Close Brothers

Banking Division Investor Seminar

Thursday 30th May 2013

Preben Prebensen – Group Chief Executive

Good afternoon to you all and welcome to our presentation on the Banking division. We last gave an update on the Banking division in November of 2010, where we talked about the strength of the lending model which has underpinned our successful long-term track record. And now, almost 3 years later, our lending model is unchanged.

As you know, the lending model is specialised, niche and relationship driven. Our highly distinctive loan book is secured, small ticket and short-term. And furthermore we ensure that we're conservatively funded and capitalised. We maintain our focus on this model in all conditions which has led to consistently strong returns. As you can see the ten year average for return on opening equity is 19% and the ten year average return on the net loan book is 3.6%. As you know we're above those levels currently.

Our position in the UK banking market is also very distinctive, not only because of our lending model but also because of our distribution and our customer relationships. And that's why we've had such good long-term growth of 11% per annum over ten years, and also why we see good opportunities for further growth.

Now let me hand over to Stephen Hodges, the Chief Executive of the Banking division, who I'm sure most of you know well.

Stephen Hodges – Managing Director and Banking CEO

Good afternoon everyone and thank you Preben.

Those of you who know us well will not be surprised by what you'll hear today, which is that we're not changing our strategic direction in the Banking division, and we're going to make a virtue of the fact that we're committed to our distinctive business model.

I've said in the past that we have a disciplined approach to lending, and that for many years we have adopted a set of principles and guidelines which allow us to trade profitably through the economic cycle. That hasn't changed. And neither has our commitment to providing our customers with the highest level of service and expertise

We offer our customers a differentiated proposition but it's also important to note that we think and do things differently, things that are hard to replicate which set us apart from other banks, large and small and things which have enabled us to deliver consistently high quality, recurring earnings and loan book growth

So, we would like to look at those differentiators in further detail and to address four key questions: What are those key differentiators? What underpins our strong financial performance through the cycle? How does our approach to funding and lending differ from our competitors? And why are we well-positioned for growth?

These questions will be addressed with reference to our five strategic pillars. I'll begin by discussing our customer focus and how this underpins our distinctive lending model. Mike Morgan, our Finance Director, will then discuss the financial attributes of our model and our approach to investment and operational excellence. Nigel Mottershead, our Head of Credit

Risk, will examine our consistent lending principles and how these support sustainable growth by allowing us to lend through the cycle. Malcolm Hook, our Treasurer, will provide an overview of our distinctive and conservative funding and liquidity position and how this ensures we're well positioned to fund future growth.

And the presentation will then conclude with a review of the opportunities for future sustainable growth, why we're well positioned and what this means for shareholders. And in addition to the speakers we've got in the front row Mary McNamara, Head of Commercial, Bob Golden, Head of Retail, and Sharon Bishop, our COO, and they will be available, along with the speakers, for Q&As and further discussion over a drink later on.

We pride ourselves in the simplicity of our business model and of our balance sheet. We make loans to small and medium size businesses and individuals, and we take deposits. That's all we do. We're an award winning specialist lender with a £4.5 billion loan book, and 60% of our lending is to SMEs. We provide finance through our large direct sales force and through a network of intermediaries such as motor dealers and insurance brokers. And our people are located across the UK, providing specialist loans and market expertise to our customers.

Our loan book remains predominantly UK focused with minimal exposure outside the UK. And as you can see, we've got offices across the UK with no regional preference or concentration. We look at where the opportunities are for each of our businesses.

And we make loans across a diverse range of assets, customers, regions and sectors. The pie chart on the right gives an illustration of this diversity; however this diversity extends much further as we have specialist subsections within each of these segments. So, for example, within Construction, Plant & Engineering we have a number of teams focussing on different specialist assets and sectors.

We provide these loans through five specialist lending businesses, which we operate through three lending divisions. And as a quick reminder, Commercial consists of our Asset and Invoice finance businesses, and these provide direct and indirect loans to SMEs. Retail comprises our Motor Finance business and Premium finance activity which we pioneered in the UK in 1977. And Property specialises in short-term residential, development and bridging finance, predominantly focused on London and the South East.

Part of our consistent approach and diversity relates to the split of the loan book by division, which we broadly maintain at 40%, 40%, 20%. But all of these businesses have been with us for over 20 years; the youngest being Motor Finance, which we have grown from a small business in the early 1990s to a core franchise today with a loan book of £1.2 billion.

So, our businesses are distinct and specialist in their field but they share a number of key attributes. And it's this common thread that underpins our distinctive lending model.

Local distribution allows us to form strong relationships with our customers and with our intermediaries, something that virtually all other lenders have abandoned in favour of a centralised model. These relationships are strengthened by our commitment to service and to speed, brought to life by the expertise and experience of our people. And their depth of knowledge and understanding also protects the business model by sticking to our consistent underwriting disciplines, lending against assets that we know and understand. And this underpins our track record of strong margins and profitability through the cycle.

Close Brothers

Just before I hand you over to Mike and Nigel, who will be dealing with this last point in more detail, I'd like to elaborate on the first three attributes, which underline our customer focus and our commitment to keeping those customers at the heart of our business model.

Firstly, local distribution and strong relationships. And these are key for our future growth.

In Retail, the businesses' distribution channels are through intermediaries such as insurance brokers and car dealers, and the loans are characterised as being small ticket, high margin, short-term, mainly secured and high volume.

Our branch model in Motor Finance allows us to work closely with our network of motor dealers, some of whom we've been working with since the business was started in the early 90s. And the strength of these relationships protects us against low-price, low-service competitors who cannot offer the same level of flexibility and expertise that our customers need. And of course local presence gives us much better knowledge and ability to respond when defaults occur, and that keeps bad debt under control.

In Premium finance loans are intermediated through our broker network of over 2,000 insurance brokers, many of whom are on long-term contracts with us. Broker relationships are very sticky; they generate high levels of repeat business and very, very low broker attrition rate.

