Close Brothers

Close Brothers Group Banking Division Investor Seminar

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Preben Prebensen, Group Chief Executive

I think we're going to get started, so let me get us going by welcoming you all here.

As many of you know we've been doing detailed presentations on our business divisions for some time now. And the first of those actually was on the Bank but back in June 2008. The Bank is clearly our most significant contributor with record adjusted operating profit of £80 million for the year to July 2010. And as many of you know that was driven by strong loan book growth which has actually continued into the first quarter and the loan book now stands at over £3 billion as we set out in last week's IMS. The current environment is clearly favourable for our Banking business, but our objective today is to provide you with a deeper understanding of the business.

The Banking Division is a leader of specialised finance in the UK and has a 25 years track record of growing specialised niche businesses. We have a business model that's focused on high margin, predominantly secured lending with conservative loan-to-value requirements. We were disciplined in the years of easy credit and we were well positioned as credit became much more restricted. Importantly we also invested in infrastructure and distribution to make the most of the opportunity and have added considerably to our management team to take the Banking division forward. Furthermore, we've always maintained a strong capital position, indeed at the 31 July the Group had a Core Tier 1 ratio of 13.9% as well as a conservative funding strategy.

In my 18 months at Close Brothers I've been really struck by first how well the Banking Division weathered the credit crisis; and second, by how well it is now taking advantage of the opportunity to grow. But the very important longer term perspective is that the Banking Division has succeeded in growing profitably over a 25 year period. Conditions have changed many times during that period but the Banking Division has consistently stuck to the discipline of its specialised business model, that has served us very well and we fully intend to stick with it going forward.

So the presentation today will be led by Stephen Hodges, the Chief Executive of the Banking Division. He will hand over to Bob Golden and Mary McNamara, as well as Malcolm Hook. Mary and Malcolm have both recently joined the management team. We also have sitting in the front row Sharon Bishop, the Chief Operating Officer of the Banking Division, Frank Pennal, Head of Property; Nigel Mottershead, Head of Credit Risk; Linda Fox, Head of HR in the Banking Division; and Mike Morgan who has just joined us as the new Finance Director of the Banking Division. And then from the Group clearly both Jonathan Howell and I are here as well. We all look forward to answering your questions at the end of the presentation but now let's begin and I'll hand over to Stephen.

Stephen Hodges: Banking Division Chief Executive

Thank you, Preben. I thought it would be helpful, both as a reminder to some, and as an introduction to others to start with a brief overview of the Banking Division and its operations. I'll then hand over to Mary McNamara, our Commercial Division Managing Director, and Bob Golden, on her right, our Retail Division Managing Director to talk about their businesses which have undergone a number of changes since our last banking seminar, and these days account for about 80% of our loan book.

I will be covering our longest standing lending business which is property lending where we continue to operate on the same basis as we have done for over 25 years. Our Property Division is headed up by Frank Pennal who is also in the audience today. And then you'll be hearing from our new Treasurer, Malcolm Hook. I hope this format will give you a good understanding of what we do, our strong business model and our growth outlook. I'm then planning on finishing tonight's presentation with a summary of what all this means for our shareholders.

I joined the Banking Division in 1985 and one key thing I've noticed is that during that long period of evolution we have maintained our disciplined approach to lending. Although our loan book has diversified the same lending principles apply and our proposition continues to focus on providing the highest quality of service to our customers. So today we're a leading, independent provider of specialist finance, predominantly to the SME sector. With a loan book of over £2.9 billion, over 1,400 employees and long standing and loyal customer base with over 1.6 million customers.

Let me take you through five key attributes of the banking division which together differentiate us from the rest of the industry. Initially I'll give you an overview of these attributes and then we can look through each one in more detail as we progress through the presentation.

Firstly, our distinctive business model - it is diverse and it's niche. Our assets range from financing trucks and coaches to beer casts and barn conversions. Moving on to our second key attribute - our focus on growth. I'm going to be covering this in great detail today. 2010 was a strong year for the banking division. We've seen our competitors retreat from the market but we've been also actively positioning ourselves to grow market share. Most importantly we believe this growth is sustainable. Thirdly, growth crystallises a requirement for operating efficiency. We continue to invest in infrastructure, we have enhanced our central functions and as you've already heard we've strengthened the senior management team. Next - credit quality. As I mentioned earlier we have never strayed from our disciplined approach to lending and local underwriting expertise is at the core of this. And finally, we have a conservative approach to funding and liquidity which has been a vital element of our success, and Malcolm will touch on this later in his presentation.

So moving on now to a more detailed look at each of these five attributes. Starting with the first of these, our distinctive business model. The Banking Division is organised into four operating divisions. The three lending divisions are Retail, Commercial and Property whose funding needs are met by our Treasury function which Malcolm will talk about in more detail later on. Now I'll give you an overview of the three lending businesses. Our Retail Division consists of a premium finance business which we pioneered back in 1977 and a motor finance business which was a small business when we acquired it in the early 1990s. The lending in this division is typically indirect through intermediaries, both insurance brokers and car dealerships.

Our Commercial Division is comprised of the invoice and asset finance businesses and this division strongly demonstrates our niche proposition and our loyalty to the SME sector throughout the cycle. At the year-end we had a customer base of over 17,000 SMEs. And finally Property, which has been a constant part of our lending portfolio, and now makes up a fifth of our loan book. Our Property Division specialises in short term residential, development and bridging finance. And we believe this structure which we introduced in 2009 has contributed to our strong recent financial performance.

So let's now move on to those results as we consider the second key attribute - our focus on growth.

2010 was a very good year for us with a strong performance from each of the lending divisions. Profits in the banking division were up 47% to a record £80 million. We achieved 19% organic growth and 4% acquisition growth to a record loan book of £2.9 billion. And you will have seen last week's first quarter interim management statement which indicated that this strong growth has continued in quarter one.

On the income line, an increase in our net interest margin from 9.4% to 9.7% allowed us to deliver growth of 15% for the year. And the robustness of this margin throughout the cycle is testament to our distinctive business model. It reflects resilience in a period where the business has undergone comprehensive stress testing as a result of the global downturn. To look at other key performance indicators our bad debt ratio marginally improved from 2.6% to 2.4% in 2010 and the underlying trend is positive.

One key hallmark of our financial ratios throughout the cycle has been the very strong relationship between our operating income and our bad debt charge. And this gives us considerable headroom to deal with the ups and downs of the cycle. Our expense to income ratio in the Banking Division reduced in the last financial year to 47% as a result of strong income growth and effective cost management achieved despite investment in infrastructure. And we delivered a return on equity, or ROE, of 20% and I'll talk more about this when we consider shareholder value. It's worth putting this 2010 performance in the context of our long and successful track record.

And the graph you see here is our net loan book trend for the past 25 years. Clearly banking is a long term business and as you can see we have a proven track record of sustainable growth. And this is reflected in our ten year compound annual growth rate of 13%. The only year with no annual loan book growth was 2006 and that was due to the acquisition of a loan book which had been purchased for run-off in the previous year.

During this 25 year period our customer numbers have increased dramatically from a few hundred to over 1.6 million. And this is important for sustainability from two perspectives. Firstly, it shows our ability to deal with significantly increased volumes. And a bit later I'll be talking to you about how we continue to build our infrastructure in order to meet future growth. And secondly, it's made up of a mixture of new and repeat customers. And both of these are critical to the sustainability of growth for the Banking division. New customers reflect our growing market share and existing customers, who endorse our distinctive business model, appreciate the service that we provide and recommend us to others. And this enables us to maintain our interest margin throughout the cycle.

