Close Brothers

Close Brothers Group

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2013 Interim Results

Preben Prebensen, Chief Executive

Good morning, and welcome to our presentation of the Close Brothers 2013 half year results.

Jonathan will take you through the results in detail, and I'll then provide an update on our businesses and our strategic progress. After the formal presentation we'll be available as usual to take any questions you may have.

First I'd just like to share with you the highlights of our performance in the last six months. Overall we delivered a good result for the group with strong profit growth of 26% to £80 million, and we've continued to deliver on our strategic priorities that we set out in the 2012 preliminary results in September.

In Banking we've delivered another strong performance while maintaining the discipline of our lending principles in order to protect our loan book quality while we grow.

In Securities Winterflood has been consistently profitable, maintaining its trading capacity and market leading position despite continued difficult markets.

And in Asset Management we remained focused on our medium term objectives as set out in September, and made progress in the period.

We've maintained our strong funding, liquidity and capital position, including a core tier 1 capital ratio of 12.7% at 31st January. And I'm pleased to say that we've announced this morning an increase in the interim dividend of 7% to 15p.

I'll now hand over to Jonathan.

Jonathan Howell, Finance Director

Good morning everyone, and thank you Preben. I'll now take you through our results for the first half.

As you can see we've delivered a good result for the period. Overall we've reported a 26% increase in adjusted operating profit to some £80 million. Adjusted earnings per share increased 31% to 42 pence and as a result the group's return on equity improved to 16%, up from 11%.

Basic EPS increased 16%, and this includes some 6 million of exceptional income in the prior year, related to the partial sale of Mako.

The board has declared an interim dividend of 15 pence, an increase of 7% on last year. This reflects the strong earnings growth in the period, which has allowed us to grow the dividend and at the same time strengthen our dividend cover.

Looking now at the performance of each of our divisions.

As we have said, the Banking division continued to perform strongly, with profit growth of 26% to £78 million. This was driven by both continued loan book growth and an improved bad debt performance.

And although profits in Securities reduced slightly overall Winterflood remained consistently profitable, thanks to its strong market position and flexible cost base.

And finally, in Asset Management performance improved with an increase in the revenue margin and a stable cost base.

The balance sheet remains strong and principally comprises loan book, treasury assets and market making assets in the Securities division.

In the first half total assets increased 10%. This reflects continued loan book growth as well as a short term increase in liquid assets which fluctuate depending on the timing of new funding. Assets and liabilities related to our market making activities, which include short term settlement balances and trading positions were also higher as a result of increased trading activity around the balance sheet date. Our funding position remains strong with good access to a diverse range of funding sources and a prudent maturity profile. In the last six months total funding increased to £6.2 billion, or some 140% of the loan book. This reflects continued growth in our deposits, which increased by some £500 million to £3.9 billion. During the period we had a number of successful retail deposit campaigns and our corporate deposit base also increased.

We also renewed around £600 million of wholesale facilities which were approaching maturity, including the £350 million securitisation on the premium finance loan book.

As a result our term funding with a maturity of over one year, increased to £3.1 billion. This is a prudent level relative to loan book, which was over 70% covered by term funding at the balance sheet date. And the average maturity of this term funding at 28 months continues to significantly exceed the maturity of the loan book at 13.

Our overall holding of treasury assets has reduced over the last several years as we've optimised balance sheet efficiency and run down our portfolio of less liquid securities. At 31 January total treasury assets were £1.2 billion and principally comprised our holding of high quality liquid assets in the form of deposits with the Bank of England and gilts. This balance fluctuates depending on the timing of new funding, and in the first half increased to £1.1 billion as a result of new funding not yet deployed in the loan book. This liquidity position remains prudent and comfortably ahead of regulatory requirements.

At the same time our holding of CDs reduced and we have now substantially completed the run-off of our FRN portfolio, which is now down to £80 million.

