Close Brothers Group

Tuesday 11th March 2014

Interim Results

Preben Prebensen, Chief Executive

Good morning and welcome to our presentation of our 2014 Interim Results. As usual Jonathan will take you through our financial performance and I'll then provide an update of our businesses and the strategic progress we've made in the first half. After the formal presentation we'll be available to take any questions.

Before I hand over to Jonathan I'd first like to share with you the highlights of our performance in the first half of the year. The Group continues to perform strongly. We delivered adjusted operating profit growth of 21% to £97m in the period with all three divisions contributing to the improved performance. As a result adjusted earnings per share increased 19% to 50 pence.

Importantly we continued to deliver strong returns while maintaining our high quality balance sheet and strong capital position. In the period reporting for the first time under CRD IV our common equity tier one capital ratio remains strong at 13.2% while we improve the Group's return on opening equity to 18%.

Finally, I'm pleased to say that this morning we've announced a 10% increase in the interim dividend to 16.5 pence. Overall we remain well positioned for growth as I'll discuss later on.

I'll now hand over to Jonathan.

Jonathan Howell, Group Finance Director

Good morning everyone, and thank you, Preben. I'll now take you through our performance for the first half. As you can see we have delivered a strong result for the period. Overall we've reported a 21% increase in adjusted operating profit to £97m. All three divisions have increased their contributions to Group profits.

The Bank is up 14% to £90m driven by good loan book growth and lower bad debts.

Securities profits increased by 58% to £17m. And Winterflood's profits grew by 81% as trading conditions against a subdued first half in the prior year.

Asset Management continued to make progress with adjusted operating profit of £3m. Finally net group expenses increased to £12m but the prior period included one-off income of £2m.

Looking now at the income statement in more detail. We've recorded a 14% rise in income driven by good loan book growth in the Bank and improved investor risk appetite in Securities.

The expense/income ratio has remained stable at 63% as operating expenses increased by 14% to £202m. We've continued to invest in the Bank to support further growth and in Securities variable expenses increased as revenue improved. The tax charge was £22m corresponding to an effective tax rate of 23%. As a result adjusted earnings per share increased by 19% to 50.4 pence. And we declared an interim dividend of 16.5 pence, an increase of 10% on last year reflecting the strong earnings in the period.

The balance sheet continues to be simple and transparent principally comprising assets and liabilities relating to lending activities in our Banking division. The loan book and Treasury assets account for over 80% of the Group's total assets. The loan book grew by £200m or 5% to £4.9bn in the first half. The risk profile of the loan book has remained consistent principally short term around 90% secured and with prudent loan to value ratios.

Treasury assets decreased slightly to about £900m. They represent our holding of high quality liquid assets principally deposits with the Bank of England. Our liquidity position remains strong and comfortably ahead of regulatory requirements. The Securities assets which include short term settlement balances and trading positions increased £200m to around £800m reflecting increased trading activity immediately preceding the balance sheet date. These assets are largely offset by related liabilities with the net position remaining broadly stable at around £100m. Overall total assets increased by 4% to £7.1bn in the first half.

We have maintained our strong funding position with its emphasis on diversity and prudence. In the first half total funding increased to £6.4bn covering some 132% of the loan book at the balance sheet date. This reflects continued growth in our customer deposits which increased by £135m to £4.1bn. Our term funding over one year remains stable at £3.4bn. This remains a prudent level relative to the loan book which was 71% covered by term funding at the balance sheet date. And the average maturity of the term funding at 23 months continues to comfortably exceed the loan book at 13 months.

We're reporting for the first time under CRD IV. The Group's capital remains strong with a common equity tier one ratio of 13.2% and the leverage ratio at 9.3% despite continuing growth in the loan book.

The impact of CRD IV is broadly neutral. The Group has taken the benefit of the discount for SME lending but this has been offset by a new deduction for foreseeable dividends. This arises from new regulations which apply to the whole banking industry. The reduction in common equity tier one capital to £670m was largely due to the new foreseeable dividend deduction. This is calculated by taking the Group's average pay-out ratio over a three year period and applying it to the first half earnings. We remain focused on holding an appropriate level of capital and continue to monitor and manage capital resources carefully.