Here is the 25 year loan book trajectory again now overlaid with our adjusted operating profit - which is the blue line - and also significant events impacting the market during the period. And I hope you can see the sustainability of our growth through the ups and downs of the economic cycle. Profit, as you would expect with consistent margins, tracks loan book growth. And you can see how resilient the profit has been over the last three years despite the impact of bad debt and an increased cost of funds. There will always be parts of the cycle that are favourable and parts which are less so. However the key point here is that when we gain market share and grow our loan book we hold on to it. Not only this, but we're able to maintain our strong margins which in turn ensures profits remain robust. And this leads on to my final point of the sustainability of our growth - barriers to entry.

We believe our growth is sustainable not only for the reasons just mentioned but also because of significant barriers to entry. Competitors are unwilling or unable to provide the focus and expertise in our smaller niche markets. And our model would be difficult for any competitor to replicate in full because of its diversity across the water front.

We also have bespoke IT systems, for example, in our Retail Division we have iPrompt which has been developed over many years and is now embedded in the business of the 3,000 insurance brokers and intermediaries who use it. And this gives us a significant competitive advantage.

Our consistency of lending throughout the cycle over a 25 year period represents a genuine barrier to entry, and we have demonstrated to our SME customer base that we are committed to serving them whatever the market conditions. And this distinguishes us from our competitors and has engendered customer loyalty and trust which is in itself a barrier to entry. Clearly the current market conditions suit our model. However, far from being passive we are taking proactive steps to ensure that we make the most of the opportunity. Let me now explain how we're doing this.

We don't aim to compete with the core business of the clearing banks. Our model is deliberately built to focus on smaller niche markets where as I have said previously the clearing banks have much less appetite. Furthermore, we deliberately choose to offer more bespoke services and products to meet the specific needs of our customers. Our strong performance this year has had a demonstrable impact on market share in each of our niches and I think there's value in repeating the statistics that we communicated as part of our year-end presentation.

In Commercial our share of asset finance related new business grew from 4% to 6%. And our invoice finance business increased its share from 8% to 13% of the independent invoice financing market. Within Retail our share of the independent used car point of sale market increased from 5% to 9%. And our share of UK gross written insurance premiums is approaching 5% and a very significant share of the independent space. And in Property we're the leading provider of short term residential lending where we have very few competitors.

As I said earlier history has demonstrated that where we take market share we're able to hold on to it so the gains we're making now position us well for the future. And these statistics also reflect our ability to achieve a greater market share despite the challenge of shrinking markets. Our competitors will of course return to the market in due course. However, some impacts of the credit crisis mean that this could take some time, for example, the retreat of foreign banks to their core domestic markets; the need on many lenders to de-leverage balance sheets; and the collapse of the Irish and Icelandic banking sectors. These will all help to postpone the return of the competition.

So we will continue to focus on our organic growth which as you may know accounted for 83% of our loan book growth last year, and there is more to do in terms of taking market share organically. We will make strategic infill acquisitions where our model can be replicated. And we're also exploring a number of strategic opportunities and new initiatives. These range from geographic expansion, such as our new motor finance branch in Swindon, to moves into complementary areas such as waste to energy lending in our Commercial Division. And Mary and Bob will cover both of these opportunities in more detail later on.

You will see that these opportunities all contain the characteristics that make our model so distinctive; a niche focus, potential for high quality earnings, robust interest margins and, of course, disciplined underwriting. And whatever opportunities we identify we will always maintain our consistent approach to lending.

Finally on growth - our customer proposition. I think you will agree that the Banking Division margin outperforms the market by some distance, and this we attribute to our customer proposition. The key factors that attract new customers and engender customer loyalty are all explicit on this slide - depth of market knowledge and expertise of our people. Our people are experts within their individual markets and therefore closely understand both the customer and the assets financed. Bespoke and innovative products and services tailored to the specific needs of our customers. Commitment to customers through the cycle - we're one of the few banks who has kept lending throughout the credit crisis. And consistent pricing and underwriting discipline managed at the local business level where the knowledge exists and where we are able to act quickly - and I'll return to this point a little later.

It's worth focussing our attention on two additional important aspects that I've not yet mentioned. Firstly, speed of decision making. Customers value the fact that our local teams are trusted to make lending decisions and our equally empowered to enable them to purchase and pay for assets in timescales that are simply unachievable by our competitors who typically work with large centralised processes. And the service we provide really matters to the customer. For instance, if we finance a truck for a sole trader we understand that they're relying on the asset as their primary source of income, and we ensure that the speed of our decisions, and the speed of our payout, absolutely supports this. And, secondly, our end-to-end relationship with the SME customer; we provide finance to our customers from business start-up through growth and in some cases through those difficult times when customer cash flows are stretched and arrears materialise. I hope this section has given you a clear indication of the sustainability of our growth. And now I'll move onto our next attribute - operational efficiency.

Starting with infrastructure our customer proposition is supported by enhanced and strengthened central services spanning HR, finance, legal & compliance, IT and procurement. But we only centralise to the extent that we believe there will be no compromise to our customer proposition. We do recognise the importance of economies of scale and we have seen a reduction in expense-to-income ratio in 2010. Our infrastructure supports a breadth of distribution channels including telesales, direct mail and online transactions. And we tailor our distribution strategy to best fit what suits the customer.

For example, the average age of our retail depositors is over 60. We recognise that these customers value a personal service so they're not contacted through automated systems and when they call us they will talk to real people who answer calls promptly and rarely need to refer. Our existing infrastructure can support our current growth and we will continue to invest in terms of people, systems and governance to achieve efficiency and cost savings. And we have the experience to know when to invest and when not to invest. We made a deliberate decision not to significantly cut costs and front line sales capability as we headed into the credit crisis. And we distinguished ourselves from competitors by continuing to lend throughout this difficult time in the banking sector. And indeed we built up our sales teams ensuring that we had the resources to continue to grow market share. And this is the benefit of experience and is one example of what we mean by actively taking advantage of market opportunities.

We recently invested in the installation of a group wide HR system led by our Head of HR, Linda Fox, who's with us today. And plans are underway to upgrade the finance general ledger software system across the Banking Division. Through these activities we're ensuring that we're always providing a scalable model with the capability and capacity to handle our growth.

And finally, Governance and this plays an important part in our expansion and an ever increasing role in the banking industry. As part of streamlining our operating divisions we have recently fortified our governance structure to ensure that risk and compliance as well as funding and liquidity are given the dedicated focus required. Whilst credit underwriting remains with the experienced local businesses we've recently made a senior internal appointment as Head of Credit Risk, Nigel Mottershead. Nigel, who's also in the audience, will oversee our lending activities and manage credit policies to ensure that we do not stray from our disciplined approach to lending. And this appointment is just one example of the strengthening of our senior management team.

Here you can see an overview of that team. There are a number of new appointments that have been made in the past year to reflect our evolving structure and our focus on growth. All of the team have a wealth of industry experience. I hope you have a chance to get to know them better through the evening.

Returning now to the final key attribute - credit quality. The management of credit risk is core to the success of our business, both past and present. Let's start by talking about our consistency in this area. I make no apology for repeating the importance of local underwriting expertise. This gives us a comprehensive knowledge of assets and their marketability. We have a high proportion of secured lending and typically we apply conservative loan-to-value ratios. That said we’re not inflexible and where it makes sense we’ll consider tailoring our offering whilst ensuring that our overall approach to risk is not compromised. And this is where our central and senior management oversight comes into play.