Our capital position remains strong and comfortably ahead of regulatory requirements. In the first half core tier 1 capital increased 4%, reflecting strong profitability. Risk weighted assets increased 5%, principally due to loan book growth. And as a result the core tier 1 ratio was broadly unchanged at 12.7%. As we have said in the past, this ratio will not be materially affected by Basel III. Furthermore our leverage ratio at over 9% remains strong and significantly ahead of industry benchmarks.

The Banking division delivered a further period of strong profit growth, benefitting from both continued loan book growth and an improvement in bad debts. Income increased 11% to £196 million, driven by 10% growth in net interest and fees on the loan book.

And other income increased to £6 million, which included some £3 million of one off income.

Expenses increased 9%, principally reflecting costs associated with strong loan book growth of 16% over the last year. This includes an increase in head count of around 110 year-on-year. As a result the expense/income ratio improved slightly to 47%. Bad debt charges on the loan book reduced 14% to £26 million, reflecting a strong credit performance across the book. And overall profit increased 26% to £78 million.

Loan book growth in the last six months remains solid, with growth across the portfolio. However the rate was slightly lower than the last few years, reflecting a moderation in demand in some of our markets.

The retail loan book increased 7% as Motor continued to grow but at a reduced rate. The Premium finance loan book also increased. Growth in the Commercial loan book was 5% and continues to be driven by Asset finance. However Invoice finance remained flat in a continued competitive market. Property growth was 6% with continued good demand offset by higher repayments.

Over the last three years we've demonstrated our ability to grow significantly while delivering consistently strong returns. In H1 the return on net loan book was 3.7%, slightly above our ten year average of 3.6%, as a reduction in the net interest margin was offset by an improved bad debt ratio. The bad debt ratio reduced to 1.2% and is now at its lowest level since 2007. This was driven by a continued improvement in Property and a further reduction in Commercial, while bad debts in Retail remain at an historical low. The net interest margin for the period was 8.9% and remains consistent with its long term range of 8.5 to 10%. Reduction in the net interest margin year on year continues to reflect a change in mix, with strong growth in some lower margin businesses over the last 12 months. We also saw a reduction in income from default and early settlement fees, reflecting improved credit performance in the period.

The Securities division's performance continued to reflect low trading volumes across markets. And Winterflood in particular was affected by continued low risk appetite among UK retail investors. Despite these difficult conditions Winterflood remained consistently profitable and its profit was only slightly down at £7 million.

Meanwhile Seydler's performance improved, reflecting increased capital markets activity. Although trading volumes in Germany also remained low, Seydler has maintained a strong market position.

The contribution of associate income from Mako reduced to £1 million from £6 million in the prior year. This reflects both a subdued market environment, with volatility at a five year low, and our reduced shareholding. As a result the division's overall adjusted operating profit reduced to £11 million. Winterflood's performance reflects continued low retail risk appetite resulting in low client trading activity.

Average bargains per day reduced year-on-year to 42,000. And income per bargain has remained well below historical levels at £6.50, reflecting difficult trading conditions and continued low volumes in higher margin AIM and small cap stocks.

Despite the difficult conditions Winterflood achieved a consistent trading performance, with only loss day in the six month period.

Overall income reduced 8% to £35 million. However expenses also reduced 7%, thanks to Winterflood's low fixed cost structure. And as a result profit was only slightly down year-on-year at 7 million.

With the restructuring now substantially behind us, Asset Management remains on track. Total operating income increased 10% to £37 million. This was driven by income on assets under management, which increased 9% to £36 million as the revenue margin expanded.

We also recorded £1 million of other income, which included a profit on the sale of our residual investment in a private equity fund. Following the last few years of restructuring and investment, we are now focused on optimising the division's cost base. In the period costs were broadly flat at £36 million. As a result the underlying performance was close to break even, and overall the division made a small profit of £1 million.