Our Commercial businesses operate through two channels: our direct sales teams of around 250 people and via appointed brokers. And we see ourselves as local business partners to our customers across 21 offices through the UK and Ireland.

In Asset, local teams of specialists provide customers with direct access to decision makers, and this generates high levels of repeat business.

And in Invoice, our regional offices network facilitates geographic reach and a proximity to the customer that a centralised model cannot replicate

Our Property division in three locations provides short-term, specialist property finance to developers. We have high levels of repeat business as many of our customer relationships began over ten years ago; some as long as 20 years ago.

So, all of this together is one of our most powerful competitive advantages, as it's taken us over 25 years to build and grow. And it is this which gives us the confidence that the growth that we've achieved is sustainable and that future growth is assured.

And this diagram illustrates the depth and breadth and variety of market access that I have just been talking about. Unique local distribution, combined with expertise and the ability to take decisions quickly, is key to our market access. And this approach allows our specialist sales teams to develop really close working relationships with our borrowers and intermediaries, and distinguishes us from other players.

Secondly, service. As mentioned our customers sit at the heart of our business model and we're absolutely committed to our customers through the cycle, and we know that that helps to foster long-term relationships. For example, we may be the only lender that can say we continued providing property development finance through both the early 90s recession and the recent financial crisis. And I certainly know of no other bank in the UK that can make that claim. High levels of service are provided by local, specialist sales teams who are experts in our assets, markets and customers. And we're successful at developing talent, but also

hand-pick sales people from the industry. And our unique, high touch model allows us to give market-leading response times. So, in our Property business applications for finance are turned around quickly and loans of less than £500,000 typically get a decision within 24 hours. And in our Motor business, we recently piloted our Motor e-click facility, which allows us to approve and issue funds within 20 minutes.

But our speed of decision-making also extends to more complex, bespoke finance arrangements. A recent example of this occurred when a logistics client approached us wishing to acquire a competitor within 72 hours. We were able to inspect, value and establish title to over 300 separate assets and provide a £1.3 million loan within 36 hours. A great example of working together to provide a flexible solution that meets our clients' needs. And again and again we win business because of speed of decision and service.

And the third thing is our experienced people. What's clear from the example I've just given is the key differentiator is our experienced people and the depth of knowledge and expertise is a fundamental component of our business model. We build trusted relationships with our customers because our people are experts in their fields. And this expertise is illustrated by the level of experience in each of our businesses. So, the average number of years experience of our Commercial and Retail leadership teams is more than 25 years; and our Senior Property management team each have more than 20 years experience in the industry.

So, people are our most important asset, and throughout our growth over the last 25 years we have continuously focused on valuing our people and rewarding and recognising talent, and we will continue to do this as we grow. And our track record of attracting and retaining talent is a key strength of our model. So, during the height of the property boom in 2007, when credit was easily available and many competitors were setting up property lending teams, we only lost two Property sales people during this time. People who are successful with us find it generally unattractive to move to other lenders who don't share our long-term approach. And we remain committed to retaining this talent that we have built over time, and we'll always look to cherry-pick experts out of industry in order to capture the best.

So, these core attributes of our lending model, unchanged over 25 years, will ensure that we deliver consistently strong margins and returns. And I would now like to introduce Mike Morgan, the Finance Director for the Banking division, who will talk more about our financial strength.

Mike Morgan – Finance Director

Thank you, Stephen, and good afternoon everyone.

Over the course of the next few slides, I want to demonstrate to you four things: why our model is so financially strong; how our different income streams contribute to our strong net interest margin; how we manage our cost base; and to conclude, the differentiators that underpin our financial strength.

We're really proud of our track record of financial performance, as demonstrated in our most recent set of half-year results. And this is underpinned by safe and controlled loan book growth; a strong net interest margin, which was 8.9% in the first half; and a consistent bad debt performance, with a bad debt ratio of 1.2% in the first half.

The strength of our margins and our consistent credit track record are supported by people intensive, high service model. This model limits our ability to generate operating leverage, but we continue to manage costs tightly. And over the last three years we have achieved

strong income growth and disciplined cost management despite considerable investment in infrastructure.

These robust ratios allow us to deliver high returns, with a return on equity of 24% and a return on loan book of 3.7% in the first half. The graph on the top right shows how favourably these two ratios compare to the ten year average, particularly given that during that period the loan book has grown from £1.6 billion to £4.5 billion today. You will also notice how consistent these returns have been over the last ten years.

The figure on the bottom right-hand side shows how those returns are generated and I think it is important for us to spend a moment or two to run through the financial dynamics. In simple terms, for every £100,000 that we lent in the first half, we made a margin including fees of £8,900. Costs of £4,000 are then offset to give a profit before bad debt of £4,900. Bad debt of £1,200 is then deducted to leave us with a 3.7% pre-tax return on loan book. This is a strong result that we're very proud of. The very nature of our model allows us to sustain a consistently strong margin of around 9%, together with a low bad debt ratio of 1.2% - a combination that is uncommon amongst peers and one we're committed to protecting.

Our model focuses on providing excellent levels of service and this allows us to maintain our strong margins throughout the cycle. Stephen has taken you through this in his overview, but I would like to stress again that this performance reflects resilience in a period of unprecedented external stresses as a result of the global downturn.

Now, there are a number of distinct income streams which contribute to our strong net interest margin. The first key element is net interest income which represents around 76% of lending income, and effectively reflects the spread on lending to customers. The second type of income that forms our NIM is fees and other income, which represents a further 24%. This contribution has remained broadly consistent over the past three years. This includes a variety of fees which are directly related to our lending activities, such as early settlement and default fees, as well as income arising from operating leases. Importantly for us, substantially all of our income is generated from our customer relationships. As Malcolm Hook, our Treasurer will tell you later on, our Treasury division is a cost centre whose primary purpose is to maintain the Bank's conservative funding and prudent liquidity approach, and as such it generates minimal income.

