investment there has helped again in terms of helping consumers to be able to apply for credit from home as an example.

If I move into Premium Finance, Premium has seen some fall off in the most latest lockdown, particularly on motor policies there have been less new car drivers as a result of not taking driving tests and some people would have stopped having a car as a result of lockdown. So less demand for car policies there. I would expect that to pick up when lockdown lifts. And we talked about more positive signs on the commercial policies for SMEs spreading cash flow. Premium has been a fairly resilient loan book throughout this period though I would say.

If I move on to Asset Finance. A significant part of the loan book growth in the first half of £337m has come from Asset Finance. There's a useful chart that splits out the amount that's come from the government backed scheme on CBILS and the non-CBILS, so the more standard lending that we've had. Now we've had record new business in Asset Finance in the most recent half. It's hard to say how much of the standard business has migrated onto the Government subsidised product and how much has just come from new business as a result of an interest-free period as an example.

I expect to see as the lockdown lifts the key parts are the CBILS scheme will end on 31st March but there's a drawdown period of between three and six months, depending on the product from there, so we have an established pipeline that will draw throughout half two '21 on CBILS and I would expect businesses as well to think about the recent Budget decision on investment, driving investment, the 130% allowance, that could bring forward demand or increase it as well in Asset Finance.

If I move on to Invoice Finance, that's been one of our more impacted businesses, largely through SME sales volumes, their own sales falling and therefore us having less invoices to discount. And the utilisation has fallen there quite significantly. I expect again as lockdown lifts and life returns more to normal for SMEs that utilisation will pick up in Invoice Finance. Importantly we still have the same client base and we have the facilities available for them to draw.

Property has been a very interesting market. The Government intervention on stamp duty and the recent extension as well have clearly driven volumes and assisted with prices along the way. Help-to-buy will change coming into April and be less favourable in the regions as well. What we've seen are very strong repayments from that sales activities but relatively modest drawdowns during COVID as developments have been protracted, typically taking three to six months longer than a normal period.

I'd expect some of that to move away as we move out of lockdown for developments to accelerate again and I would see the loan book, in line with that pipeline we described of £1bn, to pick up as well.

So the loan book growth, to bring that to a conclusion, in half one was 4.4%, the loan book did fall in January itself as you rightly point out, that was largely a seasonal impact and a bit of lockdown three, so I would expect as lockdown lifts that the loan book would continue to grow from its current position. Thanks Raul.

<u>**Question 6**</u>

Portia Patel, Canaccord

In the January trading update the annualised bad debt ratio was 0.9% but reported as 1.3% today, please can you explain why this increase happened when including January?

Adrian Sainsbury

Thanks Portia. What I would say first of all is to look back at that trend I described where half-on-half, half one '20 0.9%, half two '20 3.7% and 1.3% for the half one '21 period.

And then looking at the approach we've taken we've looked as we always do at the end of the half at the portfolios, individual exposures, the macro economic scenario of management overlay and that's where the number of 1.3% comes from. Mike would you like to build on that at all?

Mike Morgan

No I don't think there was anything, I think that's complete Adrian.

<u>**Question 7**</u>

Ian Gordon, Investec

What further volumes are you expecting to achieve under CBILS and successor Government-backed schemes?

And a follow on from that: please discuss the likely recovery process under these schemes? Will it be entirely managed in house? Please comment on the auditing of bank's compliance with the government guarantee scheme. Has your own audit been completed and have you received or disclosed your colour coding?

Adrian Sainsbury

Thanks Ian. On the CBILS volumes and what we're likely to see, as the slide shows at the end of January we'd drawn broadly £730m, that was predominantly on CBILS itself, with less than £3m on bounce-back. That's important when I go into the recovery, the next part of the question that you ask.

Looking forward, as I mentioned in the previous answer, there's broadly three to six months for the pipeline that we have to draw so I'd expect there to be good visibility of further CBILS lending closing out during the rest of the financial year for us.

The replacement scheme, the recovery loan scheme, is less attractive for SMEs. It isn't interest-free, as an example. It still has the 80% guarantee and is most closely aligned with the existing CBILS scheme. So we would plan to apply under that scheme and offer that to our customers.

I mentioned the bounce-back scheme we've done less than £3m on and there's clearly been a lot of coverage in the press of potential write-offs on that scheme. The whole Government-supported schemes come in at over £62bn now and over £40bn of that broadly is on bounce-back, we have less than £3m and that is the product where there is seen to be considerable potential for fraud and potential write-off under the Government's guarantee.

We have mainly the CBILS product, and that's on our standard approach. We took our standard credit approach, we lent predominantly to existing customers as well, so we will use our existing recovery processes there. We have no plan to use a potential utility if there is to be one at an industry level as we stand today although I am on the board of UK Finance, there is no proposal at the moment for such a utility.

And on the audit from the British Business Bank I understand, although I'm not obviously employed by the British Business Bank they have audited most parties. We have had an audit and whilst we don't disclose the rating I'm entirely comfortable with the findings that were in that audit and we, of course have suitably responded to them. Thanks Ian.

Closing Remarks – Adrian Sainsbury

I think that's all the questions. There are no more questions. In that case thanks for your time this morning and I very much hope to see you on 15 June when we have our investor seminar. Thank you and good morning.