We maintained good sales momentum, both through our own advisers and fund managers and through other third party advisers. As a result we had good inflows of £500 million. However we also recorded £570 million of outflows which include redemptions from institutional clients and the maturity of a legacy structured fund. Overall total AuM increased 6% to £8.9 billion, principally reflecting positive market movements.

And finally looking in more detail at the drivers of income in the division. We remain focused on expanding our revenue margin by improving the mix of client assets. We made good progress in the first half and the revenue margin increased from 73 to 84 basis points year-on-year. This principally reflects the increase in higher margin private client assets. At the period end total advised assets were nearly £5 billion and earned a revenue margin of 70 basis points in the first half. Total managed assets increased to £6 billion, reflecting sales to new and existing clients as well as positive market movements. These assets generated a revenue margin of 69 basis points.

Our objective is to increase the proportion of assets which are both managed and advised. These assets generate both advice and investment management income and therefore have a higher revenue margin at well over 100 basis points. In the period these assets increased to £2 billion. This reflects both the transition of existing advised clients into our investment products and sales of our integrated advice proposition to new clients.

As we continue to increase assets both managed and advised the revenue margin will benefit over time.

Thanks very much, and now I'll hand over to Preben.

Preben Prebensen

Thank you, Jonathan.

I'll start by looking first at the Banking division. Our strategic priority here is to capture sustainable growth while maintaining our distinctive specialist lending model. To make the most of a favourable market environment over the last several years there are a number of things that we've done and continue to do to ensure that we are well placed to capture growth whilst sticking to our core lending principles.

Firstly, we continue to develop strong customer relationships and maintain high repeat business levels. We now lend to around 1.8 million individuals, intermediated through brokers in the Retail business, and a further 23,000 SMEs in the Commercial and Property businesses.

Secondly, we've strengthened our presence in many of our markets through a wider geographic footprint and sales capacity. For example in Asset Finance we've increased the number of sales people we have by 65% to 200 people today.

And finally while growing we're investing in strengthening our infrastructure and systems, particularly in IT, Credit and Finance, to support a larger business. And although the investment is ongoing we're now beginning to see the benefits. For example, in the Credit function we're confident that we're capturing safe controlled growth across all our businesses, and have demonstrated an improved credit performance during the extended period of strong growth.

As Jonathan said earlier, the loan book growth in this first half has remained solid; although at a slightly lower rate, reflecting a moderation in demand in some of our markets. However, given the breadth and diversity of the assets that we lend against to individuals, corporates, property companies and SMEs we remain confident of the ongoing market opportunities in the UK for our businesses, and we believe we're well positioned to make the most of these. We continue to see solid growth prospects for the remainder of the year; and our priority remains to preserve the strong returns and credit quality as we grow.

You'll have heard us say many times before, but it's worth repeating, that our lending is specialised, niche and our loans are predominantly secured and on conservative loan to value ratios. Our loan book is overwhelmingly made up of small ticket short-term loans. At 31st January around 50% of our loan book was loans less than £50,000, and over 60% had a maturity of less than one year. And while these short-term small ticket loans represent the cornerstone of our lending model we have always had some larger and longer lending at the peripheries. The spread you can see on the charts puts this in context. But importantly, notwithstanding this diversity, we have not departed from the discipline of our lending model, and we apply similar risk and return criteria to all our lending. And it is this which has led to a consistent track record of returns through the cycle. The ten-year average for a return on opening equity is 19% in Banking, and 3.6% for the return on the net loan book; both of which we've exceeded in this first half. We also maintain these strong returns through the consistent long-term range on the net interest margin and the bad debt ratio.

I'm pleased to say that we plan to do another investor seminar on the banking division on 30th May where we can elaborate on some of these key themes and remind you in more detail of the business model and strategic priorities.