Management continue to take a disciplined approach to controlling costs and ensuring that spend is prioritised so as to best support our customers and grow our loan book. As you have heard, we maintain our margin by offering a high level of service. Our sales force has a deep knowledge and understanding of the markets that we operate in, and as such, 55% to 60% of our total cost base is formed of staff costs. Whilst we reward and retain our staff for strong performance, the bank's compensation ratio has remained stable at 27%, which compares favourably with peers.

The figure on the right splits staff costs into fixed and variable elements. Fixed staff costs comprise salaries, commissions and share based payments, variable staff costs comprise bonuses, and as you can see, we don't operate with a highly variable compensation structure, unlike some other banks.

The largest three components of other costs are depreciation, property expenses and legal and professional fees. Over the last few years we have significantly invested in our business in order to manage and support a larger bank. Some of the key areas we have focused on include building our frontline capability and capacity as well as the customer proposition, and

during the last three years we've increased head count by 7% per annum whilst loan book has increased 20% per annum.

The investment in infrastructure since 2010 has been considerable and this has increased our depreciation and amortisation charges. We have invested in systems such as SAP and implemented a bank wide credit reporting database to improve our control infrastructure. So whilst most of this investment has gone into driving top line growth we have also benefitted from better management of credit quality.

IT investment is also key to supporting growth and we're well through a programme to upgrade and migrate our IT infrastructure to state of the art data centres. We aim to complete this during 2014.

We've also markedly strengthened the management structure over the past three years to allow us to support the growth in the business. We believe that the enhancement of the bank's governance structure has had tangible benefits in the maintenance of our key ratios such as NIM and bad debt. We plan to continue investing in our business to strengthen the capacity, infrastructure and governance, and as such the expense income ratio is expected to remain broadly in line with current levels at 47% for the foreseeable future.

As you have heard from Stephen and myself, we have a distinct business model which we very much believe in and it is this model that allows us to differentiate ourselves from the competition and retain the financial attributes set out on this slide that have served us so well.

Now, with that I will hand over to Nigel Mottershead, Head of Credit for the Banking Division, who will talk about our consistent lending principles.

Nigel Mottershead - Head of Credit

Thank you, Mike. Good afternoon everyone.

In our interim accounts we said that our priority remains maintaining the discipline of our lending criteria to protect our business model and our strong returns. I'm going to explain how our credit culture and unique business models have provided, and continue to provide, the discipline, environment and structure for our long-term sustainable growth and low predictable loan losses.

Let me start by looking at our performance history. This slide which you've seen before shows both the sustainability of our growth through the cycle and our narrow range for bad debt. If the business doesn't fit our model we simply don't do it. The range for our bad debt charge has been only about 70 basis points to 2.6% over a 27 year period. But it's not that we're rocket scientists or we have some kind of magic formula, but that we know our model, we know our appetite and we stick to them relentlessly.

I talked at the start about our credit culture, providing the underpinning for our disciplined approach. This is a combination of people and structure on the one hand and policy and principles on the other. Our template for people and structure is simple, we've always believed that getting the right people, specialists in their own area and empowering them to manage their own business will produce the right results. That's true not only in the context of growing the book, but also maximising recovery. Using local expertise and having people lend only to their specialism means that when the loan hits problems we know where and who to go to to sell the asset.

This local model is supported by central oversight and control. Over the last few years we've invested significantly in our infrastructure and systems, as Mike has said. We have clearly articulated risk appetites and policies and principles which we approve centrally. We recognise that one of the biggest risks to our model is doing larger, more complex loans, and therefore all loans over one million pounds are either reviewed by my team centrally or approved by a bank credit committee.

So, let me turn to our lending principles. Whilst our businesses are diverse and specialist there are five common principles running through all of them. Firstly, we're predominantly a secured lender and we lend at typically prudent loan to values. Over 90% of our book is secured, and where we do unsecured lending it's in specialist markets with good quality. Second, we lend short and we fund long. Over half our book has a residual contractual maturity of less than a year. Our behavioural maturity is even shorter, and Malcolm will talk in more detail about our funding and liquidity strategy later.

We keep loan sizes low and we spread our risk. Most of our loans are less than £50,000 in value, and the top ten loans only account for 3% of our loan book. As I said earlier, we use local underwriting expertise based on deep knowledge of the asset with central oversight. For example, in our print business we've maintained good growth in a difficult market with low bad debt by sticking to very standard assets, in this case, new and used German sheet fed lithograph printers. We centre our underwriting on the likely recovery value by checking stock and demand in real time with the buyers and suppliers of those machines. And because we have 26 year's experience of doing this our estimates have proved highly accurate through the cycle.

Finally, we diversify rather than concentrate our portfolio by business or by asset type. Our mix by division, retail, commercial and property has stayed close to a 40/40/20 split over many years. The net result of this is our consistently low bad debt through the cycle, but these principles work mainly because of the characteristics of our unique business model and the specialisms which provide stable credit quality.

Many of you will be familiar with the table at the top of this chart which has many of our key lending statistics. I'd like to explain further from a credit risk perspective how the different businesses work. We need to look at them individually as they have different risks and mitigation. However, all of them are based on strong underwriting disciplines, predictable stable arrears and effective recovery.

In Motor Finance we have a regional branch network which ensures we have close relationships with the dealers, but also, as I touched upon earlier, strong performance on repossession and resale. Our branch managers are incentivised on net profit and they work to minimise bad debt. So if you were to go round one of our branches and look at the white board, yes of course you'd see the sales and the core volume targets, but you'd also see targets for arrears, for repossessions and for sales at auction. As a result of that, nearly 60% of our loans one month in arrears are returned to performing, however, where we're really successful is writing consistently good quality business so our arrears are low in the first place. When compared with our peers we have significantly lower arrears rates, because although we credit score all our loans we manually underwrite around 90% of them to double check quality. We're therefore less vulnerable to the one thing that we can't control, which is swings in the residual value movement or price.