That Banking division delivered a good performance in the first half as the loan book continued to grow and bad debts improved. Income increased by 11% to £218m principally due to a 10% increase in net interest and fees on the loan book. Costs increased by 15% to £106m as we continue to invest in our business to support growth. This included additional volume related costs including increased headcount in both the front and back office to continue to support our customer proposition, and infrastructure investments to ensure our technology remains robust and secure. Overall the Bank's expense/income ratio increased slightly to 48%. A strong credit performance across the portfolio has meant the bad debt charges on the loan book reduced by 12% to £23m. Overall profits increased 14% to £90m and the return on equity for the division increased to 25%. This reflects our strong returns but also improved balance sheet efficiency and lower tax rates.

The loan book has grown by 5% to £4.9bn in the first half and by 11% over the last 12 months. The growth rate has remained good with record levels of new business although net growth has slightly moderated from the prior year as expected.

The Retail loan book increased 5% to £2bn primarily driven by growth in motor finance. We've continued to see good demand for second hand car finance although this has been offset by an increase in competition. The premium finance book also increased in the period with growth across the book.

Commercial grew by 3% to £1.9bn driven by asset finance with good growth in SME lending in particular. The invoice finance book reduced in the period principally due to a seasonal decline in demand in January.

Growth in the Property loan book was 6% to £1bn as we continue to benefit from good demand and limited competition. Our distinctive model has continued to drive our consistently strong returns.

The net interest market has remained stable at 8.8% as the mix of our business has remained broadly unchanged.

The bad debt ratio has continued to fall and is now 1%. A further reduction in the first half was principally driven by improved credit performance in Property and asset finance.

Overall the return on net loan book increased to 3.8% driven by the continued reduction in the bad debt ratio.

Now turning to the Securities Division where adjusted operating profits increased 58% to £17m reflecting improved market sentiment from Retail investors. Winterflood has maintained its trading capacity throughout the difficult market conditions in the last two years. As a result it has benefited from recovering risk appetite and adjusted operating profit increased 81% to £13m in the period. Seydler's profits also improved to £3m. As a result, the division's return on equity improved to 25%, up from 16% in the prior period.

Winterflood's performance improved in the first half as we saw better trading conditions, particularly in AIM. Trading performance was again consistent with just one lost day in the period. Income increased by 39% to £48m, costs also increased by 28% to £35m, reflecting higher performance related costs which were driven by the improved trading.

Average bargains per day increased to 52,000, up from 42,000 in the first half of 2013, but stable on the second half. However income per bargain improved to £7.20 in the first half due to the change in mix towards higher margin sectors.

Now turning to Asset Management where we continue to make good progress. We recorded good income growth of 9% principally in investment management as we continue to grow assets under management. We've continued to control costs which increased only modestly to £37m. Overall adjusted operating profit increased to £3m.

AUM increased by 2% to £9.3bn in the first half with positive net flows. We maintained good sales momentum as gross inflows amounted to £590m in the period. These inflows were partially offset by total outflows of £400m, this resulted in positive net flows of about £190m, equating to a growth rate of just over 4% on an annualised basis. In addition we saw slightly positive market movements of about £25m.

Now looking at the components of AUM in more detail. Total managed assets increased by 5% to £6.5bn reflecting good inflows and consistent good fund performance. Total advised assets were broadly stable at £5bn as we saw modest outflows in the period. However, managed and advised assets increased by 3% to £2.3bn. This increase is important for our integrated proposition as managed and advised assets generate advice, investment management and platform income. These assets now represent 45% of total advised AUM.

Thank you, and now I'll hand back to Preben.

Preben Prebensen

Thank you, Jonathan. Before I talk about our three divisions in greater detail I wanted to highlight key aspects of our strategy which reflect our modern merchant banking principles and underpin Close Brothers' strong competitive positioning. The Group has maintained a strong financial position through the cycle and we've always recognised the need to maintain a strong balance sheet and capital position. This approach has served us well in recent years and we came through the financial crisis without needing to recapitalise or cut our dividend.

As Jonathan said, we take a prudent approach to managing our balance sheet and have been able to continue to invest and grow all of our businesses while maintaining our capital position and increasing our dividend.