We have a low average loan size, as shown by the table on the right hand side of the slide. Even as our loan book continues to grow including into adjacent areas we will not see a material change to the proportions or dynamics of the overall loan book portfolio. The short average maturity of our loan book at only 12 months enables credit issues to be worked through quickly. It also allows us to re-price and recalibrate asset values more frequently thus protecting our overall returns. And we've deliberately diversified our loan book over the past 25 years. However, most importantly we still only finance assets that we know and we like.

Our local underwriting expertise means that our knowledge is always current and this allows us to take a highly responsive approach to collections and arrears management where we work with the customer and act quickly. This also means we can accurately assess the value of repossessed assets and utilise strong routes-to-exit, such as financing or selling assets to our other existing customers rather than losing value on the asset at a general auction. In many of our asset classes the difference between trade and retail value is significant and can make a difference between getting our money back or crystallising a loss. And this local knowledge in turn informs our new business underwriting.

From the 25 year trend you can see that the bad debt ratio peaked at 2.6% both in the early '90s and then more recently in 2009 during the credit crisis. This percentage is despite the growth and diversification in the loan book over that period and we attribute this to the disciplined lending principles that underpin our model. And these have remained the same for 25 years.

As you'll have heard from the first quarter interim management statement our bad debt ratio was higher relative to the second half of last year due to a bad debt in the legacy property portfolio. Clearly we remain at the high end of our bad debt range and in an uncertain economic environment, and we're not complacent about that. However, at this early stage of the year the Banking Division bad debt ratio for the 2011 financial year is expected to be slightly down on last year.

So, before we move on to a detailed look at our divisional lending businesses, I just wanted to summarise what is next for the Banking Division and where our strategy is taking us. I've talked about the distinctive business model and we're clear that this will not change going forward. The composition of the loan book is expected to remain largely unchanged, with retail and commercial roughly the same size and property around half their size. We're committed to achieving organic growth in the UK through increased market share in our niches without compromising our strong margin. And we will continue to explore adjacent markets for opportunities to support overall growth. We have proved that we're able to retain our growth and build on it and so we're making the most of the current opportunity and rest assured we will stick to our disciplined approach to lending.

Finally, our focus will remain on funding the growth in our loan book using the diverse sources of funding that are available to us. Malcolm will tell you more about this shortly.

Now I'll move on to our three lending businesses. I will talk to you about property lending before handing over to Mary and Bob.

Property is a niche business focused on short-term residential development lending. And it's been part of Close Brothers for the past 25 years and we have lent consistently to the market throughout this time, including through the property recession of the early ‘90s and the more recent credit crisis. And we’re one of a very small number of property lenders who can say this. We lend across the spectrum from first time buyer units to prime property in Hampstead and elsewhere and we’ll finance barn conversions, refurbishment of Listed buildings, as well as new build.

In 2008 we moved into bridging finance through our acquisition of the Commercial Acceptances business and these are generally shorter term loans of three to six months duration, very often to assist with auction purchases. Whilst we lend throughout mainland UK the majority of our lending since January 2009 has been focused on London and the South East and more recently in Scotland, in Edinburgh, Glasgow and Aberdeen. In 2010 we grew the loan book by 12% but, more importantly, we also remained profitable which cannot be said for the majority of the competition and we did this while increasing the number of our customers to over 500.

The key attributes which I’ve described already are fully reflected in our property business. So, looking now at what makes us different. Firstly, we have a specialist team, Frank Pennal and Lawrence Brown who head up our Property Finance and Commercial Acceptances business respectively, each have over 25 years of experience in the property finance market. Secondly, we focus on our niche. Over 70% of lending is residential refurbishment and development and we’re now the leading provider of sub £5 million lending in the property development market, and we see few other players. Thirdly, we’re relationship driven, reflected by over 75% of our loan book being repeat business.

On the subject of customer loyalty we still have borrowers today who came to us in the difficult years of the early 1990s. And finally, the same disciplined lending criteria is applied. Although the loans in property are typically larger than the rest of the book the loan- to-value ratios are typically lower than other divisions at 50% to 60%. We closely monitor our developments on at least a monthly basis using our own independent valuers, and in addition we always want our borrowers to have at least 10% of cash in the deal. So, we continue to do here what we do best, focussing on our niche and the strength of both our expertise and our longstanding customer relationships.

I hope that I’ve given you a good overview of both the Banking Division and our property lending business and I’ll now hand over the Mary McNamara to talk to you about the Commercial Division.

Mary McNamara: Commercial Managing Director

Thank you, Stephen. Good afternoon. I’m one of the newer members of the team I’ve been with Close Brothers for six months now. My background is in lending and I’ve been in specialist finance for 20 years. I spent the majority of my career with GE where I worked in a number of their asset finance businesses, from equipment leasing to portable accommodation where I later became the CEO of their European car leasing business.

Since I’ve been here I’ve been hugely impressed by the team’s desire to embrace new ideas whilst remaining passionate about being true to the things that make this business successful and I really support that. It’s great to have the opportunity to share with you an overview of the Commercial Division, our growth story, what makes us different and how we get higher margins and more volume.

The Commercial Division is made up of two core businesses; Asset Finance and Invoice Finance. Together these make up 40% of the Banking Division's loan book. In both businesses we operate through two different channels, our direct sales team and via appointed brokers. The total number of the SMEs in the UK is something close to 4.8 million and as Stephen said, we have relationships with over 17,000 of them. Not all the 4.8 million will have assets they need to finance or require an invoice financing facility, but these numbers should give you a sense of the scale of the organic opportunity we have.

In Asset Finance 55% of our volume comes from repeat business. We fund a diverse range of assets and in most cases we have security, either with hard assets or receivables. We achieved strong loan book growth of 32% in the last financial year and the book now stands at over £1.1 billion. Both businesses are over 20 years old and have strong, well established management teams with specialist market and asset knowledge which sets us apart from our competitors.

When we look at funding a deal the key is to establish the security on offer through the assets we are funding. In Asset Finance the term of our lending is based upon the useful life of the asset and we look to lend on quality assets where there's a proven secondary market. In both asset and invoice a key consideration is ensuring that there's a clear exit route in the event of problems. This is an area that is debated and understood before we approve deals. Both businesses specialise in the provision of flexible funding solutions to the SME market. Our success is underpinned by our speed of response, flexibility, innovative expertise and commerciality. Our disciplined lending approach is based around a deep knowledge of the customer and their business and reinforced through tried and tested tenets of lending. As you can see this has resulted in a diverse loan book by asset and sector with attractive returns where managing concentration risk is key to our success.

So why are we in these particular businesses? Let's take transport which is a significant part of our portfolio as an example. Logistics is a fundamental part of the UK economy, particularly in this day and age when consumers are relying increasingly on internet home deliveries. Whilst trains and planes compete to some degree they will never replace our reliance on getting goods around by road and we believe this is a growing market. So, you can see why this is an interesting sector for us.

Our market share has increased over the past two years as a result of increased new business volumes and strong customer retention. The value of our customer proposition is further reinforced when we consider our performance against the overall market. In the last 12 months our outstanding balances have grown by 26%, whereas figures from the Finance and Leasing Association show that the market has reduced by 5%. At the same period our new business volumes have grown by 36% at a time when the new business volumes in our market have contracted by 30%.

Parallel data from the invoice finance sector shows our business growing ahead of market rates too. Currently in invoice finance we have 13% of the independent market which is about £2 billion or 2% of the total market which is around £11.5 billion. Since the start of the credit crunch in 2007 we've doubled our new business volumes in Asset Finance and increased our Invoice Finance loan book by 80%. This demonstrates our support of the SME community at a time when we know the major banks and other funders have retreated. We have been there when it mattered in the good times and not so good times.