In premium finance we have three layers of protection. Firstly, the insurer who provides a refund on the policy. Secondly, the broker who provides recourse on our Personal lines business and cancels the policy and gets a refund from the insurer and finally, the borrower who doesn't want us to cancel the policy because it's generally critical to them, be it home or

motor in Personal lines or fleet in Commercial. And again, this protects us in large part from a major deterioration in the macro economy or the markets, elements that we can't control.

As Stephen commented earlier, our asset finance business accounts for over 30% of our loan book and uses experts in a diverse range of asset classes. Our credit policy is very clear, however, specialists in print can't do loans for trucks and so on, so the knowledge and experience is incredibly concentrated, leading to strong customer relationships and deep asset market intelligence. Because of our relationships we identify issues early and we act quickly. As I illustrated with the print example we're able to predict with great accuracy repossession values; often repossessed assets are sold to existing customers who will pay a higher price because we package the finance for them. This is a completely different approach to our motor business where we can't influence the price and therefore sell the cars quickly at auction.

In our asset business we only sell around 10% of our repo-ed assets at auction and our asset for sale website has around 200,000 hits per annum, and it's these kind of bespoke approaches which lead and provide our consistent high quality earnings.

Our invoice finance business also has a triple-tiered approach to managing credit risk. Firstly, advance rates on the approved debtors tend to be around 80% which is below the industry norm but at any point in time our book is only drawn on limit to about 50%. Second, we always seek to tie the principals and directors in by way of guarantees or warranties and indemnities, and finally, over 30% of our debtor book is credit insured. We have our industry leading software called Ideal which gives us visibility of the borrower's ledger and transactions and we use a real-time program to identify probably the biggest risk in invoice which is fraud. Our impaired loans have fallen from a peak in 2008/9, but like our other businesses our recovery rates are stable and actually slightly improving.

And the final business area is Property Finance. Property lending is more vulnerable to changes in the market than our other businesses, that's why we continually challenge and enhance our credit policy and rules. Unlike other banks, for example, we don't allow the borrowers to use their own professionals for management or valuation purposes, but since the credit crunch in 2008 our average loan to value for new business has been less than 55% and despite strong recent growth we've had minimal losses.

So to summarise, we have specialist discrete businesses which all follow a set of consistent lending principles, stay within their specialisms and are protected to a considerable extent from the events they can't control. We have no intention of changing this model and we anticipate maintaining our sustainable, high quality earnings. I'd now like to hand over to Malcolm Hook, our treasurer, who will talk in more detail about our funding strength.

Malcolm Hook - Treasury

Thank you, Nigel.

Today I'm going to talk to you about how we fund and how we manage the liquidity of a growing specialist bank. To do this I'm going to start by comparing how we were funded at two points in time, July '08 and January '13, a period that saw the impact of the credit crisis on the financial sector.

In looking at the graph the first point that I want you to note is the extra one billion of funding raised. All of this has gone to support the increase in lending. The second point that I want to make is that this uplift has been accompanied by a broadening of our funding base, we have taken significant steps to diversify our funding. And on the graph they are circled in green.

We have raised £1.9 billion of retail deposits under the Close Brothers savings brand, it complements our longstanding deposit taking services offered to corporates.

We have developed a capability to raise funding on a secured basis, £0.9 billion by January '13, and we have accessed the capital markets with a senior unsecured bond. However, one thing has not changed, the importance of longer term funding to us. Such borrowings stretch the runoff of our liabilities and give us more choice over when to refinance.

As noted on the slide, term funding, and by that I mean funding which has more than one year to run before it matures, grew by £1.3 billion to £3.1 billion between July '08 and January '13. At that point, such funding covered 72% of the loan book. Keeping term funding to a level that is around two thirds of the loan book is, we think, sensible.

Now, on the other side of the balance sheet our focus has been to concentrate treasury assets into more liquid instruments. By January '13 our holdings of high quality liquidity stood at £1.1 billion, comfortably above our internal and regulatory stress test needs. In addition, the concentration of treasury asset holdings enabled us to become more efficient in the use of the balance sheet. This in turn has allowed us to redirect funding to the growth in the loan book.

In consequence, we're now in a strong funding and liquidity position. Moreover, the changes that have taken place have given us more flexibility to manage the fluctuations in the cost and in the supply of different sources of funding. Our core funding markets and existing distribution channels will remain very important to us but the journey to find ways to support sustainably a growing loan book is not over. On the slide I've listed some of the areas that we're exploring, and for example we have already begun to upgrade our systems to improve our capabilities to fund on a secured basis, possibly by via public securitisation or funding for lending. We have also started to look at how operationally we can extend the Close Brothers savings proposition.

I am confident that we have the financial strength and the brand to take more steps on this journey when the time is right. And in doing so, we will, of course, not compromise on our core principles. One: borrow long, lend short. Two: diversity of funding. And three: plenty of liquidity.

Thank you for your attention, now let me hand you back to Stephen.

Stephen Hodges

Thank you, Malcolm.

If we're to grow sustainably we need both new business and to hold on to as many of our existing customers as possible. So, why are we well positioned for growth? Well, firstly you're going to be particularly interested in understanding what we're seeing currently in some of our markets. As you know the last three years have been a period of exceptional dislocation in the UK market as the big banks have been deleveraging and shrinking balance sheets and foreign banks have retreated to their domestic markets. So this presented a significant opportunity for us and without changing any of the lending disciplines that Nigel has referred to we were able to capture particularly strong loan book growth of circa 20% per annum in the last three years.

Looking now at the current financial year, conditions continue to be favourable. We announced last week in our Q3 interim management statement that we've delivered 9% growth for the first nine months of the year. Very good growth, but clearly a moderation from

the super-cycle growth of the last three years. And there are principally two factors driving this moderation.