We continue to benefit from applying a consistent strategy and our clear business models have supported sustainable growth in all market conditions. We serve niche markets that require specialist expert knowledge and an in-depth understanding of our clients' needs. In particular as a small but growing financial services group we differentiate ourselves through our prudent approach lending on a predominantly secured basis and through our focus on returns, not volume driven growth.

While we operate within an established model, and we will not change that model, we're always enhancing and optimising our business processes and we're continually improving our technology and customer service. In particular we believe we remain able to implement change effectively across the Group. We're large enough to have the resources to invest, but small enough for change and technological development to have a meaningful impact across the business.

For example, in Banking we've consolidated and upgraded our IT infrastructure across the entire division, a project that would be expensive for many of our smaller peers and complex for many of our larger peers to undertake effectively. Similarly in Winterflood a significant proportion of our employees are focused on IT and in-house development, supporting our leading market making position. In Asset Management we've invested in our platform technology and we're working with our financial advisers to increase their capacity to enhance our client offering.

Lastly, we continue to benefit from our customer proposition across the Group supported by emphasis on client service. Our specialist teams developed close relationships with their clients, helped by a local presence in many of our markets. While many other firms have moved to centralised models our bank has maintained a decentralised model and we continue to strengthen our distribution network. Our lenders operate out of nearly 50 locations enabling us to build stronger more focused relationships with our customers and intermediaries.

Similarly in Winterflood our specialist proprietary technology enables us to deliver flexible client led trading solutions, while in Asset Management our local model is supported by our national network of ten regional offices.

Overall we retain the culture and characteristics of a focused local merchant banking group and we believe that our financial principles and cultural values, that have served us well in the past, will continue to serve us well in the future.

Our strong market position and consistent lending principles in banking have enabled us to deliver sustainable loan book growth in all market conditions. Of course the rate at which we can grow continues to reflect developments in our lending market and our growth rate remains sensitive to changes in credit supply and demand.

When we last updated you in September we were seeing signs of competition returning as we expected. Sticking to our lending model and not changing our strict lending criteria resulted in our loan growth moderating from the very high rate we enjoyed during the financial crisis when credit supply was very constricted. However, as we stand today the market remains fragmented, there's still very few specialist lenders in our space. Many of the banks we used to compete with remain constrained and continue to have a reduced presence in our markets while very few new entrants have the expertise and distribution in our niche areas.

As the graph shows we've consistently grown our loan book even during times of easy credit. Moreover, given changes to the regulatory landscape we think it's unlikely growth in credit supply will reach the same levels we saw during those periods any time soon.

We've also not yet seen a broad based increase in SME demand, but we remain well positioned to benefit when this improves. Overall we have a strong long term market position. It's taken us nearly 30 years to grow our loan book to its current level of nearly £5bn and our track record gives us confidence that future growth can be sustained. We lend to SMEs and individuals against a diverse range of assets which provides us with wide ranging opportunities across different markets.

I've talked about growth, but our position in the UK banking market is very distinctive, not only because of our lending model but also because of our continued strong performance and returns. I'm sure you're familiar with the model but to summarise briefly we're predominantly a secured lender and we apply prudent loan to value ratios to our lending. Around 90% of our loan book is secured and we keep our loans short term and small in size.

Further, we provide our customers with a highly differentiated proposition which supports our strong margins. We build long term customer relationships and have demonstrated commitment to our customers through the cycle.

Our specialist sales teams possess expert knowledge of our assets, markets and customers and have local autonomy enabling them to provide flexible lending solutions and make fast decisions.

We also continue to benefit from our credit control based on strong underwriting disciplines, predictable stable arrears and effective recoveries. Overall we've continue to improve our returns in the period. Our return on net loan book increased to 3.8% and our return on opening equity improved to 25%. We have a clear model built over 30 years which is not easily replicated. This supports our strong market position and we remain confident that we'll continue to grow.

Let's turn to Winterflood. Market conditions improved in the first half following difficult trading conditions over the last two years. The majority of our order flow comes through retail brokers and therefore Winterflood's performance is strongly correlated to retail investor sentiment. A number of positive market changes over the last six months have contributed to a shift in sentiment and encouraged retail investors to increase their risk appetite. Improving primary market activity can be supportive of increased secondary market activity, and in 2013 the number of IPOs in the UK increased with a strong pipeline for the current year. In particular new listings on the AIM market where Winterflood generates higher margin trading, were at their highest level since 2007.