We see ourselves as a business partner to our customers and believe that customer feedback is important. I thought it would be interesting for you to hear directly what a few of our customers have to say about us.

Customer recommendations

- *My name's Peter Prescott and I'm the Manager of Avtech that is a corporate aircraft maintenance company. We've known Close for over 20 years and we can get to hear about people that are buying aeroplanes, we can then recommend Close because they can tailor a good deal.*

- *Established in January of '89 my first truck was purchased from Heathrow Commercials of which I was introduced to Close Asset Finance as my first financer of my first truck. From there we have grown the business and Close have been alongside us to the position now that for 84 trucks, four ships and 109 items of plant later we're a substantial local company.*

- *Over the years Close have demonstrated that they can put together fairly complex deals involving offshore assets that others might shy away from. They'll understand various registers that they can put their mortgages on and so they may be more expensive, slightly than the others, but they get the job done because they're knowledgeable of the market, both with finance and with aeroplanes.*

- *Response time is very important if something goes radically wrong for you in a business. We had a circumstance when I had a very technical and very expensive piece of equipment for ship unloading that failed and I needed a new one. Close, within 24 hours allowed me to view the new replacement piece of equipment in Holland, go there, view it, agree to buy it and pay for it within 24 hours. And that to me was worth every extra percent of interest that I have to pay.*

- *We're happy with their service and I haven't used anybody else in 16 years and I don't know anybody who says different. I don't know anybody, and I know quite a few printers obviously, and I don't know anybody that trades other than the same way I do through the personal touch.*

- *Close give you a complete service and it's personal and it's competitive but it's not the cheapest, they give you a service where you can rely on their support to grow your business. They will study your business, they will follow your business and they will support your business but they will also be strong at times where they feel that you're going too far or they'll feel at times that they can't do any more and they'll tell you so. We have a vast array of finance houses that we deal with but I will always use Close because they were there from the start, they'll always be there at the end.*

It's great to get customer feedback, especially when it's like that. We've also been recognised by a number of industry bodies for our consistent service to the SME market. So, what makes us different? Why have we continued to achieve growth in margin and volume at a time when many of our competitors have struggled?

Our deep knowledge of our core markets and the assets we finance, together with local knowledge of our customers and their businesses allow us to make informed decisions fast. The senior team within the Commercial Division have an average of over 27 years experience. This provides an exceptional knowledge base which spans many asset types, including transportation, manufacturing, construction, print and trade receivables.

I mentioned our fantastic growth earlier, we've achieved this by providing a personalised bespoke service and adopting a cradle to grave approach where we stay in touch with our customers throughout the life of the agreement. This starts when we uncover an opportunity and continues through negotiating the deal, finalising the deal and then managing it in life. This includes offering a quick responsive service. In Asset Finance, for example, we look for a fast turnaround time from first contact with the customer to transferring funds to their bank. This responsiveness is highly valued by our customers.

We are in touch with our customers servicing their needs and in the right place when new opportunities arise. Our approach also ensures the sales team have a strong knowledge of asset values and their knowledge, expertise and closeness to the markets means we are well positioned to obtain accurate valuations quickly. This helps us to maintain a strong credit discipline.

In today's world this definitely helps support sustainable earnings as it improves quality as well as reducing attrition. It also enables us to spot potential problems. Our business units monitor arrears daily and as new arrears cases appear our sales people will go out and see customers to determine how serious these are or whether it's just a short term issue. This fast and personal approach helps us maintain and protect our net interest margin and ensures we're ahead of the game. I've not seen this in any other business that I've worked in.

Most other asset lenders sell their repossessions through auctions but because of our knowledge of our assets and the markets, we remarket them ourselves and this provides an opportunity to achieve higher prices. In the last year nearly 20% of the assets we repossessed we sold to our existing customer base. This is because our local teams know their customers and their businesses intimately. For example, in the haulage industry if a customer in London is having trading problems and needs to sell some of their Volvo trucks we'll be aware of another customer in Manchester who is looking to buy Volvo trucks. We will arrange the deal and support the transaction with finance. This again builds loyalty that people remember and makes us more than just a finance provider.

By doing all of these things we have secured good business growth, attractive returns and a high quality loan book.

We have invested significantly in our platform for growth. It's with great pride that I can say the majority of our growth is organic and will continue to be so. However, we will leverage our expertise and look at other opportunities for growth. The creation of the Commercial Division allows us to build our existing customer relationships and cross sell invoice finance to asset finance customers and vice versa. This is something we've never tried to do previously.

I believe we have a real opportunity here. As we know, our existing finance customers have invoice finance facilities with other providers, this enables us to strengthen our existing relationships and target new customers through the provision of group solutions whilst being aware of managing our concentration risk.

To further support this growth we have also broadened our existing services in these complementary areas, always looking to build on the current model of success. We have opened an asset finance business in Ireland using the same routes to market, lending on the same asset classes to the same types of customers. This is being delivered through our existing Invoice Finance business in Belfast so it ensures that we benefit from local knowledge and understanding.

The management structure has been strengthened by the formation of the Commercial Division providing a strong platform for growth. Over the last 12 months we’ve invested in the recruitment of 50 new asset finance employees, 35 of these frontend sales. Interestingly, whilst we look to recruit from within the finance industry we also recruit staff from asset suppliers as these people have an in-depth knowledge of the assets we finance. Invoice Finance has also bolstered its sales team with the recruitment of a number of seasoned industry professionals.

Significant investment has also been made in systems. The IT infrastructure has been upgraded and all asset finance businesses are now on one system, thereby providing economies of scale and consistent future IT upgrades and development programmes.

Organic growth in the UK is our main focus. We believe we still have share to take in our existing market but we are also looking at some additional strategic initiatives. I stress that these are at a very early stage but that some examples would be: Waste to energy, looking to take advantage of the many initiatives aimed at lowering carbon emissions, reducing landfill sites and exploring renewable energy. We believe this represents a great opportunity to build a niche within a niche.

Secondly, agriculture. This offers the opportunity for attractive returns coupled with the level of security that we require. We’re also looking at asset finance in Germany. We’re looking to see if we can replicate our longstanding and successful UK model. We’re researching Germany because the manufacturing and transportation market is 14 times bigger than the UK and these are sectors that we’ve been very successful in.

Finally, we’re also investigating asset based lending, or ABL. This is receivables, funding, inventory, property and plant and machinery all under one agreement. We believe that given our expertise in asset, invoice and property through Frank's team this is something that is really worth pursuing. The challenge we have here is whether we can get the returns that we require. Undoubtedly, some of these ideas will develop further, some may not. The great thing for me is that since I've joined the business there are plenty of opportunities to leverage the existing strengths and capabilities and I'm also really excited about the scale of the market opportunity.

I hope this has given you a feel for what we're doing in the Commercial Division and how we're developing, and thank you all for listening. I'd now like to hand over to Bob.

Bob Golden: Managing Director

Thank you Mary. Well good afternoon everybody. I've been with Close Brothers for 11 years most of that time running the Premium Finance business but also involved in various capacities with other businesses around the group. I've been running the Retail Division for 18 months and prior to Close I was at RBS where my last job was the setting up of the Tesco Bank in 1997.

What I'm going to do in the next 15 minutes is to take you through what Retail does, why it has grown by so much over the past three years and to discuss its sustainability for the future.

Now as you can see the loan books of Premium and Motor are in growth mode, both increasing by nearly £100m in the last year alone. Three years ago the retail businesses lent to 577,000 borrowers. In 2010 that number was around 1.6 million. These businesses' distribution channels are through intermediaries such as insurance brokers and car dealers and the loans are characterised by being small in size, high margin, short term loans, mainly secured and high volume.