Turning now to the Securities division, where performance continued to be impacted by the low market volumes and subdued retail risk appetite. However, Winterflood has maintained its leading market position in core market making to retail stockbrokers in the UK. Its flexible model allowed it to continue trading as expected at this point in the cycle, maximising order flow and profitability from its core business, despite continued market headwinds. Seydler has maintained its leading market position in Germany, with its strong corporate relationships and in the period benefited from increased capital markets activity.

Looking now at Winterflood in a bit more detail. This is a cyclical business which is sensitive to the market environment. Given the majority of Winterflood's order flow is from retail its performance is strongly correlated to retail investor sentiment. As you can see on the chart, in the first half of our 2013 financial year average daily retail market volumes were below the 2005 level. An active secondary market is somewhat dependent on an active primary market, with capital raisings and IPOs providing new securities to trade. Looking at the AIM market which generates the higher margin trades for Winterflood new money raised in 2012 was at its lowest since 2002. Notwithstanding this we remain confident in our business model and leading market position, and as such our priority remains to maintain our trading capacity.

Through the skill and experience of our traders we were able to deliver a profit on all but one of the 128 trading days in the period. The highly variable cost base, which fluctuates in line with trading revenues, has enabled us to remain consistently profitable in the current environment. Additionally, we have strong relationships with over 450 clients, and are connected to over 40 trading venues, including exchanges and MTFs across Europe, providing continuous liquidity. Our primary focus is on preserving these core attributes, regardless of market conditions.

We're also looking to leverage these attributes in new ways in order to make the most of any future structural market changes. Although in early stages, we've made progress with Winterflood Business Services, providing outsourced dealing and execution to 14 clients. We've also strengthened our fixed income offering, having joined the LSE's order book for retail bonds in February.

Overall we're confident that we're well-positioned to benefit from any market recovery, as well as respond to market changes.

Finally, turning to Asset Management, where we've made progress on the delivery of our strategy in the period. Before I go through some of the areas of recent progress I'd like to briefly remind you of our integrated proposition, which combines the core capabilities of advice, investment management and an efficient platform all in one business.

The Asset Management industry as a whole has gone through a lot of change over the last few years as businesses have tried to adapt and prepare for changes in the regulatory environment, demographics and technology. As you'll know, we spent the last three years designing, developing and building our integrated proposition that you now see on the slide. This is now complete and has been fully launched across our business. RDR is now here, and while it's still early days we believe that we're well-positioned in this new environment. Our pricing is unbundled, simple to understand and has been well accepted by clients. The feedback from our advisers has been that having such an integrated, high quality investment capability is of significant value to clients and a strong differentiator. The pipeline of new business reflects this and continues to be strong.

Now looking at the process that we've made over the last six months, we're pleased with a sales momentum and new business levels from both our own advisers and fund managers, and also third party advisers. It's encouraging to see a significant proportion of new advice business also flowing into our investment products. Given that our advisers are not incentivised differently to sell our own products this is a full testament to the quality and breadth of our offering.

We also remain focused on improving the efficiency in the division. In addition to the progress that we've made on migrating existing clients to our integrated proposition we're also actively streamlining the back office infrastructure, administration systems and processes to improve scalability.

Our longer-term focus remains to expand the revenue margin by selling our integrated proposition both to existing advised clients and to new clients. As Jonathan said, earlier in the period we've increased the assets that are both managed and advised by 24% to £2 billion; and we've increased the revenue margin overall to 84 basis points. We've been working hard to optimise the cost base, and this remained flat year-on-year.

Given this progress we're on track to deliver our short-term objective of reaching profitability during this financial year. And we remain focused on achieving the medium-term targets of a revenue margin of around 100 basis points, and an operating margin greater than 15% by the 2015 financial year, as set out in our preliminary results last September.

Now turning to the outlook to conclude. We've delivered a good performance for the first half, and our businesses remain well placed for the rest of the 2013 financial year. We continue to see solid prospects for loan book growth in Banking, and expect similar performance in the second half. In Securities, through its leading market position, Winterflood remains well positioned ahead of any sustained recovery in market conditions. And Asset Management continues to make progress and remains on track. Overall we look forward with confidence, and expect a good result for the year as a whole.

