Close Brothers
Modern Merchant Banking

Preliminary results

Tuesday, 22 September 2015

Preben Prebensen, Chief Executive Officer

Good morning and welcome to the presentation of our 2015 preliminary results. As usual, Jonathan will take you through the Group's financial performance, and I'll provide an update on the Group and our businesses. After the formal presentation we'll be available to take any questions.

We have delivered yet another year of strong performance for the Group. Adjusted operating profit increased 16% to £225m, building on our consistent track record of earnings growth. Importantly we're delivering this increasing profitability while investing in our business and maintaining our strong financial position. Our capital position strengthened further in the year, and our return on equity also continued to improve.

We're therefore announcing today a further 9% increase in the full-year dividend. Overall the Group remains well positioned to continue to deliver sustainable growth and good returns over the long term.

I'll now hand over to Jonathan.

Jonathan Howell, Finance Director

Thank you Preben, and good morning to everyone.

We're pleased to report another year of strong performance. The Banking division achieved its sixth year of double-digit profit growth, up 15% to £209m.

Winterflood delivered profit of £25m, despite tough trading conditions in the first half. And in Asset Management operating profit increased to £18m. This reflects good progress in the business, as well as the benefit of one-off private equity income.

Overall, Group operating profit increased 16% to £225m, and adjusted EPS was up 19% to 120 pence. As a result our return on equity increased to 19.5%.

We've increased the full-year dividend by 9% to 53.5 pence, reflecting the strong result for the year and our commitment to sustainable dividend growth.

Looking now at the income statement in more detail. Revenue increased 10% to £690m. This was driven by higher income in both banking and Asset Management. The expense income ratio improved slightly to 61%, and expenses increased 8% as we continue to invest in our business.

Bad debt charges reduced to £42m, helping to support the strong growth in operating profit.

The effective tax rate reduced to 21%, in line with the corporation tax rate for the year. And profit after tax increased 20% to £175m.

These results reflect continuing operations and exclude Seydler, the German securities business which we sold in January.

Our prudent funding position is a core part of our business, and supports our ability to grow in all market conditions. In the year total funding increased to £7.5bn to support loan book growth. This remains a good level of cover, at over 130% of the loan book. We have a diverse funding position, with access to both deposit and wholesale funding, and we maintain a prudent maturity profile where we borrow long and lend short.

At the Year End term funding covered 70% of the loan book, which is short term with an average maturity of only 14 months.

On the asset side, the loan book and our treasury assets make up almost 90% of the balance sheet. The £5.7bn loan book remains predominantly secured, supported by our prudent and consistent underwriting criteria.

And we've maintained a strong liquidity position, with over £1bn of liquid assets, primarily on deposit, with the Bank of England.

In recent years our strong financial position and prudent approach to capital have allowed us to grow our loan book, and at the same time meet increasing regulatory requirements. Our capital ratios improved further during the year. The common equity Tier 1 ratio increased to 13.7%, and the leverage ratio increased to 10.2%. This was driven by a 14% increase in Tier 1 capital, reflecting our strong profitability, whilst risk-weighted assets increased 9%, primarily reflecting loan book growth.

Our capital ratios are strong and comfortably ahead of current regulatory requirements. However, capital levels across the industry remain under review by both the UK and international regulators. Nonetheless we are confident that our strong capital position and prudent approach will ensure we can meet future requirements and maintain flexibility as we grow.

In Banking we delivered another strong performance and further improvement in returns. Income was up 12% year-on-year to almost £500m. Expenses also increased 12% reflecting higher staff and IT costs as we continue to invest in our service-led business model. As a result the expense/income ratio was broadly stable at 50%, which is in line with our ten-year average. The bad debt charge continued to reduce, falling to £42m. Overall this resulted in a strong profit growth of 15% to £209m, and a return on equity of 27%.

The loan book was up 8.5% in the year. Most importantly this was achieved whilst maintaining margins and with consistent underwriting. In Retail the loan book increased 8.3%. This reflects good growth in motor finance, supported by a strong car market. Premium finance also grew in the year.

Commercial increased 6.1%, this was driven by asset finance which grew 8.5%, with good levels of new business across all sectors. However, the smaller invoice finance loan book declined slightly.

Property continued to grow strongly at 13%, reflecting continued good demand for residential development finance.

As you can see, all key ratios improved in the year. This reflects our disciplined approach to lending as well as the current favourable market conditions. The net interest margin remains strong at 8.8%, reflecting our focus on maintaining margins as competition increases, and helped by a slight reduction in funding costs.