In the same way tax changes such as the abolition of stamp duty on AIM shares, as well as their inclusion within ISAs, may also have helped to increase risk appetite by encouraging retail investors to trade less liquid small cap stocks. While none of these changes alone will have had a material impact on Winterflood's performance, they're all potential catalysts for more general improvement in retail investor sentiment.

Clearly trading behaviour and risk appetite remain susceptible to economic conditions and events. While average daily retail market volumes have improved - as the chart shows - they continue to be lower than the levels we saw at the peak of the last cycle. Similarly equity markets have rallied but remain volatile. Winterflood is a daily business, and while we see the immediate benefits from improving market conditions, sentiment and risk appetite can change quickly. The last six months have been a strong period for equity markets, but as we all know trading conditions remain susceptible to external events, such as last October when markets were subdued during the US debt ceiling and budget debate.

Winterflood is a cyclical business and has responded as expected to better conditions with an improved first half performance. Despite periods of volatility we reported just one loss day out of 128 trading days in the period, reflecting the skill of our market makers. In particular we have benefited from continuing to concentrate on our core market making activities and from maintaining our trading capacity in weaker markets. We've also continued to invest in our leading market proprietary technology to provide the best prices and execution for our clients. Technology plays a key part in the success of Winterflood and we invest considerably in this area, with around 20% of our employees focused on technology and in-house development. Our fast and resilient electronic trading systems can be customised to the specific requirements of our clients, which include 300 retail and 150 institutional clients.

Overall we've maintained our market leading position. Trading conditions are improving, although we're not yet near the levels of performance we saw in 2010 and 2011. However, while it remains difficult to predict future market behaviour, Winterflood is clearly well positioned to benefit if sentiment continues to improve.

Finally turning to Asset Management. We're seeing significant developments in the UK wealth management market, and I'd just like to highlight the strengths of our core client proposition and describe our business model in more detail to help demonstrate how we're well positioned going forward. Our strategy is founded on our core belief that it's important for everyone to have a financial plan. The value of a financial plan lies in identifying the actions clients need to take today in order to secure the lifestyle they want in the future. The costs of not taking action early and losing the benefits of planning opportunities can be significant and can grow over time.

Therefore we've built our proposition to provide clients with everything they need to create, implement and review their financial plan at any stage of their life. We've developed a vertically integrated model founded on our core capabilities of financial planning, advice, research, investment management and platform technology, all enabling clients to choose the services they require according to their personal preference. Our professional advisers assist clients in developing their financial plan. This is broad in scope and covers forecasting lifetime earnings, expenditure and retirement income. We help clients establish a long-term investment strategy and assist with tax and pension solutions, insurance to protect against key risks, as well as estate planning for the next generation.

Alongside this we provide global diversified investment management across all liquid asset classes through a range of investment vehicles. These include our own funds, model portfolios, and a fully bespoke service for our high net worth clients. Our platform technology provides clients with a consolidated picture of their wealth. We've designed these capabilities to work in tandem and to deliver a comprehensive and integrated approach for clients. In particular we believe our range of capabilities and the flexibility of our proposition is differentiated and well suited to the current environment.

We developed strong credentials in our markets and are building scale in the business. We have over 120 financial advisers and 50 investment professionals managing over £9bn of client assets. We remain focused on building enduring long-term relationships with our clients and will benefit as they increase their assets over time. Ultimately we earn revenue from several sources: advice; investment management; and our platform, which maximises our profit potential per client and provides significant scalability, particularly in investment management and through our platform.

Looking at the last six months the division has continued to make progress towards our profitability target. We continue to build scale, growing assets under management in the period, and seeing solid demand for our products, reflecting the quality of our integrated proposition. We're benefiting from investment in distribution and are seeing good growth particularly in our managed AUM. Supported by the strong performance of our funds we continue to see a good demand for our Close Discretionary Fund range, which provides a cost effective way to access professional investment management for both our own and third party advisers. Importantly, none of our distribution channels have reached maturity, and we expect continued growth across our proposition as we build scale.