Firstly modest changes in credit supply and some patchy competition. Let me give you a few examples of what we're seeing. Looking at our Motor Finance business first, over the last six to nine months there has been some players moving back into the second-hand used car financing space and chasing hard by pricing aggressively. Despite this, we're sticking to our consistent lending principles, and this has moderated our growth rate from the particularly high levels we have been enjoying for the previous few years, but we continue to see good opportunities for growth. So there is more competitive activity out there but it is still patchy. The players are generally small, markets are fragmented, and we think we're still a long way away from the levels of competition that we saw back in the days of easy credit.

Secondly, fluctuations in demand for credit with some specific factors at play in some of our lending areas. So for example in Asset Finance, as continued uncertainty in the UK economy remains, many SMEs are delaying investment and holding on to assets for longer than they would otherwise. As such, their needs for financing reduce. Furthermore, where other companies have got cash they are often choosing to use it as an alternative to bank finance, and we're seeing this for example in our Commercial Lines Premium Finance business. More generally across the UK the demand for credit is currently suppressed, and while we have not yet seen any sign that this is changing, we think that when the economy does recover to more normal levels, we will benefit from the increase in demand.

Overall, these remain very favourable conditions for us, now I personally believe we're in an extended period of good growth opportunities, and I remain confident that we're well positioned to capture these while sticking to our distinctive and profitable lending model. So let me now explain why I have that confidence.

Starting with our existing markets where we have a proven track record of winning and retaining business and we believe there is significant room for further growth in those existing markets. Firstly, we believe that the use of specialist finance products like ours will continue to grow. There is really good demand for specialist, tailored, innovative finance solutions. By way of an example, there are an estimated five million SMEs in the UK, and whilst of course not all of them require finance solutions, the majority of them are underserved by the high street lenders. Compared to that five million SMEs, as you know we currently have 23,000 SME customers in our Commercial business, and I think that gives you a sense of the scale of that opportunity.

We're also going to continue to push to increase market share. While we have experienced strong growth over the past few years, we remain a small player in many of our niche markets, and here are some facts to try and give some context to that. In Asset Finance, we have got a £1.4 billion loan book in a £22 billion market. Within that, transport in the UK is a very important sector for us, particularly with the rise of internet shopping which clearly requires this service for delivery. We're continuously focusing on capturing more of that market and maximising our current relationships. And although we're a leading player in the Property Finance market, we still have a small market share. Our property loan book of just over £800m at the end of January, compares with a total property lending market in the UK, excluding mortgages, of about £220 billion.

We're going to capture this growth opportunity by continuing to invest firstly in our people, and headcount has increased some 30% since 2009, and this combined with training and development programmes and a strong succession pipeline, ensures that our human resources will not be a constraint to capturing growth. We're also going to continue to invest in our local distribution model, further embedding via technology solutions such as broker

and motor dealer portals, better integrating our systems into our introducers' business processes, to ensuring that we remain their long-term business partners.

Since 2009, we have increased the number of motor dealers we work with by 50% to nearly 9,000 today. However, over the same time we have more than doubled the Motor Finance loan book, hence increasing the penetration from those dealers. We believe there is a lot more to go for. Many of those dealers give us just one deal a month or less, and we can increase with technology the activity that we get from each dealer and make it easier and simpler for them to deal with us. And finally, as I touched upon earlier, we think there is an opportunity for us to benefit from any improvement in the economic environment. If demand recovers more quickly than supply, we're really well positioned to capture growth during a continued period of dislocation.

But as well as existing areas, we continuously explore opportunities to grow in adjacent areas that share common attributes with our core businesses. We have got a dedicated Business Development Committee who are focused on expanding our product offering, exploring new routes to market by undertaking "test and learn" pilots of new businesses. Some examples of those that we have explored and developed over the last few years include, our Key Accounts in the Motor area, where we now have a team of 20 people exclusively focused on larger, franchised motor dealerships, such as our relationship with Suzuki Motorcycles.

In Asset Finance we have leasing where we have a specialist sales team with a strong market reputation for arranging bespoke leasing solutions, who see high levels of repeat business in excess of 70%. And in Property more recently we have developed loans to Housing Associations. This is where we provide loans to Housing Associations to assist with their private for sale developments, i.e. not to finance their social housing stock. This is an adjacent market to our existing one but with really attractive returns, particularly given strength of covenant of our borrower.

So I have been talking about opportunities for existing and adjacent markets, but it is also important to consider the competitive landscape and how well positioned we are in that. As you can see from looking at this slide, the playing field today in the UK is significantly dominated by five big players. But if we had looked at the competitive landscape in 2007, there would have been many more bubbles on this chart. For example, at the top of the slide we would have seen larger Irish and Icelandic banks who have since withdrawn or collapsed, and these were previously some of our fiercest competitors, particularly in the Asset Finance space. Other specialist banks that have exited such as Dunbar, or more recently ING who have pulled out of asset finance in the UK. And of course down at the bottom there were many, many other smaller specialist banks, HP companies and asset financiers who have had to close over that period due to lack of funding.

Any recovery is likely to be slow and gradual over the next few years. Few lenders have the ability or the desire to grow in our niche areas, and many of them remain constrained. So all of this has created a lot of space around the middle of the market and around us. And of course, if we just looked at secured specialist lenders there would be very few bubbles on the chart and a much greater distance between them. This secured specialist nature of our lending is what protects us and provides a long-term position for us in the UK.

Of course, in some of our markets we're seeing new entrants such as Titlestone in Property, or Aldermore, but these are smaller than us and they are not filling the void left by those larger banks. But in addition it is difficult to build businesses in this area, not all will succeed. The very nature of our niche lending requires specialisation, expertise and experience, and as such it is very easy to get it wrong and it takes a long time to consistently get it right.

So we have a very good model and very good market position in the UK, which means we perform well in a range of market conditions, and that's why I remain confident that good growth opportunities continue to exist for us.