Thank you very much for listening. We now look forward to answering any questions that you may have. As well as Jonathan and myself we have with us in the front row the heads of our businesses, Stephen Hodges, Julian Palfreyman and Martin Andrew, who are also happy to take any questions. Can I remind you to state your name and company before asking any questions?

Question & Answer session

Question 1

Arnaud Giblat – UBS

Three questions please. On the Banking division could you perhaps give us a bit more detail around the growth dynamics in each of the sub divisions? What are the market shares? Are the large banks coming back in in some divisions?

The second question would be on the Bank. Broadly staff costs have grown more or less in line with the income; but non staff costs haven't, they've grown at a slower rate. Is there something specific going on in the first half or should we expect more of that going forward?

And the third one is could you run us through the gross inflows you've seen? And in which areas have they been coming: from private clients or have you seen any pick up in direct, the self-service advisory channel?

Answer: Preben Prebensen

I'll start on the first of the bank questions. And I may ask Stephen actually also to address those.

Your first question was to do with our market share and growth across the segment, and whether we're seeing the big banks coming back. I think overall, as we mentioned, we've seen a slight moderation in demand, but there's no single factor or trend. There are two examples that we could give there: in Motor it's growing, but growing a little bit less than it was. But part of that is actually to do with what is happening in the primary market. And in 2012 the primary producers came back with very, very attractive financing deals. So, the proportion or the growth in new car financing was very marked. That tends to have an impact on second-hand cars, and then you see that turning around basically as those new cars become a year old and so on. So, I don't think that's symptomatic of an underlying trend that's simply the ebb and flow of primary versus secondary.

And then a second example might be in Asset Finance, where actually we did see some clients hanging on to their equipment for a bit longer, and that slowed down new acquisitions of assets and therefore asset financing. But again, it's not a predominant theme and in fact in January and February Asset Finance had very good months. So, it's patchy.

Answer: Stephen Hodges, Managing Director and Banking CEO

Shall I just add to that point? I think that is exactly right. I would say we've not seen a material change in the overall environment for our banking businesses. As far as we can measure it – and in some sectors it's easier to measure than in others – we believe our market shares have been consistent; competition is patchy and I think it's not possible to say there's been any material change in trend in competition at this stage.

Preben Prebensen

You asked a second question about costs in the Bank about growth in non staff costs versus in staff costs. Jonathan, do you want to have a crack at that first?

Answer: Jonathan Howell

Just in terms of costs, as you quite rightly say income has gone up by 11% to £196 million, and costs have gone up by 9% to £92 million. So, there's a £7 million cost increase half year on half year. And the principle driver of that has been staff costs, as you say that's about two-thirds of that cost increase where our total headcount in the bank went up by about 110, as I highlighted in my presentation. And of that increase in headcount the bulk of that came in Motor and Asset Finance, those where we've been expanding our geographical footprint and where the operational gearing is slightly less.

And then the balance of that cost increase is part of this continuing ongoing investment in IT and infrastructure, which we've been doing for three years now and we anticipate will continue to happen in the future. And that's partly to service a larger growing organisation which has more capacity to lend but also sort of continuing to improve the systems and processes and procedures around credit risk and risk management and the control functions.

The increase in headcount is as we expect: we have a very sort of service driven, knowledge based, high touch model, which supports the returns and the margins that we get in the banking model. And that is going to continue in the future. But nonetheless we are seeing a little bit of operational gearing. We've seen the cost income ratio come down by 1% in the first half. It's still below the ten-year average of 49%, and we're at 47%.

So going forward I don't anticipate any material change in the rate of cost growth when set alongside the growth in the bank top line and the loan book. And we will continue to invest in infrastructure as required and invest in the capacity that we need for growth, given this service driven local expertise based model that we have.