Lastly, we continue to make progress towards our medium-term profitability target. As well as benefiting from operating leverage as we build scale we're also focused on improving the efficiency of our advice process for clients. The revenue margin increased slightly in the period and we expect this to improve over time depending upon the business mix. We're confident we'll continue to increase our operating margin and are on-track to achieve our 15% target by 2015.

So to conclude, our business model, strong performance and financial position ensure that we're well placed going forward. We're confident in our strategy, seeing good opportunities for growth, and will continue to deliver strong returns for our shareholders. In Banking we expect to continue to deliver good growth at attractive margins. Winterflood is well positioned to continue to benefit from a stronger cyclical recovery, and in Asset Management we continue to make progress as the business builds scale. Overall we remain confident in the outlook for the year.

We now look forward to answering any questions that you may have. As well as Jonathan and myself, we have Stephen Hodges from Banking, Julian Palfreyman from Winterflood, and Martin Andrew from Asset Management, who will also be happy to take any questions. As usual, could you please state your name and company before asking a question.

Question and answer session

Question 1

Nitin Arora, HSBC

A couple of questions. Firstly on Banking. When I look at the non-interest income that has barely moved compared to last year, could you elaborate a bit more on why it has not changed.

Then secondly on Winterflood, Preben, you highlighted that trading on AIM is similar to 2007 levels now, which should have helped you guys a lot, but if I look at the income per bargain it is still running 30/40% behind 2011 levels of 10/11 per bargain. So if you could comment on why that has not picked up.

Jonathan Howell

That line includes treasury income, and what you see there is a temporary effect of us taking the benefit of reduced funding costs in the funding markets at the moment before passing them on in a renewed blended rate to the loan books, and that is done on a periodic basis. That just represents a timing, a temporary effect, and also represents the fact that we are seeing slightly improved rates that can be achieved in the funding markets.

Should we factor that into a change in the net interest margin? The answer is no, for two reasons. One is, we are seeing increased competition across the book, the funding markets are benefiting everybody in the banking arena at the moment, and so therefore much of that is effectively being passed through to customers. Secondly, it takes a long time for that blended rate to pass through to our book in its entirety. As you know, we effectively borrow long and lend short, the average term on our book over 12 months is 23 months, and therefore it's going to take almost two years until much of that benefit is passed through to at least some of the book. So that's what's caused it. Will it create a change in the net interest margin going forward? Our anticipation is that it will not.

Preben Prebensen

On the income per bargain, I think we've talked in the past about this being quite a crude measure, it's all income over all bargains, and if we look at those two component parts, the first six months was obviously much better than the equivalent period a year ago, but we're still some way behind the income levels that we saw in 2010/2011, in fact we're 25-30% below those income levels. So while it's a bounce back, I think you still need to recognise that it's only a bounce back compared to quite a poor level of a year ago.

I think on the other side the number of bargains is also something that we have talked about in the past. The number of bargains has increased over time. In fact, if you go back five years ago I think on the London Stock Exchange the average trade was twice as big as it is now, £13,000 compared to £6,000; so every time we take on a client trade and we lay that off, we're doing it more times than we used to do certainly four or five years ago. So we're not yet at the income levels we were in 2010/11, and we also have this kind of continued proliferation in the numbers of bargains that we use to lay off trades that we take on, and that's why you have to be a bit careful about just tracking income per bargain as such a crude measure.

<u>Question 2</u>

Pras Jeyanandhan, Berenberg

Just a quick question on costs. I suppose given the revenue uplift across the Group I would have maybe expected a bit more operating leverage in the Banking business and also maybe in Winterflood; and obviously you've talked a little bit about the investment in infrastructure, the technology spend. I just wanted to get a little bit more guidance in terms of how you see the operating leverage benefits panning out in the coming years?

Preben Prebensen

On the Wins side I think you do see the operating leverage. It's a business which has got manifestly variable costs as opposed to fixed costs, so compensation levels will go up as trading profits go up, and in a normalised year that relationship is two thirds/one third in terms of variable versus fixed costs, so I think you do see it there. I think in terms of operating leverage in the Bank it's all about what we're spending that is volume related and what we're spending which is investment related. Do you want to go into some detail on that one?

