Close Brothers Group plc

Full Year Results 2024

Thursday 19th September 2024

Mike Morgan, Group Finance Director

Good morning, and welcome to the presentation of Close Brothers' 2024 full year results.

Unfortunately, Adrian can't be here with us today. As announced earlier this week, he is taking a temporary medical leave of absence from the business, so I will be taking you through the presentation this morning. I'll start with an overview of the year before taking you through our financials. After that, I'll cover the progress we've made to date on the capital management actions and our strategy update. I'll be happy to take your questions afterwards, both via the telephone conference line and over the webcast, which you can submit either during or after the presentation.

Our business delivered a resilient performance in an uncertain environment, with the key metrics in line with guidance we had given you for the Full Year 2024. In Banking, we continued to deliver growth at strong margins, albeit at a reduced pace due to the measures taken to moderate capital consumption. CBAM delivered market-leading net inflows, although Winterflood's performance remained impacted by the unfavourable market conditions. We remained focused on cost discipline and have made further progress against the cost actions identified to improve future efficiency.

The FCA's review of historical motor finance commissions announced in January introduced significant uncertainty for the industry and the group. We're taking a series of proactive steps and we're making significant progress against the capital actions outlined at the Half Year. We said that, combined, these actions could increase the group's CET1 capital by up to approximately £400m by the end of the 2025 financial year.

Following a comprehensive strategic review, we are pleased to announce the sale of our Asset Management division, CBAM, this morning. This transaction marks an important step towards the strengthening of our position, to navigate the current environment. In addition, the agreed sale represents competitive value for our shareholders, allowing us to simplify the group and focus on our core lending business. I will shortly provide an overview of the sale agreed with Oaktree and update you on the progress we've made since March.

Whilst the timeline for the FCA's review has been extended, our priorities remain to further strengthen our capital position, and protect our valuable franchise. Against this backdrop, we

have continued to support our customers and provide excellent service, and have made significant progress enhancing our business and customer offering over the year.

Customer demand has remained strong, and we have written healthy levels of new business. We've acquired Close Brothers Motor Finance in Ireland, and we've taken this opportunity to review our processes and implement ways to operate more efficiently in the future.

While we have taken decisive actions to navigate this environment, the distinctive strengths of our business model – our long-term relationships, the deep expertise of our people, and our consistent service – endure. Our customer-centric approach underpins everything we do and is reflected in strong customer sentiment scores across the group. We're confident that we've got the right model to support customers through the cycle. The consistency of our lending criteria gives us confidence in the quality of our loan book. We have a strong balance sheet, which is being further strengthened by the actions we previously announced.

While we remain focused on building our capital strength, we continue to be encouraged by the strength of demand in our Banking business and see good long-term growth prospects for our core business.

Turning now to our financials. This year, we have delivered a resilient performance, notwithstanding the uncertainty, with adjusted operating profit increasing 50% to £171 million, reflecting the impact of Novitas in the prior year. Return on tangible equity was up to 8.3%.

In Banking, we achieved growth in income and maintained our focus on costs and pricing discipline. We grew the loan book 6%. The net interest margin was strong at 7.4%, and credit quality was stable on an underlying basis, in line with guidance. We maintained strong capital, funding and liquidity positions, with our CET1 capital ratio at 12.8% at 31 July.

In Asset Management, net inflows were strong at 8% and we grew assets under management to £19.3 billion.

Market conditions remained unfavourable for Winterflood, although Winterflood Business Services grew assets under administration to £15.6 billion, as we move towards our £20 billion target.

Turning to the income statement. We had £29 million of adjusting items in the year, and so on a statutory basis, operating profit was up 27% to £142 million. Covering the performance on an adjusted basis, we delivered a robust income performance, with growth in both Banking and Asset Management, partly offset by a decline in Winterflood and higher group interest charges.

Expenses rose 10% from increased staff costs and continued investment in Banking, with Banking costs increasing in line with guidance. Impairment charges of £99 million were down significantly from the £204 million incurred in the prior year, which included £117 million of Novitas-related charges. And as a result, adjusted operating profit was up materially to £171 million.

Banking reported profit of £205 million, with the increase reflecting the Novitas-related prior year impairment charges, and a robust performance overall.

In Asset Management, profit reduced to £12 million, as income growth was more than offset by investment in new hires to support future growth, and increased staff costs.

Winterflood's performance reflected lower trading income and unfavourable market conditions, as well as one-off dual property costs, resulting in an operating loss of £2 million.

We also saw an increase in the Group net expenses to £45 million due to higher professional fees associated with the potential impact of the FCA's review of motor commissions, as well as interest on the Group's £250 million bond.

Turning to the adjusting items, of which only £2.9 million were incurred in the first half, with the remaining £25.7 million coming in Half Two.