So as I wrap up, I would like to remind you of some of the key strengths of the franchise and why we think we're in a strong position in the UK with really good opportunity. As a small specialist bank we believe we remain well positioned to capture growth. Our distinctive lending model, characterised by a well-established distribution network, experienced specialist people, and high levels of service and speed of decision making, is central to our ability to create and sustain long-term relationships and recurring income from our customers. As such, that model is difficult to replicate and one which we're confident will continue to support sustainable growth in shareholder returns.

I know you are all very interested in the outlook and I would like to leave you with some of our thoughts on this. We have already told you today why we really like our strong model and our strong market position in the UK, and so we're clearly not going to be changing either of those. Conditions remain favourable for us and we believe that we remain in an extended period of good growth. This will obviously be affected by any significant change in supply or demand.

What happens to supply of credit? Well, as you have seen today some of our businesses are more protected than others from an increase in competition. However, overall the supply of credit is a long way off the levels that existed pre credit crisis, and therefore the market remains favourable for us, and underlying changes in demand could deliver potential upside from any recovery in the economic environment. As you know, our long-term growth rate is 11% per annum compound, and our current growth rate is just above that level, and we remain confident of continued good growth opportunities for all our businesses based both on current market conditions and our excellent position in this market.

Thank you. That concludes the formal presentation. I would now like to open up to any questions, so if I could ask you to please state your name and company before asking the question. Then after the formal Q&As you are all very welcome to remain for a drink and ask informally any other questions you may have.

Q & A

Question 1

Gary Greenwood - Shore Capital

I have got three questions. The first is just in terms of growing pains for the business. You've talked quite a bit about the investment in infrastructure that you have been putting in place, but I just wonder if you could talk a little bit more about what potentially holds the business back in terms of the rate at which you can grow, and at what point you might reach a size at which you get potentially diseconomies of scale.

Then the second question just on competition. You've talked a lot about competition earlier, but I just wonder if you could talk a bit more about what you are seeing from the big banks. Obviously Lloyds and Royal Bank of Scotland both talking recently a little bit more optimistically about the pick-up in loan growth, and obviously the Government putting pressure on them to grow in the SME market.

Then the final question is just on the yield curve and what impact that might have on the numbers if we see a steepening of the yield curve, particularly given that you fund long, lend short.

Answer:

Stephen Hodges

Right. Well quite a lot to talk about there, so where shall we start? Maybe we will start with the last point, the yield curve. Clearly we match all our funding, and clearly we have got a short-term book, the average life of our loans is just over 12 months, and even though we borrow long and lend short, we swap all of our funding into variable rate. So I would say that we have a pretty well protected position against movements in interest rates. Clearly because of the short-term nature of the book we can re-price our lending quickly and reflect any changes in underlying cost of funds. And to the extent that we don't run positions in our Treasury operation, our Treasury operation as you have heard is a cost centre primarily, so that we're not running any particular positions there that could either benefit us or catch us out. So to the extent that interest rates move up, we'll earn a little bit more on our capital, on that bit of our funding that is tied up in our lending, but it shouldn't have a material effect on our earnings or on our ability to access markets.

On competition, I have said quite a bit about competition, so I might ask my colleagues in a moment to talk about particularly what they are seeing from the larger banks.

And on growing pains for the business, we normally expect to see the question the other way round actually, we normally expect to see when are we going to see economies of scale coming in, rather than when are we going to hit diseconomies of scale. So I think the answer is that we have a high service, high touch element which requires people, and therefore of course we continue need to find good quality people to provide the sort of service that we've been describing to our customers. We've grown those people by 30% over the last few years so I think we're in a good position from a human resources' point of view. I don't see any shortage of good people, I don't see any reason why that should be a restriction on growth. Other restraints on growth might be capital or funding, but as you know we're in a good position from both of those points of view. Mike, I don't know if you want to add ...?

Mike Morgan

I would add to that. On the diseconomies of scale point, and we have invested quite significantly across the bank over the last few years in the front office as Stephen has said, but also in the infrastructure in a very big way. So for instance, we have put one general ledger right across the bank, we have got a credit risk database right across the bank, we're now moving all the infrastructure into the data centres, as I commented on. I think if we had not done that then I think you would really start to see diseconomies of scale coming through, but that has helped us control that. I don't see in our current environment that we will start to see diseconomies of scale because of this investment in the back office.

Stephen Hodges

And on the question of competition from the big banks, perhaps I could ask Mary McNamara who runs our Commercial Division just to say a word about that.

Mary McNamara - Commercial Division

If I look at our Invoice Finance business, we have always seen competition from the big banks, so that has been a constant. If I look at the Asset Finance business, it is still quite patchy. We're seeing some competition from RBS and Lloyds, but it is very patchy across the businesses.

Stephen Hodges

Thank you. Bob, anything to say on retail?

Bob Golden - Retail

I think in Retail especially we deliberately don't go toe-to-toe with the big banks, so it has not been a material impact. One area where you might consider would be Motor Finance, but we really work in different markets in that our core business that we get our business from is primarily smaller sized details, whereas the big banks really are going after the larger dealers. So we don't really come across them that often.

Mark Cathcart, Investec

I thought you said that you were going for the larger dealers though.

Bob Golden, Retail – Close Brothers

What you can do is you can break the market into various slices. I think right at the top end is an area that we wouldn't go for because the margins are just not there. In terms of what are we looking for in our Motor business, we're looking for price, we're looking for the quality of the credit. Volume is second. So although we've gone upscale if you like in terms of our key accounts, it is not right to the top end.

Stephen Hodges

And in our Property business, as you would expect, we're not seeing the big banks because they still have got sizeable property portfolios that they are unwinding. So we certainly don't see them in the Residential Development/Finance sectors. Any other questions?

Question 2

Mark Cathcart, Investec

I just wondered about the FLS, if you see it as an opportunity or threat, and if you see it as an opportunity are you going to go for it? And the second question is, I guess people talk about jaws nowadays, and I just wondered if there was a threat that you might get a closed jaw at Close? In other words, you have been expanding quite a lot, your headcount has gone up by 30%, or your expenses have gone up by 30%, I just wondered if you could see a scenario whereby volumes were coming off, if not contracting, and how quickly you could get your expenses back down again?