Jonathan Howell

Just to reiterate on Winterflood, that cost model hasn't changed at all over the last 10 years, and exactly as Preben says, once you get up to the full level year of profitability, £45-50m, that relationship is about two thirds/one third between fixed and variable, and that hasn't changed and should be consistent with past cycles that we've seen.

In terms of the bank increase, about two thirds of that increase was volume related. It is a high touch, high service local model that we need to maintain in order to achieve those net interest margins of anything between 8.5% and 10%. And during the course of the year we've taken on an extra 90-100 heads in the Bank to take us through to 1,700 people in total.

In terms of the other third, that really is IT and infrastructure spend. It's part coping with the significant growth that we've seen in the Bank. If you go back to 2009 the loan book was £2.4bn, that's more than doubled in that period to £4.9bn, so we just need to make sure we've got greater IT capability and greater IT scalability, but also a constant attention to upgrading the quality, the robustness and scalability of our IT.

Just to give you an idea of some of the things that we've done and are currently doing, we had 12 separate data centres across the whole of the Bank about three years ago, we've now migrated that into two state of the art data centres. We've upgraded a completely new general ledger across the Bank, we had previously 33 general ledgers, that's down to one now. We put in place from scratch a credit management information system which enabled us to have central quantitative and qualitative oversight of the lending decisions being made out in all the local branches. And importantly we're upgrading legacy systems in the property part of the business and in the premium finance part of the business.

What are we doing currently now and going forward? Cyber security and general information security is another area of spend that we're involved in. And importantly and critically we're taking considerable steps at the moment to have more technology at the point-of-sale within the Bank, and a very good example is e-click and motor where effectively now we're getting to a lending decision which is almost paperless. That sort of ties in with the way that the industry is going, it gives greater flexibility to the way in which we dispense with our services, but also importantly it gives us greater accuracy over the information because it's being actually input at the point-of-sale rather than subsequently off some sort of hard copy documentation.

So to get to the question, can we see any significant change coming forward in that mix in the Bank? Probably not. I'll point to the 10 year average of cost income ratio of 49%, the first half we were about 48% so we're in that type of range, 49% to 48%, for the cost income ratio, and it reflects the nature of the business model that we have.

Preben Prebensen

I think the point that we can't emphasise enough is that we need the investment to support the growth, but we also need the investment to make that safe growth. This is a clearly highly regulated period of time, and for us to ensure that we can continue to grow and do that safely is actually going to continue to be a real competitive advantage, so this is investment well made.

<u>Question 3</u>

Gregory Simpson, UBS

Two questions, firstly back on Winterflood. When I look at the AIM volumes reported by the LSE it looks like January and February have been significantly better than other months in the year. Do you see this short-term volumes uplift transcribed through to Winterflood, or is it a slower process? Then secondly on competition, you said it's kind of coming back but do you think it's starting to intensify now? I know Paragon announced they're opening a bank for car finance, RBS is voting more on SME lending, and the parts of the market which you said were competition is least present like property, that's where the strongest loan book growth is being seen. Are you starting to see this intensify or is it still quite subdued?

Preben Prebensen

On the first question, in terms of January and February trading on AIM and whether or not that's reflected in Winterflood; Winterflood has a strong position on AIM, it's a leading player on AIM, it's good for Winterflood when AIM is seeing lots of volume, but it's a daily trading business. So what we cannot do is to try and predict trends, all we can do is to point to the leadership position on the one hand. Then as you all know based on what you do, the IPO pipeline for the next period looks quite strong, but that's obviously subject to market conditions. And as I mentioned in my remarks, Winterflood doesn't do the IPOs but it trades them and it's good if that product is out there providing interest to investors. So we can only judge it as it happens as opposed to looking forward, but they're very well positioned.

On the competition point in the Bank, overarchingly we see that as patchy, so there are places where there is more than there was, motor is an example of that, the clearers are clearly more present in the motor business, they're a bit more present in large ticket property but that tends to be larger than where we play. The likes of Lombard are more present in asset finance, but again that tends to be in the slightly larger ticket areas, and the start-up banks are all looking to do what they can do in places like asset and invoice financing. And there I think the issue is distribution where we've obviously been at this for a very long time, we have a lot of people that are focused on distribution in the SME space and that's clearly a comparative advantage. So it's increasing but it's still fragmented and it's still nothing like it was back in the '07 period.