The bad debt ratio continued to improve, reflecting our ongoing focus on credit quality, and supported by the current low interest rates environment. This resulted in an excellent return on the loan book of 3.8%.

Winterflood reported £25m of profit, despite difficult trading conditions in the year. Trading was affected by low risk appetite from retail investors, reduced market activity and increased volatility, particularly in the first half. Conditions in the second half improved slightly; but overall trading income reduced year-on-year, and lost days increased to 14.

However, Winterflood was helped by a good result in the investment trust business, as well as the sale of Euroclear shares, which we reported in the first half. As a result total income was broadly stable year-on-year. Expenses were also broadly unchanged, and Winterflood maintained at solid operating margin at 26%.

And turning finally to Asset Management where we continue to make good progress. Income increased 13% to £96m. This was driven by good growth in investment management, which was up 15%. The revenue margin on total client assets remained broadly stable at 88 basis points. We also benefited from non-recurring income relating to our former private equity business, resulting in other income of £5m.

Expenses increased modestly, reflecting the predominantly fixed cost base and operating leverage in the business.

As a result, total profit increased to £18m. Excluding the one-off income, operating profit increased 35% to £13m, with an operating margin of 15%.

Total client assets were up 11% to £10.8bn. This reflects good demand for our investment management services, both on a standalone basis and as part of our integrated Wealth Management offering. As a result, our total managed assets increased 16% year-on-year to £8bn. This was driven by net inflows of £700m or 10% of managed assets.

We also benefited from positive market movements of almost £400m. Importantly, these managed assets now include £2.7bn in our integrated offering, where we provide both investment management and advice, an increase of some 14% on last year, whereas advised assets in third party funds were broadly stable at £2.8bn.

So overall, we’re pleased with the progress we’ve made during the year. Thank you very much, and I’ll now hand you back to Preben.

Preben Prebensen

Thank you Jonathan. The strong results today demonstrate continued execution of our clear strategic priorities and the discipline and values that define Close Brothers. Our primary focus is on delivering high-quality service and using our expertise to maintain leading positions in our specialist markets.

Maintaining our strong and prudent financial position is a core part of this strategy, and allows us to be there for our customers in all market conditions. It also allows us to continue to invest in our business and to maintain and develop our client proposition.

Each of our three businesses is a specialist in its own niche markets and we apply the same conservative approach and disciplined focus on returns across all of them. The evidence of this clear strategy manifests itself differently across each of our businesses. The Banking division has delivered its sixth successive year of double-digit profit growth and continued loan book growth against a backdrop of increasing competition.

Winterflood has provided continuous liquidity to its clients and delivered broadly stable profitability this year despite tough trading conditions. And Asset Management continues to make good progress in its core private client proposition with underlying profit up 35% and accelerating growth in client assets.

The success of each of these three businesses has ensured the Group has made tremendous progress in recent years. Over the last five years we've doubled our loan book from £2.9bn in 2010 to almost £6bn today. Our profits have increased at 14% per year to £225m and our RoE has improved to over 19%. And this in turn has allowed us to grow our dividend 7% a year, while at the same time increasing the cover from 1.6 to 2.3 times.

Now let's look at each of our three businesses, starting with Banking.

Our Banking business has a highly differentiated lending model, targeting niche markets that require specialist knowledge and a local presence. It's the expertise of our people in these niche markets which builds the long-term client relationships that in turn drive high level of repeat business. Importantly, each business maintains local responsibility for underwriting and any impairments or workout situations that may arise.

We have a long-established distribution platform with a dedicated sales force of over 500 people, as well our network of specialist intermediaries, which includes motor dealers and insurance brokers.

As the market environment that we operate in continues to evolve, our key priorities over the coming years are, firstly, to maintain our strict focus on returns and prudent underwriting. To do this, we'll adopt the same approach that has served us well throughout the previous cycles, by maintaining our margins and ensuring that we continue to price risk appropriately rather than chasing growth.

Secondly, we'll continue to invest in our model, to both protect our strong position in existing markets, but also actively seek out opportunities in new markets that fit our business model.

This investment will take many forms, but will include further investment in people to expand our distribution capabilities, such as our Sales Academy to train the next generation of sales people in our SME lending businesses; continuous investment in technology to enhance our customer experience and speed to market.

And thirdly, further pilots of new products and new markets, such as our point of sale finance offering for specialist retailers that we shared with you earlier this year, which is progressing well.

You've all seen this chart before, but we've included it again, given how relevant it is as market dynamics continue to evolve. Throughout this 30 year period, we've done what we always do: stuck to our specialist markets and maintained our robust and prudent lending model.