What I would like you to take from this slide is that our unique selling points are long term and close relationships with the intermediaries and our advanced technology. More of that in a minute. Let's talk about Premium first of all.

There are two parts to the Premium Finance business, commercial where we lend to some 200,000 clients who are typically SMEs, and personal with over 1.3 million clients. Both want to spread their annual insurance premium over typically ten months, rather than using cash resources, credit cards or other forms of borrowing. With the whole book turning over every ten months it provides us with an attractive balance sheet dynamic which is that we can re-price the book very quickly and amends the lending criteria if needed.

Now I thought it would be helpful if I briefly describe the mechanics of Premium to you. As you will know if you cancel insurance partway through the year you normally obtain a pro rata refund. We use this mechanism as our security by taking in effect a mortgage over the insurance policy. So if the borrower defaults we have the right to cancel the policy and claim the refund. The business model works by an insurance broker offering the facility to his clients and completing an evergreen loan contract which rolls on year after year without re-signing. The broker receives a commission for selling the loan and he is able to provide a cash flow service to his client. The client has access to additional lending lines and we provide liquidity in the market for insurers. 30% of Premium's income is further secured by also being recourse to the broker. The key message for you to take away for this business is that it is incredibly sticky with high barriers to entry. So why?

Well firstly over 70% of the income derived from brokers who use Close are on exclusive long term contracts which includes an agreed price so not only are we locking in volumes but also margin for something like three to five years. With the average commercial loan at around £10,000 and personal at about £500 with ten months tenure it allows us to quickly re-price. Nearly 99% of the loans are received via our integrated systems with the 3,000 plus brokers who use Close and we are therefore embedded in the brokers' infrastructure.

80% of loans renew because they just rollover using the evergreen contracts. In this business the key selling points are our relationships with the brokers, which in many cases exceed 20 years, the long term contracts and our technology which is embedded with the broker's back office software. For a competitor in the independent space to disrupt our relationship with the broker they have to come up with a commercial deal that materially undercuts us, the broker has to be prepared to break a longstanding relationship and known service and they have to completely disentangle our systems and then re-sign all their clients. In 11 years we have only lost two significant accounts and won many more.

Insurance is paid for by the insured in a number of different ways. About 40% of the UK's £32 billion market is paid for by cash or own-sourced funding, circa 50% by insurer monthly payment schemes and 10% by the independent premium finance specialists of which Close is roughly half.

In commercial lines the UK market in 2009 was £11 billion. That's down 14% from the previous year as insurers reduce their rates. However our lending in this sector remained at £1 billion meaning we gained our 9% market share by completing more loans which are now over 200,000 per annum. Of the other £10 billion, £1 billion is funded by other premium finance specialists and the rest is from independent loan facilities, cash or insurer-funded schemes. Roughly one trading company in ten in the UK has a loan with Close Premium. Now this is a mature part of our business we believe short term growth will be modest until we see premium inflation rather than deflation coming through. However there is no sign so far this will happen anytime soon.

Now looking at personal lines. We currently lend to over 1.3m personal lines clients which has trebled in the last three years. This is very high margin and very secure lending as much of the business is also recourse to the broker. We complete one loan every four seconds and generate some 20,000 letters per day.

As I mentioned earlier the majority of monthly payments in this sector is provided by the large insurers. Of the estimated £21 billion personal loans market in the UK, £12 billion is sold direct by insurers who provide their own monthly payment schemes, brokers sell the remaining £9 billion which is our market. Of this we fund £0.5 billion as do the other premium financiers, so this leaves £8 billion of gross written premiums paid for in other ways, including by cash, personal loan facilities such as credit cards, broker finance and insurer schemes, the latter are not popular with brokers as they do not generate commission. It is also the area where we see our biggest opportunities for growth as we think our proposition provides a compelling alternative to these other methods of financing. Indeed over the last two to three years this area has particularly benefited from credit substitution as clients look for alternative sources of finance as traditional sources may no longer be available to them.

Finally, over the last three years in both personal and commercial lines we've seen competitors leave the market or have been purchased by us, leaving only two material specialist players in this field. Reduced competition and increased demand for our services have led to the increased volumes you can see. History has demonstrated that once brokers sign up to our contracts and our processes and clients sign rollover loan forms they both stay for a very long time. The message I leave you with in Premium is that we do not see increased competition in this sector anytime soon. We believe this is a long term, stable, growth business where our points of difference, such as broker contracts, are both significant barriers to entry and engines for growth.

Now turning to Motor, Close provides hire purchase facilities to end purchasers of mostly second hand vehicles which are typically nearly-new cars, motorbikes and light commercial vehicles sold by dealers. The HP contract is important as it means legally we are the owner of the vehicle until final payments and therefore can reclaim the vehicle in the event of default. We do not provide loans because they cannot be secured on the vehicle very easily and we do not do unsecured loans. We do next to no personal contract plans and therefore we do not take a residual risk on the value of vehicles by guaranteeing a buy-back price.

Now when talking about this area it helps to define the market which is split into three broad areas: the new and nearly-new market which is dominated by manufacturers and large franchise dealers; the used dealership network which is spread between corner plot dealers right up to the large supermarkets and lastly private sales and auction houses. We have never wanted to enter this market due to the credit and fraud risk and the difficulty in obtaining an HP contract.

The used dealership network has been our core market for many years. We have two key differentiators which are our local service and our technology. We have 12 branches based around the UK whereas all our competitors are centralised with a local sales team. Our branches are semi-autonomous businesses. They make their own credit decisions based within set guidelines and if the debt goes bad they take possession of the car and resell it. Local responsibility has led to excellent service and close relationships over a long period of time.

Our online systems are used for submitting nearly 70% of loans which, in an industry not known for its use of cutting edge technology, is very high. We do use a credit scoring system but only 14% of applications are agreed or declined automatically, 86% are underwritten in the old-fashioned eyeballing way by experts. Typically from the submission of the application online to a final decision is less than 30 minutes, so most loans are agreed while the dealer is completing the paperwork with the client.

More recently our performance has benefited from an increase in the residual value of second hand cars should we need to repossess and resell. In this way throughout the credit crisis and the recession our bad debt has been the lowest in the industry and we have been able to pass on, and more, the increased cost of funds and volumes have increased due to less competition.

During the credit crunch we saw the market consolidate. Santander bought GE, Black Horse merged with Capital Bank, Northridge and Southern Finance scaled back or left the market. This has left four major players and as you can see we have substantially increased our market shares with used car increasing to 9% from 5%, LCVs to 36% and used motorcycles to 27%, and just like in Premium history demonstrates that once dealers start using us they do not move and so we expect this business also to be sticky.

Organic growth in this business we believe is likely to continue. In the last year we have opened new branches in Swindon and Northern Ireland and increased our frontline sales team by over 30 people. We are currently considering the Republic of Ireland.

An area that we have recently moved into is the new and nearly new large dealership franchise and manufacturing sector. This historically has been cut off from us due to the ease of available cheap finance through solo exclusive deals with funders. This has changed as dealers are looking to have multiple finance providers rather than single sources which caught them out in the credit crunch. We do not believe cheap money will come back any time soon and so we have set up what we have called our key accounts team of 20 people to focus on these larger dealerships.

We've already had some considerable success gaining over 30 contracts including major names in dealerships such as Perrys and Cambria and with manufacturers such as Mercedes Direct and Suzuki motorbikes. We consider the motor business will continue to grow organically in both its traditional core used car dealerships and in the key accounts area utilising its branch network, relationships, systems and we can do this within our lending and pricing disciplines. History and experience have shown that we can grow this business despite peaks and troughs from low priced competitors. We have succeeded and there is no reason to think we cannot again in the future when and if they appear.