Answer: Preben Prebensen

The final question you had was on the Asset Management side in terms of inflows I think. Again, I may ask Martin to comment on this. But the inflows that we saw did come from our core distribution channels. So advisers, fund managers if you like in high net worth and third party sales to IFAs, they are our core business, our business going forward. Do you want to add to that, Martin?

Martin Andrew, Managing Director Asset Management

Only to say yes, that's absolutely the case, around half of the inflows came from our own advisers and the rest was roughly evenly split between the high net worth fund managers and third party IFAs. The self-directed business which I think you also asked about, at this stage of this development is not a significant contributor to either the gross inflows or the net flows.

Preben Prebensen

Which is by intent actually.

Martin Andrew

By intent, simply at the stage of its evolution within our business strategy.

<u>Question 2</u>

Philip Middleton – Merrill Lynch

I just wonder if Jonathan or anybody could talk a little bit through the capital management policy, given that you seem to be able to generate enough capital organically to keep your core tier one stable without the cyclical businesses really firing. How are you thinking about that going forwards?

Answer: Jonathan Howell

Philip, it's a very good question. Exactly as you say, the core tier 1 ratio 12.7%, more or less in line with the core tier 1 ratio at the last year end six months back at 12.8%. And that's being driven by strong profitability in the first half, adjusted operating profit of £80 million, offset by good loan book growth, 6% growth in the loan book over the six month period.

Now I mean the really important thing is that over the last three years we've seen compound annual growth in the loan book of 20% per annum and that's been this period of extremely strong growth and throughout that period we have consumed surplus or excess capital and as a result you've seen our core tier 1 ratio progressively coming down year-on-year.

Now what we said during that period, we said at some stage we will revert to a more normalised level of growth and the average long term growth in the loan book is about 11%, and when we begin to get back to that moderated level of growth you will see a moderated level of consumption of capital and therefore we will eventually get to a stage where our capital ratio will stabilise and at some stage begin to increase.

The two key levers that we've got on capital, not necessarily completely within our control, one is profit and just to give you a rough idea, on our current capital base an adjusted operating profit increase of £7 million will increase our core tier 1 ratio by 0.1 of a percent and going the other way, an increase in the loan book of £50 million or 1% will reduce our core tier one ratio by 0.1 of a percent.

So those are the two sort of key dynamics, there are other variables as well, and exactly as you say, Philip, we've got to the stage now where at this level of growth we've just about stabilised. Going forward as and when Winterflood sees a sort of a permanent clear trend of higher order flow and higher profit performance, and similarly when Asset Management move into a position of stronger profit contribution we will get to a stage where that capital ratio will stabilise as it is now and then begin to improve. And at that stage we will just need to look at the continuing dynamics of what we forecast in terms of loan book growth, what we continue to see in profit performance of all three divisions, particularly from the lower capital intensive divisions, and we'll be able to form a view about where that capital trajectory is going, and the options that that gives us an organisation.

Preben Prebensen

And indeed what the environment is like at that point.

<u>Question 3</u>

Mark Cathcart – Investec

I just wondered are there any signs at the moment that Winterflood is starting to come through, say the past month since the close of the first half?

And second, what is your message on second half loan growth? You said that there's been no overall change in environment but what would your expectation be for growth in the second half?

Answer: Preben Prebensen

In terms of wins I might ask Julian to comment on this, but just to give you a bit of context, in our first half if you look at the London Stock Exchange average daily volume on the order book it was down 21% and wins bargains per day were down 14%; so quite consistent in terms of our reaction to the market. Similarly, when markets do improve we do see that and we see it immediately in Winterflood, so if you remember back when Draghi made his comment about whatever it takes we had a tremendous week in the equity market, that went right down to small caps quite quickly and Winterflood had a very strong week. So it responds immediately to an increase in investor and retail appetite, not just market levels, but the follow through.