As expected, our growth rate is moderating slightly from the exceptional levels seen in recent years. But the more important point to note is the stability of both our margins and returns over the long-term.

As shown in the table, these have been very stable over the last ten years, a period which includes the full spectrum of market conditions.

The chart illustrates the ability of our business model to deliver consistent growth and strong returns through periods of recession and financial stress, as well as both high and low interest rate environments.

As we've said before, we continue to see a steady increase in the supply of credit and competition from both traditional and the newer banking groups. But we believe the total supply of credit in a number of our specialist markets still remains below pre-Crisis levels.

It's also important to note that we continue to see a good demand for all our products.

Our Motor finance business has seen robust demand due to growth in the underlying car market, and as a result, we've grown that book by close to 10% at consistently strong returns.

In Asset Finance, we've seen good demand across all sectors, and actually wrote record levels of new business last year, which helped drive the 8.5% growth in that book.

And our Property Business delivered the highest rate of growth again last year and has a good pipeline as activity in the wider property market remains buoyant.

Through the years, we have significant experience of developing new products and entering new markets. This history of extending our business model into new areas has helped support continued growth over the long-term and through previous credit cycles.

To give you some perspective on these initiatives, we only entered both the Irish market and Alternative Energy Finance market a few years ago, but we've already turned these pilots into material businesses contributing significant growth.

Our Irish business currently has a £300m loan book and offers motor, asset, premium and invoice finance in areas of the market which meet our prudent risk and return criteria.

The Alternative Energy team are specialists in project financing for a variety of renewable technologies and have built a loan book of almost £100m. Both these businesses are now generating good profitability and have robust pipelines going forward.

As you know, we do not manage this business to a gross target and our priority is always to maintain our strong margins, prudent underwriting and good returns. But as these slides clearly demonstrate, we're confident that our business model can deliver us sustainable growth over the long-term in a wide range of market conditions.

Now moving on to Winterflood. As you all know, Winterflood is a market-maker with a client-specific offering that combines the extensive trading experience of its staff with sophisticated IT trading systems. We're committed to providing continuous liquidity in all conditions and maintain a leading market position, and as a result, the business is exposed to wider market conditions, which were quite mixed last year.

The chart on the bottom shows the AIM market, which is a core part of Winterflood's business. Most equity markets, but particularly AIM, experienced weak and volatile conditions in the first half of the financial year. This resulted in lower levels of both primary and secondary activity, both of which improved in the second half. And as Jonathan highlighted, the investment trust side of Winterflood's business performed particularly well last year, which helped to offset some of the headwind in trading revenues.

This illustrates the overall strength and diversity of Winterflood's business model which enables us to trade profitably in a variety of market conditions and has ensured the business delivered a solid result for the year.

Now on to Asset Management. The Division continued to make good progress in the last year, total client assets are up 11% to £10.8bn and underlying operating profit, excluding the private equity income, increased 35% to £13m.

Since the year-end we've entered into an agreement to dispose of our small corporate business to further focus on our core private client advice and wealth management offering. So the numbers on this slide relate to the underlying performance of our business, excluding the corporate business, and as you can see the core business is making good progress. Adjusted operating profit has increased to £13m in 2015. The operating profit margin was 15%, in line with our target, and the revenue margin of 95 basis points highlights the lower margin nature of the corporate activities we've sold.

In terms of client assets the business is delivering good growth in all areas. Managed assets grew by 18% in 2015 and assets that are both advised and managed grew by 13%. This illustrates strong demand for both our high quality integrated advice and management proposition as well as our tailored investment management products.

Here is an overview of our fully integrated solution which is core to our private client business. This offering incorporates both advice and investment management and is designed to support clients at all stages of their financial life cycle. Our advisers help clients to build a plan designed to support the financial and lifestyle goals and our investment managers provide clients with global diversified investment management through a range of vehicles which include our own funds, discretionary portfolios and a fully bespoke high net worth service for larger clients.

And our platform technology provides clients with a consolidated picture of their wealth. This is a differentiated high quality and well branded offering, and therefore we're well positioned to benefit from the increasing demand for financial advice driven by ongoing demographic and regulatory changes as well as the UK Government's recently announced pension reforms.

In addition to the extensive opportunities for organic growth we'll continue to look at adding further scale and geographic presence through selected infill acquisitions and hiring but we will, as ever, remain disciplined on price and quality.

To conclude, the Group is well positioned to deliver further growth and investment and we're confident that our strategy and proven business model will continue to deliver value for both our customers and shareholders over the long term.