Answer:

Stephen Hodges

I think if you look at the history of our cost/income ratio over any lengthy period, it has been pretty consistent. And of course we have the ability to trim our costs in the event that growth were to slow or income were to slow. So we don't see that as a particular issue. Mike?

Mike Morgan

We have a rigorous exercise at least on an annual basis to look at that very issue, and we understand our cost base well, we understand the fixed element of it, the variable element of it, we understand the projects we're undertaking and how those could be deferred. So we're very clear what we would do if that were to happen.

Stephen Hodges

And on funding for lending, Malcolm would you like to?

Malcolm Hook

Yes. I mean, I think obviously the first point to make is that along with other central bank initiatives, FLS, as we've seen since last summer, has contributed to an easing of general funding conditions and a drop in the marginal cost of funds. That said, the bulk of the FLS that has been drawn down has been directed probably mostly to the mortgage market, and to that area. We're looking at it quite seriously and I've referred to the investment we've made in terms of upgrading our systems. The however is, one, we are personally quite well funded and two, the collateral that we might wish to put in is to some extent different to what has been seen in the first wave, and we're sort of looking at what the dynamics of that would be and how that would work out for us. So in general I would say it has been an opportunity, because it's been beneficial from an easing of funding conditions.

Supplementary Question

Hasn't it been extended to the SME market and so it becomes more of a threat?

Malcolm Hook

Yes. And it's also been extended by year, but I still think, you know, when you look at the peer group of banks and the big banks, most of the big banks for example are very well funded at this point, and so, you know, the pick up in terms of draw downs has been perhaps less than was initially first thought of.

Question 3

Robin Savage, Canaccord

I wonder whether you can talk about 21st century banking. A lot of what you've described today is a way in which Close has operated for a long period. You did mention internet shopping, and I wonder whether you can perhaps share a little bit of maybe the way in which you might use technology to interact with internet shoppers or other businesses perhaps that are trying to sell product to individuals that might be suitable to have a bit of stapled debt. Perhaps you could also provide an indication of the way in which you might use data to actually understand your customers, and certainly some of the smaller banks you're talking about growing, that's certainly the way they're looking at lending. They're looking at using data in a way which the big banks can't use data and can't understand their customers. I wonder whether you can perhaps – you certainly understand the customers that you've got. I

wonder whether you can perhaps share the way in which you use the data to feel comfortable about extending the credit to those customers.

Answer:

Stephen Hodges

Yes, well, on that last point I'll let Nigel comment in a minute about how we use credit MI to give us the confidence to make lending in our existing ways. I mean I think the important thing about the new possibilities that you raise is absolutely we have to be aware of what's going on. We have to be aware of new methods of distribution, we have to be aware of new technologies. But we have good growth opportunities from all our existing ways of lending. They are secured ways of lending, and as we've tried to describe today they are differentiated ways of lending, which have barriers to entry and would have high margin, and where we think we can distinguish ourselves from the competition, and I think some of the new types of lending that you've referred to are much closer to what I would call "commoditised" lending, where it's much more difficult to differentiate yourself, and where we would see it quite likely that many of those will just drift down to high volume-low margin commodity-type lending. And that would be an area we would be very nervous about participating in, and very nervous in particular about leading.

So our instinct, I think, is to keep a very close eye on what's going on. You're absolutely right, technology is changing all sorts of things, and we can't be complacent about that, we must be aware of it and look at how it will impact our existing businesses, let alone create new opportunities. But I think we would be nervous about committing too much to that at a time when our existing businesses, we believe, still have plenty of opportunity to grow.

Nigel Mottershead

Yeah, Mike mentioned during his speech CRMI, which is the Credit Risk Management Information System. We've invested heavily in that over the last few years. That gives us insight down to low level data. What's important is when I say "insight", that gives those of us at bank level centrally the ability to drill down at a moment's notice into an individual characteristic of a loan, or we can look at the performance of a book in the last month. And that's been complemented by developments in CRM, I think, Mary, as well. Customer Relationship Management Systems. So over the last couple of years we've really expanded our quotient of knowledge. And our ability to understand and manage our book from those respective developments.

Stephen Hodges

I could just ask Bob to talk about our e-click facility in Motor.

Bob Golden

Yeah, I think generally your point is a good one, and actually we're looking at a whole number of possible innovations. Clearly you wouldn't want me to tell you what they are today, but one of them that we've actually launched and is in pilot that I can talk to you about is called "e-click" in our Motor business. And this really is leapfrogging, we think, the competition and the technology that's out there.

The concept really is that you're able to walk along the road past one of our dealerships who provide our loans, and to be able to go into that dealership and to be able to purchase a car

with a loan having no documentation on you, which previously you'd have to go home and get proof of identity and various money laundering documentation and Know Your Customer stuff, but actually we can now do that electronically online. But not just that, the electronic documents, the electronic signatures, the electronic credit assessment as well and, most importantly for the dealer, the instantaneous payments to the dealer. And we actually launched that about six or seven weeks ago. It's going very well, and we're looking for a full roll out on that later on in the year. And we really do think that that will, for a period of time, because technology only gives you an advantage for a short period of time, but we think for a period of time we will have a USP out there on that. So we have invested heavily, and that's a recent example.

Question 4

James Alexander, M&G

Just a couple of questions. Three questions. Where are the commissions to your brokers to your originators or to your brokers or dealers in the sort of flow chart of expenses or income? That's one question.

Answer:

Stephen Hodges

I'll let Mike deal with that. But my understanding is they're netted off. Netted off the NIM? So the NIM is net of those commissions.

Supplementary Question

Just looking at your non-staff costs, if you'd asked me what your non-staff costs would be as a percentage of your total costs I would have said a third. But they seem quite high. I mean, your non-staff costs. Just you don't consider them too high? I'm just wondering whether half/half is about right.