January, February, March, clearly a bit better. Now, does that continue is everyone's big question, but Julian, I think the point here is that with your market position and cost structure you're kind of as well placed as you could possibly be and you'll make the most of the flows when they come. I mean do you want to say any more about how February and March kind of feel?

Answer: Julian Palfreyman, CEO Winterflood

Yes. As you know, market levels have been very resilient throughout the new year, but it's too early to call it a sustained recovery, we saw a similar situation last year in the first half where markets started the calendar year well and then ran into headwinds and sort of quite depressed levels throughout the rest of the summer. So as Preben says, we're well positioned and we're there ready to take advantage when we see it more sustained.

Answer: Preben Prebensen

I think the other point is that we have the ability of maintaining trading capacity in the face of a year from quite difficult markets, we made almost as much money in the first half this year as last year, £7 million versus £8 million and we only lost money on one day over 128 days, so it's as good a model as you can have, but you do need retail back, you need IPOs back, you need it to be sustained in terms of risk appetite and we can't predict that.

You also asked about what we are expecting in terms of second half loan growth, we saw 6% in the first half, what we're saying is that we expect a roughly similar amount of loan growth in the second half. And again, we can't predict it, but it wouldn't surprise us to see about the same.

Further question

And in relation to the NIM, but that's purely in terms of the scope of the business, I mean there is no underlying pressure on the net interest margin in addition to the change in the scope of the business?

Answer: Preben Prebensen

Yeah, in terms of the NIM I think that the drivers there, first of all kind of context, in the second half of last year the NIM was 9.2% and in the first half of this year it was 8.9%, so we're kind of there or thereabouts.

Our long term corridor is 8.5-10, and that is the nature of the model. There are two actual reasons that you can look at in terms of the slight change, our lower margin businesses are growing more quickly so it's a change in mix, property, larger dealerships and motor, that kind of thing. An actually interestingly, and this is tied to our improvement in bad debts, as defaults reduce we get fewer default fees and settlement fees. So that's a kind of ironic connection with the improvement in bad debts.

Answer: Jonathan Howell

And just to reiterate Preben's comments on loan book growth we said that in the first half it was solid and we expect that to continue for the full year. Also in terms of actual profitability over the period we've said that we're expecting a similar performance in profitability as well as loan book growth.

<u>Question 4</u>

Barney Randall – J P Morgan

Can I just ask, the majority of the growth in the loan book seems to be coming at the longer duration loans, is that a reflection of the asset finance piece and what's the average duration of loan within asset finance?

Answer: Jonathan Howell

I think if you take the portfolio, if you take the whole loan book portfolio, in fact it's come back slightly year-on-year, and so the average term on the loan book was 14 months, at the same time last year, and that's reduced slightly to 13 months. So in fact that's the underlying trend and much of that I think has been to do with the property book where the property book grew very quickly over the last 12 months or so, very high quality opportunities for us to lend into, and by definition we're getting that money back very quickly. The developments are happening and the loans are being paid off quite quickly.

Further question

And the Asset finance side, is that longer duration?

Jonathan Howell

No, the Asset finance side, I don't think there's been any material shift in the duration there and that's anything between two to three years in duration. The shortest duration is obviously the Premium finance loan book which has increased slightly and that's the average term and that is about five months or so, with a ten months maximum period of a loan. So just to get to the point of your question, the overall mix and maturity profile of the loan book has not changed materially, there have been some slight fluctuations within it, net it's slightly down but there's no material change overall.

Answer: Preben Prebensen

And actually in terms of the mix, again the whole book was up 6%, the three big blocks, Retail, Commercial and Property, were all between 5 and 7. So there wasn't really a kind of an outlier.

<u>Question 5</u>

Robin Savage – Cannacord

Firstly, thank you very much for arranging the seminar on the Bank division on 30th May - it looks like I'm going to have to cancel my plans for the bank holiday. Can I make a request that when you do have the banking presentation that you give some disclosure about the gross loans and the repayments because although I'm absolutely confident in your division's ability to make good loans, 20% growth in the loan book no doubt has got even stronger growth in actually loans origination.