They key message in motor is that the branch network and local service delivers long term relationships that defends us against short term low rate competitors. And this is what a couple of our intermediaries think.

- *My name's Paul Matthews, I'm the Managing Director of Footman James. Footman James is part of the AON Group of Companies. Our relationship with Close Premium Finance started probably about six or seven years ago. In my opinion the relationship with Close is one of the strongest I have in the market. It's what I call a true strategic partnership. We took the decision because of Close's commitment to invest in broker technology to put all of that business together with Close around about four or five years ago. So we're now funding or Close are funding a significant multi-million pounds worth of business. Technology's vital and in the broker world unless we invested in our technology we'd go backwards. And Close supported the move to paperless environment, online trading, efficiencies that we were never going to get before using the other provider. So one of the main reasons that Close were chosen, one of the main reasons we still use Close is its commitment and its investment in that technology.*

- *My name's Keith Hodges, I'm a Sales Manager at Theale Motor Works. Fulton & Leasing, our main holding company, use Close anyway over many years, our Managing Director approached Mike the Area Manager at Close and he came and met us at the showroom, we told him about our ideas for the retail service at Theale Motor Works and Mike was really good in helping us get going and setting the thing up. Speed of service - very, very quick. We've had answers back in less than a minute. The more difficult cases still I don't think it's ever taken more than 24 hours to get an answer back. But I would say the majority are back within 30 minutes. The Area Manager who comes in, I can call him up and he can be with me within 20 minutes so it's the day to day looking after the account, the staff at the Swindon office are very friendly and helpful, it's just a good working relationship. And I think they really do put themselves out to try and do that deal. With some finance companies* *they're looking not to do the deal, and I just feel with Close they are. So they are very helpful.*

Not satisfied with the growth we are seeing in Premium and Motor we are investing in the future. We're continually investing and improving premiums, online trading and automated systems for brokers to ensure we deliver the best service in the industry plus we are currently piloting an internet portal where borrowers can access and amend their personal details as well as printed documents. We expect this to assist us with reducing our costs and maintaining our position as the leader in our field. In motor we're building a new dealer facing front end to make the dealer experience even quicker and easier to use.

While we see strategic opportunities to expand selectively in adjacent businesses our focus will largely be where we can grow our businesses organically such as in personal premium lines and motor key accounts.

I finish by saying that Retail has enjoyed a period of substantial growth. We believe that the opportunities exist to continue that growth but what is encouraging is the growth has come in our core businesses where we have proven skills, barriers to entry and we know it is sticky and long term.

Thank you. Malcolm will now talk to us about Treasury and how we fund our lending requirements. Malcolm.

Malcolm Hook: Treasurer

Good afternoon. I've been with Close Brothers only since July and prior to that my career has been spent in treasury roles at HSBC, the Woolwich and GMAC. Over the next few slides I will talk to you about how Close Brothers funds itself and how we look after our liquidity. I will also comment upon the impact of Basel III on our capital position. I will remind you that, yes, we are more conservative than many other banks in our approach to funding, capital and liquidity.

My objective today is to demonstrate that we have the depth, the flexibility and the diversity of funding on how and when we use our available sources to fund the loan book. I will end by outlining the guiding principles for funding liquidity and capital that we are using to help determine future treasury and capital management initiatives.

Over the last two years we have updated the existing conservative funding model in the following two ways. Firstly, the improvement in the diversity of funding and as a result much better access to funding. And, secondly, the improvement in the quality of liquid assets held. Over the same period we have narrowed the scope of the role of Treasury at Close Brothers. Our core focus now is to fund the existing loan book, future growth and to maintain high levels of liquidity.

The graph on the right compares how much funding was available to the Group at 31 July 2010 against the loan book and also includes the residual floating rate note portfolio which I'll touch on more a little later. Put simply this is a strong funding position. When one delves a little deeper and looks into the maturity mix of two key elements, the average maturity of the loan book was 12 months, the average maturity of wholesale facilities including the group bond was 22 months. This reinforces the picture of strength.

The strong funding position is matched by a robust conservative capital position of which Preben has already spoken about, Close Brothers is well capitalised. Moreover, as Jonathan said in our results presentation in September we expect no material impact from the new Basel III regime. Why? Our capital base largely consists of Core Tier 1 capital. Even allowing for all the new potential buffers proposed we would expect to remain comfortably above the ratios proposed by the Basel Committee. However, we realise that this is a continuing focus for the regulators and we will continue to monitor and evaluate developments. So in summary, a strong funding and robust capital position.

I turn now to the actions that we've taken to increase the diversity of funding and, therefore, significantly improve our access to funding and our flexibility. We have been proactive in managing the funding mix according to source, choice of term, and price. The graph shows how total available funding has moved over the last three year ends, the makeup of this funding and the movement in the loan book and the FRN portfolio. Two things are clear. One, the change in funding has not been in one area alone, in fact the opposite. Two, we use some of our customer deposits to fund the loan book and the FRN portfolio, and we're comfortable with that. They have proved resilient through the cycle.

So, what has been the diversification in funding? Pre 2008 we were best known for our use of two main sources of funding: committed unsecured bank facilities; and deposit taking from corporates and SMEs. We still view these as important. However, since June 2008 we have diversified our funding through, firstly the creation of a retail term funding proposition that during 2008 and 2009 gathered over £1 billion in deposits from over 30,000 depositors. Doing this transformed our access to funding. It opened a completely new market for taking deposits. It also gave us a much greater choice over when we raise funding, and how much. The elastic nature of this source means that it is likely to continue to be a part of the overall funding mix going forward, and one that we will access more in some times and less in others.

Secondly, a return to the bond markets with a £200 million group bond that matures in 2017. This lengthened the maturity profile of our funding. And the third and final source of diversity so far has been within the raising of £0.9 billion since 31 July 2010 through a mix of wholesale facilities. It includes a securitisation of part of the premium loan portfolio, a long term repo transaction, and a new syndicated facility. The combined facilities have an average maturity of 19 months.

Going forward I expect that we will maintain our focus on improving the diversity, term, mix and capacity of funding. Which tools are used at any one moment will depend upon availability and price. However, to give you a flavour of the things that we are looking at, one, we could replicate our successful securitisation of premium loans, possibly with our motor portfolio. And two, we may raise more term retail funding or encourage the rollover of existing offers as they mature. What this demonstrates is that we have now got the depth, the flexibility, and the diversity on how and when we use our available sources, using less or more of our customer deposits according to our needs.

Now, has this focus on diversity come at a cost? Yes. Like other financial institutions we have seen an increase in our cost of funding. However, as Stephen pointed out earlier, we win our business through strong customer relationships, specialising in niche sectors, and having a consistent approach to our lending. In spite of the substantial rise in our term cost of funding, particularly in 2008/2009, the net interest margin has been pushed up from 8.6% in 2008 to 9.7% in 2010. Moreover, the loan book grew by 23% in 2010. It is important to note that the step up in funding cost occurred 18 months ago and has been relatively stable since. Therefore the strong performance of the bank that you have seen in the last financial year takes these additional costs into account and shows that we can absorb them. So in summary, greater diversity brings a bigger pool of funding that can be tapped. We are confident in our ability to access what we need to support future loan book growth.