In banking we see continued opportunities for growth while maintaining our prudent risk profile and focus on returns. Winterflood is well positioned but remains sensitive to market conditions and we expect Asset Management to continue to deliver net inflows and increasing profitability.

That now concludes the presentation and there's just one last thing for me to do which is to invite you to join us on 26th November for an investor seminar. We're planning to hold a deep dive of our banking division so please put that date in your diaries and we'll send out a formal invitation in due course.

We'll now take any questions that you may have, we're also joined by our business heads seated in the front row, Stephen Hodges from the Banking Division, Philip Yarrow from Winterflood and Martin Andrew from Asset Management. We'll also be happy to take questions and as usual please state your name and company before asking a question.

Q&A Session

Question 1

Peter Lenardos, RBC

Good morning, it's Peter Lenardos from RBC. I just had a question on the bank tax surcharge and your updated thoughts on whether that will be amended in future years? Thanks.

Preben Prebensen

We issued a statement with our update in July on the estimated impact of that tax surcharge and as that statement said we think that it bites in 2017 and given what is currently in scope and out of scope and the £25m current threshold we think that will have a 5% impact on us from that time in terms of our tax rate at that time.

As you know from the press we have, along with a number of smaller banks, made representations to the Treasury and made suggestions about raising that threshold or putting in a tiered threshold and we'll have to wait and see.

Question 2

Philip Middleton, Merrill Lynch

Thanks, it's Philip Middleton from Merrill's. Just two questions, firstly on Winterflood you talk about the investment trust team having had a good year and well done to them, could you give us some idea of the materiality of that and is that trading and corporate finance which I know is a big component of what they do?

And secondly, when you look at the wealth management business how much of the growth comes from moving clients from one service to your deeper services, or how much of that is pure inflow, the differential growth rates?

Preben Prebensen

Jonathan, do you want to take the investment trust question?

Jonathan Howell

Yes. In terms of as you know Winterflood has a market making service which covers the full UK list and the full European list with some US stocks as well, the bulk of it is UK market making, however Winterflood also has an investment trust business which is both the primary and the secondary market, market making and normally Winterflood will have about 15% to 20% of its total income coming from that investment trust business and because of the good performance in the second half you can assume that that contribution was around the 20% and slightly higher end of the range rather than the more normalised 15% to 20%.

Philip Middleton

Thanks, and was that secondary, primary, corporate finance, a bit of both?

Jonathan Howell

A bit of each but there were some good new issues as well, but consistently throughout the years as you go back it is nicely split between secondary and primary. There was a little bit more primary in the second half of this year than we'd seen previously.

Preben Prebensen

And in terms of the inflows or the impact, there is some impact from clients moving from advised only to advised and managed, i.e. into our products and services, we'd obviously like to see that continue, but the major impact is new clients coming into the business as opposed to that migration.

<u>Question 3</u>

Gary Greenwood, Shore Capital

Hi thanks, it's Gary at Shore Capital. According to the statement you took some money from the Funding for Lending scheme during the year, I just wonder if you could quantify that and the impact that it had on the margin, and also whether you plan to take any more?

Preben Prebensen

Absolutely, I think the answer, Jonathan, in terms of amount is £375m?

Jonathan Howell

That's right.

Preben Prebensen

£375m, that's how much we've currently drawn down, and in terms of whether or not we'd look to increase that, it won't be by very much, it won't be material from there, and that's the nature of the assets that we have to pledge and our alternative funding sources.

Gary Greenwood

And the benefit to the margin?

Jonathan Howell

Well, I mean it is marginal, we've got £7.5bn of funding, the average cost of that is LIBOR plus 200 so if we're adding 375 for a partial year, it's a pretty small effect and as you know because we borrow long the impact takes time for any sort of rate changes to affect us.

Gary Greenwood

Just a useful alternative source of funding really, a diversifier?

Preben Prebensen

Exactly, and we look at that as a diversifier. We also pledge our assets in securitisation vehicles so to us we look at it as almost another securitisation vehicle.

<u>Question 4</u>

Justin Bates, Liberum

Justin Bates from Liberum. Just going back to Philip's question on the Asset Management Division, could you provide a bit more detail on the net inflows, i.e. the split between IFAs and direct please?

Preben Prebensen

Yes we certainly can, the IFA channel is an important source of inflows for us into the managed-only side of the business. We actually benefit from that in more than simply economic ways because it's a corroboration of the quality of our investment management services.

In terms of the amount that that represented do we actually disclose that?

Jonathan Howell

No, we don't disclose it.

Preben Prebensen

We don't break it out.

Concluding Comments – Preben Prebensen

Thank you very much indeed.