Preben Prebensen

Yes, we'll look at that.

<u>Question 6</u>

James Hamilton – Numis

Good morning, it's James Hamilton at Numis. Just one question, it's on credit quality. Clearly credit quality is excellent, I appreciate your points about the slight mix change being beneficial, but given that the macro environment doesn't look to be changing very much should we be looking forward to keep the impairment charge at a similar proportion of the loan book, are there any one off or one off-ish factors in the period where it was such a good performance, because obviously the book's up and the impairment charge is down? Should we use this as the sort of run rate or, I know you always say it's going to go back to normal and it never does, but I was just sort of wondering what's your…

Jonathan Howell

It will eventually! It will eventually, James.

Answer: Preben Prebensen

Let me just start then and then you can both pitch in. The context that we would kind of draw your attention to is this ten year average, so the book at the high is 2.6%, at the low is 1% for a full year, and the ten year average is 1.6%. So obviously at 1.2% we're pretty close to the low. And I think that's just factually true and important in terms of context. Stephen or Jonathan, do you want to add anything more to what we might expect, or indeed, whether we expect any outliers, because the portfolio itself hasn't really changed in terms of its distribution.

Answer: Stephen Hodges

That's right, the portfolio hasn't changed materially, I don't think we would point to any particular one offs that have caused distortion, we expect to be within the long term range for the foreseeable future. During the period our Property book improved a bit, but as Jonathan has already said, our Retail book is at a historically low level.

Preben Prebensen

So the momentum, Retail improved first, and that was really some time ago and is really very low. Commercial is probably towards the end of its cycle because it's done very well. And Property was always going to be third in that list and basically you can draw a distinction in Property between our pre 2009 book and our post 2009 book, and the post 2009 book is in excellent shape. So again, we're getting through most of that too.

<u>Question 7</u>

Marc Cathcart, Investec

I just wondered what the risk is that you've been levering up in a really sweet cycle, I just wondered say in say two to three years the big banks or other competition comes in so that you can no longer write on your required return, how would you unravel, I mean what's your kind of safety net?

Answer: Preben Prebensen

This is a really easy one. It's an open goal. We are completely committed to sticking to the model, and that is the safety net, so the model is secured lending, conservative loan to value ratios, small tickets, short periods, lots of diversification in markets that we really, really know. We're very experienced in them, we've got very experienced people. If anything we've built our ability to analyse the portfolio in terms of the investment in the credit MI and the credit function, so we're quite confident about that. And we've said this before, but I'll repeat it, we don't have a growth objective, we're not hooked on growth, we're hooked on the model. And we're absolutely addicted to it and we're not going to deviate from it, and that is what protects us. And if you look back over previous cycles when the competition returns and is storming in at cheap prices our growth moderates and it moderates because Stephen and his team don't change the model.

Further question

What about the fact that your headcount's gone up, is it easy to unravel headcount?

Answer: Stephen Hodges

Well, we wouldn't want to unravel headcount necessarily, because part of the model is asset quality, but the other part of the model is sustainability and hanging on to the growth that we get in times like this when the competition comes back, and that's all about service. So I don't think it's necessarily the right assumption that when the competition come back we want to reduce headcount, we want to hang on to the loan book that we've picked up and continue to maintain that high level of service.

Answer: Jonathan Howell

Preben's covered the asset side of the balance sheet, on the capital side of the balance sheets that we've levered up, I think we're still in a very comfortable position in terms of our core tier 1 ratio and in terms of our leverage ratio which at 9.3% is way above most industry benchmarks and considerably above any regulatory requirements, so we feel very comfortable on that side of the balance sheet as well.

Concluding Comments: Preben Prebensen

Thank you very much indeed.