Question 4

Arnaud Giblat, UBS

Are there any new niches you're exploring to grow into in the banking business?

And secondly, I'm just wondering if you could comment a bit more about the profitability, the revenue margins in asset management, that has decelerated somewhat, where do you see those going in time?

Preben Prebensen

In terms of new niches in the banking business, we have always looked to expand into additional niches and over a long period of time we've done that. And what we want to do is to preserve the overall model, that establishes the risk parameters that we have, we're overwhelmingly in smaller ticket, shorter term secured high margin lending; but that's not to say that we won't explore the edges and what might be available to us. And that could be high margin retail, specialist retail lending, it could be more complicated small project lending in newer alternative energy for example. Those are two examples of where we might kind of look at the distribution curve of our lending, and both of them are interesting to us but they have to fall overall into the context of us sticking kind of fundamentally to the model. So we look at it all the time basically and we're constantly kind of challenging ourselves to push out the edges.

In terms of the revenue margin and asset management, I think a bit of context here. In 2011 that revenue margin was 71 basis points. For the six month period a year ago it was 84, it's 87 now. We will continue to see it increase over time, it will be partly a function of mix if we take on more managed assets, more high net worth assets in any period then those are slightly lower margin. If we take on more new advised business in any period then that's slightly higher margin. So I think you'll see a gradual increase in the revenue margin but it will depend on mix. It's an indicator of the performance of the business, not the only driver of the performance of the business, and what we obviously look at is the overall operating margin in the business. And we're looking to get operating leverage out of our investment in the business and that's tracking very nicely, a 9% increase in income, 3% increase in cost, this period is what is driving that increase in profitability.

Question 5

Philip Middleton, Merrill Lynch

Just a couple of questions, firstly can you talk us through what you see the trajectory of the credit charge, because it seems to me to be about as good as it gets, and I wonder if you could talk us through that in the context of the cycle we're in.

And secondly capital generation, I mean your capital numbers are very strong, how do you see that panning out over the next few years and how do you think about what you might do with that capital?

Preben Prebensen

I think in terms of bad debts and where we are there, we're at 1%, the ten year average is 1.6%, the peak over a long period of time has been 2.6%, and in any one year this is about as good as it has been and I think that's right. So what's going on there? We're still seeing some improvements in Property because we had a legacy book which takes a while to work through. We still saw some improvements in Asset Finance and Retail is about as low as it's going to get. So yes we're at a long term historical low point, on the other hand as we look forward over the next few months for example we don't see a sudden spike in that happening any time soon either.

Jonathan Howell

And then on sort of capital, thanks for that question, your attention to capital is always there and ever present, we are in a position now that at this level of loan book growth that we've experienced and this level of overall Group profitability we are in an environment where capital will begin to accumulate, and all things being equal, and there are some small adjustments but that's around wins op risk, or wins market risk or other small CRD IV adjustments, but everything else being equal we will begin to see the common equity tier one ratio increase and that contrasts to our results presentation six months ago when I was asked the same question and I said at that level of Group profitability of £167m and that level of Group loan book growth of 13% that, all things being equal, we are about capital neutral. So we've just moved through that inflection point over the last six months and that's quite important. And if we continue on the types of trends that we see and the types of levels of loan book growth and the types of level an increase and improvement in Group profitability our common equity tier one ratio will increase.

That is a gradual process, it's a process that will take a number of years, we want to be extremely well capitalised as we have been in the past to make sure that as a bank of our size that our capital integrity is without question. Secondly, we want to have a degree of flexibility to be able to go through very strong periods of organic growth as we've just experienced, when our core tier one equity ratio came down from about 15% down to 12.5%. And lastly, we want to have the flexibility where appropriate, and if appropriate, to do any infill acquisitions in the asset management division.

So once we've gone through that period of increasing capital and giving ourselves the flexibility to address those three things I've just identified at some stage we will have a question and clearly we'll look at that question in a very, very economic way, but that I hasten to add is a good period of time off and that is months or years.

Concluding Comments – Preben Prebensen

Thank you very much.