The other difference over the last two years has been to change the mix of the treasury assets, and the reason for doing this has been to enhance the quality of liquid assets. The changes are illustrated in the graph, which shows, one, the level of treasury assets over the last three year ends, their makeup, with some new elements coming in over the last two years, and other elements being managed down. And thirdly, treasury assets as a proportion of the group balance sheet. From this you can see that with the strategic focus on funding the loan book, the FRNs that were purchased during 2006 to 2008 are being managed down. 75% of the residual FRNs held will mature within two years. Active management of treasury assets is helping to reduce their size as a proportion of the balance sheet. I expect this to continue, particularly as the loan book grows. At the same time we have materially enhanced the quality of our liquidity holdings. As the graph shows, at July 2008 we did not hold any gilts. Since then we have built up a portfolio of gilts and also placed funds on deposit with the Bank of England. By 31 July 2010 they amounted to £286 million and £453 million respectively. These actions were taken well ahead of when Close Brothers became subject to the new FSA liquidity regime. So in summary, higher quality liquidity, a more efficient balance sheet profile.

So let me conclude by providing you with our key principles for managing our funding liquidity and capital. We will focus on funding the loan book from a diverse range of sources. Improved access to funding will give us greater flexibility over how to grow the business. There will be a sensible level of term funding versus the term of our assets. We will maintain a high quality stock of liquid assets. We will stay well capitalised, which will largely be formed of core Tier 1 capital.

Thank you for your time, and now I'll hand back to Stephen.

Stephen Hodges, Managing Director and Banking Chief Executive

Thank you Malcolm.

I hope you now have a better understanding of what we do. However what you're probably interested in understanding is what does this mean for our shareholders. We recognise the importance of sustainable loan book growth and consistent earnings. As I said earlier, the ten year compound annual growth rate of our loan book is 13%, which we've achieved whilst maintaining an exceptionally strong margin, exceeding 8.5% over that period.

That consistent performance was maintained during the recent credit crisis, which is a particularly good outcome as most other lenders saw a more significant fall in their earnings.

To demonstrate the quality of those earnings let me share an example with you, using a snapshot of the returns earned during the last financial year. For every £100,000 we lend, we deliver a net return of £3,000. And that equates to a 3% net return on the loan book after cost of funds, operating costs, and bad debt. A good return and a result that we're proud of.

I've shown in the graph on the right hand side of the slide ROE has remained strong throughout the cycle, averaging 19.5% over the past ten years, whilst the loan book has grown over three-fold during that period.

So to conclude I would like to return to the 25 year trajectory of our loan book and profits. I hope from this presentation you now have a better understanding of our distinctive business model, which has delivered this strong and successful track record. Going forward we'll pursue organic loan book growth and explore strategic opportunities, and we remain absolutely committed to this model. We are well positioned for the future.

Thank you very much, ladies and gentlemen. That concludes the formal part of our presentation. The team and I will now be very happy to take any questions you may have. If you could direct your questions to me in the first instance, and then I can direct them accordingly. If I could remind you that the event's being audio webcast, so can I ask that you speak clearly into the microphone and state your name and company before asking any questions. Thank you very much.

Does anybody have any questions? Yes?

Question and Answer Session

<u>Question 1</u>

Robin Savage – Collins Stewart

It's Robin Savage from Collins Stewart. I was just wondering, if we look on your company website, on the group website, we'll see a copy of the Close Brothers Limited group accounts. I just wondered, are there any bits of the Banking Division which are outside of that group accounts?

Answer: Stephen Hodges

Yes, from a P&L and management of business point of view the offshore banks are part of our asset management business. But for balance sheet purposes those are consolidated within the Close Brothers Limited accounts that you've referred to. So what we've been talking about today is our Banking Division.

<u>Further question</u>

Sorry, can I just ask a second, completely unrelated, question? I just wonder, in the recent IMS there was a comment about a legacy asset. I just wondered how many other legacy assets there might be.

Answer: Stephen Hodges

It's a reasonable question. Our expectation is that this is a single item and I'm happy to refer it to Frank Pennal, who runs our Property Division, to say any more about that.

Answer: Frank Pennal

Yes, it was a loan that we put on the books in 2007 for a customer at that point in time who'd been a customer for ten years. It has its own particular issues, but we believe it to be an isolated case.

<u>Question 2</u>

Ben Moore – Goldman Sachs

Ben Moore from Goldman Sachs. A couple of questions. One on your cost base. If you could give any more colour on the scalability of that cost base, given the kind of strong loan growth that you're seeing. And then just the second one on loan loss provisions, if you could give any colour on when, if at all, you expect them to normalise back to that kind of 1.5% level that you were talking about, or if there's been a change in the mix of the portfolio which means that you wouldn't expect to come back down to that level. Thanks.

Answer: Stephen Hodges

Fine. If I just have a go at answering the second part of your question, and then I might hand over to Sharon Bishop, who is our Chief Operating Officer, to talk about costs. In terms of bad debt, I think we've indicated in the IMS that we expect to see a slight improvement in the rate of bad debt in the current financial year relative to last year. But we expect, and accept, that we remain at the high end of our range. So we're at the high end of the range is the 2.5%, 2.6% that we saw 18 months ago and prior to that in the early nineties, you referred to 1.5% which is the sort of perhaps through the range sites average. We're not predicting when we'll get back to that level. On the cost point and the scalability, Sharon, I don't know whether you want to say a few words about that?

Answer: Sharon Bishop

It's a very good question, thank you for asking that. You saw a 5% drop in cost income ratio between 2009 and 2010. We don't expect that to continue in a linear fashion as we continue to invest in infrastructure, but we're looking very closely at scalability and the clear thing for us here is to make sure we can handle our growth and that we're investing for the future. So that's where we're at with it.

Answer: Stephen Hodges

Yes, and I would add the point I made during the presentation, which is that whilst we accept that there are economies of scale, we distinguish very clearly between costs that are effectively internal operational issues and costs which impact the customer. And we're very clear in our own minds that the customer proposition must be retained through that process.

Question 3

James Hamilton - Numis

Clearly you're growing your balance sheet quite quickly at the moment, as you did last year, and I appreciate the duration of the book is quite short. Could you comment on two things: one, the new growth that you're putting on, do you perceive the credit quality there to be about the same as the historic run rate, adjusting obviously for the economic cycle point we're at, and looking across that to the high level of growth you're putting on at this point of the cycle, what makes you confident that this is the right point of the cycle to be expanding your balance sheet so rapidly?

Answer: Stephen Hodges

Yes, I mean good questions. I think on the point about is this the right point of the cycle, I think all I would say is that what we have tried to emphasise today is that our approach to the market is consistent. So what we don't try to do is feather our proposition depending upon the economic circumstances. So our LTVs are consistent, our disciplined approach to underwriting is consistent, and we factor into that an assumption that we might have to deal with any stage of the economic cycle. So we're not putting on those assets because we think now is a particularly good time to do it; we're doing it now because there is an opportunity to do so and because our long term growth rate, as you've seen from that compound figure that I've mentioned a couple of times, is 13% over the last ten years. So this isn't a sort of judgement about the state of the market, but we are very confident that, because the majority of that growth is organic and within the core areas of our business, that we understand the assets that we're putting on and, therefore, to answer your earlier point, we don't anticipate, we're not planning, for a different bad debt or credit quality aspect or characteristic to that bit of the loan book that we've put on than we've ever had previously. We expect it to manage or react in a similar way, subject of course to economic conditions.

Question 4

Justin Bates - KBW

Evening, it's Justin Bates from KBW. Just a couple of points please. You've obviously made some pretty impressive market share gains. Are there any natural ceilings in any of those markets that it's worth us knowing about and also do you feel you're capacity constrained in any of those markets? Secondly, very broad spread of introducing brokers, it seems, but are there any concentration risks that we should be aware of?