Mike Morgan

Yeah, well we clearly consider them to be right at the moment. And as I said during my session, we take a very disciplined approach to costs. If you look through there, the three large elements, we've got the depreciation on the operating leases, so that pushes the number forward quite significantly. We've invested very heavily in technology and IT, so there's an IT cost coming through on there. And we have legal and professional fees as well, which come through. So those are challenged very hard, and we're comfortable that those are the right level for the organisation.

James Alexander

I can't remember, did you give the operating lease figure how much that is?

Mike Morgan

I'm not sure we actually gave an explicit amount for that. No.

Supplementary Question

My last question is kind of semi-strategic. Just I know you like to lend short and borrow long. As you get bigger, you know, you have to run very fast just to stand still with your loan book, given the short tenor of the book. Are you tempted to go out a bit further on some slightly longer loans just as you get bigger and more mature and you've got better systems to give some three/four year loans just as a way of keeping the book?

Answer:

Stephen Hodges

We have always had a small proportion of longer term loans and in our asset finance business we have always had loans that are up to seven years long. They are a very small proportion of the whole. I don't think we are tempted to grow our loan book by stretching the average maturity. Because it goes against the benefits of the model that we've been talking about. It goes against the ability to re-price. It goes against the benefit that we have in liquidity terms. And in many of our areas we are lending against the maturity of the underlying asset. So if you're providing premium finance, you're constrained by the fact that it's a 12 month asset and you're providing a ten month loan. And you can't go any longer than that, because the asset itself won't exist, and similarly with debtor financing. We're typically financing 90 day debtors. And it would be foolish to extend your loan for longer than that period. Nigel, I don't know whether you would want to add to that?

Nigel Mottershead

Well I think it is a key pillar of our lending principles that we lend short and we fund long. And I think as Stephen said, in a few cases we will consider longer term loans. Particularly in one of our smaller business, leasing, which has those characteristics. But that's complemented by the premium business especially, which is really short-term run off. And I don't see us changing that model at all.

Question 5

Robin Savage, Canaccord

This isn't a plea, but I did notice on the school fees that I got the other day that Close were providing school fees finance, and actually I've always thought that's actually a really good business to be in, because the one thing that parents will do is make sure that they pay for school fees. And I think you might have noticed that school does last for more than a year. So in terms of getting a product that could have longer term – maybe, James, that's the sort of product that maybe you should be looking at. Having a sort of five year…

Stephen Hodges

Multi-year facility?

Robin Savage

Multi-year facility type of thing.

Stephen Hodges

And just hope your child doesn't get expelled? Any other questions?

Question 6

Arnaud Giblat, UBS

A quick one on leverage in Core Tier 1. At the last set of results and there was an indication of the level of growth that the Bank needed to achieve in order for the Core Tier 1 to stay still if growth is slowing somewhat, as you've indicated, from the previous 20%. At some point Core Tier 1 starts to build up and there is potentially some surplus capital coming back into the business. What is your thinking around that?

Stephen Hodges

Capital is generally managed at the Group level, so I might ask Jonathan Howell to answer that.

Answer:

Jonathan Howell, Finance Director

Yes. The question is very good and very topical. We reported at the interims that our Core Tier 1 ratio had stabilised in that six month period between the previous year end and the interims. We reported a ratio of 12.7%/12.8% for that six month period. And that is after a three to four year period of capital ratio reduction, which had been driven by the very strong loan book growth. Where we sit at the moment with a more moderated level of growth that Stephen's just described, and with Asset Management moving into a break even position, and with Winterfloods still operating somewhere at a ten year low in levels of profitability, that we would become capital generative. So as we stand here now and look forward just to this year end, we expect this capital ratio to stabilise and begin to move forward, and at these types of growth rates it will continue to grow, with potential for enhanced levels of growth when Winterfloods come back from its cyclical low and when Asset Management comes through this structural period of development that it's going through.

So yes, it will grow. We anticipate that that will be a steady process over the next two to three years, and of course then that gives us options. And those options are either for reinvestment back within the business or alternatively for some form of enhanced distribution. But what I will hasten to add at this stage is that it's still very, very early. It's not an issue for today. And it certainly won't be an issue for the next 12 months or 24 months, but it is something that we will begin to sort of monitor and consider.

Question 7

Nitin Arora, HSBC

Just a question on Motor Finance. I think you said that you don't compete with the bigger banks in the Motor Finance area, and that's one part of the business which has been growing very strongly over the last three/four years. Could you put some numbers around the market share? What areas are you playing? What is available to you? And how has your market share changed over the last three/four years?

Stephen Hodges

Yes. Who would like to-?

Answer:

Bob Golden

Broadly the key numbers are probably back in 2008 our market share, and you have to be very precise as to what you're talking about here, if you're talking about the independent financiers of used cars, so that's including Santander, Lloyds, Motor Novo, Barclays, ourselves we did have a 5% market share in 2008. Now it's about 12%. In 2012.

Nitin Arora

And you think it can go to?

Bob Golden

I think we can improve on it. And I think, you know, that's an area that clearly we're working on very hard to try and increase that. But I think, you know, we really need to underline that when all the people who run the businesses in Close, we focus on our NIM, we focus on the credit quality and what volume, in a sense, follows from that. So of course we chase our sales people hard. And we try and come up with innovative products and really good service. And speed of decision making is incredibly important. But NIM, credit quality, then volume.

Stephen Hodges

And I think the statistic I gave earlier about how many of those dealers only give us one deal a month just gives you some sense as to the scope of the opportunity there. So just by increasing the penetration within our existing dealers, with whom we have often very, very close relationships, which go back a long time, if point of sale finance continues to be attractive to purchasers, then we're in a good position to pick up that increased use of specialist finance.

Right. Well, if there are no other questions, please join us for a drink. Thank you very much indeed.