Answer: Stephen Hodges

Right, well I think on market share I'm very happy for perhaps each of the lenders to talk very quickly about the market share in their particular areas and give you some sense of that. On the infrastructure and capacity point, I think we made that point during the slide, we see no capacity or capability restrictions imposed on us by infrastructure at this moment in time. Introducer concentrations, no, I don't think so. I mean, Bob, you might want to pick that up in terms of our introducers, because you're a largely intermediated business so that might be something you want to touch on.

Answer: Preben Prebensen

Could I just add on the capacity question, one of the reasons why we strengthened the management team so much is to ensure that we can absorb this level of growth and indeed more. We actually think the management team is now very capable of running a bank larger than this one, and that's very important to us. And the control environment that's around that has equally been increased, so it's not just kind of the front end but it's also the control environment.

Stephen Hodges

Mary, do you want to say something about market share?

Answer: Mary McNamara

Yes, from a Commercial point of view, as you saw from the slides, I think from a market share we've moved from 4% to 6%, which is still tiny, so still a massive opportunity there from an asset finance point of view. And then again if you look at invoice finance, again in the independent we've moved from 8% to 13%, but still a small percentage, so still a lot to go at. And if you look at the total market we're only at 2%, so as I said in my presentation, I think it's really exciting that we have a lot of growth to still go for.

Stephen Hodges

Frank, would you like to talk about property?

Answer: Frank Pennal

Yes, well we're a tiny part of the market. I mean our book's £550 million and the non-residential mortgage market is £225 billion, so that puts it into context and that perhaps gives us plenty to go at. We're obviously benefitting at the moment from a relative lack of competition, a number of the specialists have either gone bust or have moved out of the market, so there's plenty of opportunity out there. Clearly we have some market concerns, but there are still good developers out there building good product and selling good product, and it just means that the overall quality of our borrower as a consequence of lack of competition is improving quite significantly.

Stephen Hodges

And lastly retail?

Answer: Bob Golden

In Retail, we're split between Motor and Premium. If we look at Motor, we've just moved into the key accounts area that I talked about, which are the new and larger dealerships, where we have a zero market share there at the moment. And those larger dealers are looking to have more than one finance provider, so we clearly see some opportunities there. On our traditional core markets of the used, medium and small size dealerships, our 9% market share, yes, has grown, but actually we're seeing that continuing to improve in the first quarter of the year as we've talked about. So we're hopeful there that that certainly isn't flattening out.

In Premium Finance, commercial lines yes we've been in that business a long time, we've got £1 billion of £11 billion, and the challenge there has been one of getting more accounts, which we do do on a regular basis, but they're riding cycle of the insurance premiums going up and down. But in personal lines, you know, clearly we think there are growth opportunities there. We finance half a billion of our broker-introduced business of £9 billion, so we've still got a lot to go for, I think, right the way round.

Preben Prebensen

I think the key thing here is that there's a lot to play for. But the whole message is that that's set against the discipline of our criteria. So we'll play, providing it's high margin, predominantly secured, and kind of niche customer focused, all of those conditions are met. So the overall markets would shrink based on parts of those markets where those things are not clear.

<u>Question 5</u>

Thomas Moore – Standard Life Investments

It was just a quick one following up on one of the earlier questions. I wasn't quite clear whether there were any structural reasons why bad debts couldn't come down, not just to the average but below the average, because I know you are unwilling to answer on the economic outlook, but I think that was the follow-up for that question, which wasn't answered.

And the second one was, just given that I know the average term of your loans is relatively low, but clearly the fact that bad debts can go back up again on the basis of a legacy loan, was slightly disturbing, just in that I'm not quite sure across the rest of the book how many others of these legacy business suddenly reappear.

Answer: Stephen Hodges

Well, as we've said, we think the legacy loan is an isolated case. It was a larger loan. We have always had a small number of larger loans, we continue to have a small number of larger loans, but this was a particularly... this was an isolated case with exceptional circumstances that surrounded it. So I think we remain in a difficult economic environment and the level of bad debt reflects that, and therefore we're hesitating to, looking forward, see any sudden return to the very benign conditions that we saw previously.

Preben Prebensen

I guess the key question is has the mix changed so significantly that history will not repeat itself, or could not repeat itself. So is there something about the book now, or going forward, which means that kind of the new average is different from the old average?

Stephen Hodges

Yes, and the answer to that is no. I mean there's absolutely... our parameters, our LTVs, our mix, our discipline remains the same. So sorry if I missed... didn't pick up that part of the question, that could we return to those, absolutely we could.

<u>Question 6</u>

Paul Measday – JP Morgan Cazenove

It's Paul Measday from JP Morgan Cazenove, the niche part of it. Could I explore capital and I'm sure you won't... sorry Preben! I'm sure you won't give us a Tier 1 ratio target, but your current rate of loan growth is running roughly twice the level of the historical average, which seemed to be a sort of self-funding rate, given the returns you expect from the business, so to put it another way, how many years do you think you could run at this rate of growth, given the growth opportunities, where is your appetite to bring down that core Tier 1 ratio?

Answer: Stephen Hodges

The growth rate is twice the long term growth rate. But of course over that time we were paying dividends for some of that time, so I think if you looked at what happened in the last year, our loan book grew by 23%, our risk weighted assets grew significantly, but the Tier 1 ratio only dropped very slightly from 11% to 10.8% so that implies to me that we're self-sustainable. Jonathan.

Answer: Jonathan Howell

Just to pick up on that particular question, we don't have a publicly stated target for capital. We feel very comfortable where we are at 13.9%. We feel very confident that, given the type of loan book growth that we've got, that for the foreseeable number of years we're able to service that in terms of capital. How do we do that? It's very, very simple. We're principally core Tier 1 capital, we just retain cash within the Bank. We've hardly taken a dividend out of the Bank in the last 18 months or so, but that gives us more than sufficient to service external costs and dividend from elsewhere within the Group. So we feel very, very comfortable with the flexibility that we've got for a number of years.

<u>Question 7</u>

Arnaud Giblat – UBS

Just quick follow-up again on scalability. You've indicated that a proportion... that the cost base within the management team has been scaled up quite significantly to cope with the cost. Can you maybe give us an indication or a feeling of what percentage of the cost to income ratio, how that has changed versus a few years back? The question is basically what proportion of cost would the centralised bit be and how much bigger is that now to see what... how the underlying businesses have benefitted from operational gearing?

Answer: Stephen Hodges

Yes, we don't give a forward looking view on cost income ratio, as you appreciate, and you've seen how the numbers have improved over the last 12 months. We will still look for cost income improvements over time. But different businesses have different cost income ratios, so there are things that impact the cost income ratio that can depend on mix within the underlying business that won't necessarily predict it, not all businesses will grow in a straight line going forward. Jonathan.

Answer: Jonathan Howell

Just to pick up on that. I think in terms of the cost income ratio, the central capability that we've added isn't material in the context of the overall profitability of the Bank, or the Bank's balance sheet or anything like that. So it's not a material component. We have seen quite sharp increase in the cost income ratio, there is further improvement to be had over a period of time. But one of the key elements of the whole business model, as you'll appreciate, is a great degree of local presence, local offices, local people that give us that competitive edge to support that net interest margin. So it won't be a pronounced operational gearing that you would see in a more manufacturing type bank. But nonetheless we feel that there is improvement to be achieved.

Concluding Comments: Stephen Hodges

Any other questions? Very good. Well thank you all very much indeed for your time today. Thank you.

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