Firstly, we incurred £6.9 million of costs on the handling of complaints and other operational expenses associated with the FCA's review of historical motor finance commission arrangements, which included increased resourcing in our complaints and legal teams, and investments in data, systems and processes. This was lower than our guidance of approximately £10 million, as we sought to mitigate the impact through outsourcing and the deployment of automated solutions. In FY25, we currently estimate that these costs will be between £10 and £15 million.

Secondly, Borrowers in Financial Difficulty. Following discussions with the FCA regarding its market-wide review, we have conducted a voluntary Past Business Review of customer forbearance relating to our motor finance lending. As a result, we have recognised a provision of £17.2 million relating to the review and expected customer compensation. We have started making compensation payments to customers, with the remediation programme expected to be materially complete this year.

Whilst this is higher than we had previously expected, it reflects our decision to both widen the population of in-scope customers and increase the assumptions for distress and inconvenience payments, in line with our commitment to achieve fair customer outcomes. The provision should sufficiently address the outcomes of the review.

Thirdly, we incurred £3.1 million of restructuring costs, mainly driven by redundancy and associated costs. And we expect to incur £5 to 10 million of restructuring costs in FY25 as we continue to implement cost management actions to improve future efficiency.

Finally, there was £1.4 million of amortisation of intangibles on acquisition.

Moving to the Banking division, where we've been pleased with the performance overall. Income increased 2% to £725 million, reflecting good loan growth and the strong, albeit slightly lower margin. As previously highlighted, the prior year income benefited from Novitas and profit and loss movements from derivatives. And excluding these items, income was up 4%. The net interest margin reduced to 7.4%, reflecting the impact of Novitas and the derivatives that I just called out, as well as margin pressures and lower fee income in Commercial.

Expenses were up 8% to £421 million, reflecting higher staff and regulatory and assurance costs, as well as continued investment. And this was at the lower end of our guidance range for cost growth. Impairment charges decreased to £99 million, which corresponds to a bad debt ratio of 1.0% and remains below our long-term average of 1.2%.

Overall, adjusted operating profit increased to £205 million and including the adjusting items I ran through, statutory profit rose to £178 million.

Now, highlighting the key metrics from across the Banking division, excluding Novitas. We saw income growth of 3% and loan book growth of 6%, taking the loan book to £10 billion. The net interest margin was strong at 7.3%, although down 30bps year-on-year. Expenses grew 9% and the bad debt ratio was stable at 0.9%. Overall, adjusted operating profit reduced 9% to £206 million.

Now looking at each of the businesses in turn. Firstly, Commercial. Income was down 3%, notwithstanding growth in the loan book of 6% to £5 billion, as the NIM reduced to 6.5%. This reduction reflected both lower fee income and the need to balance the repricing of new business written in Asset Finance, with our focus on maintaining support for our customers in the higher rate environment. Expenses grew 10% from higher staff costs and investment spend on our Asset Transformation programme, which was completed in the year, introducing a single technology platform across the business, increasing efficiencies and standardising processes. And adjusted operating profit reduced 27% to £90 million.

Moving onto Retail. Income was up 6%, reflecting loan book growth of 1% and a strengthening of the margin to 8.7%, as we maintained our pricing discipline in the higher rate environment. Expenses rose 8% driven by the acquisition of the Irish motor finance business, as well as higher staff and regulatory costs. And adjusted operating profit increased 9% to £38 million.

Finally in Property, income was up 13% reflecting loan book growth of 15% to £2 billion. Although the NIM decreased to 7.3% as one-off redemptions benefited the prior year, and we also saw lower fee yields. Expenses were up 13%, reflecting an increase in staff costs and a higher apportionment of indirect resources, in line with the loan book growth. And adjusted operating profit rose 12% to £78 million.

Moving to the loan book. We saw 6% growth on a reported basis and 7% when excluding the businesses in run-off, Novitas and our legacy Irish motor finance book. And on this basis, the Commercial book grew 6% and reached £5 billion. Asset Finance was up 5%, with good demand in Leasing, notwithstanding a stabilisation in the second half of the year, and Invoice Finance increased 8%, driven by strong new business and higher utilisation.

Our Retail book was up 6% driven by 10% growth in the Motor book, which included the recently acquired Irish motor finance business. This was partly offset by a 3% decline in Premium Finance, reflecting the competitive environment. And Property delivered 15% growth, with healthy drawdowns from our new business pipeline.

And whilst we saw good loan book growth overall, the growth rate slowed to 2% in the second half, reflecting the actions taken to selectively grow the loan book and further strengthen the capital position. In FY25, we are planning for low single digit growth in the loan book, as we continue with this approach.

Net interest margin. As I've mentioned previously, approximately 12 basis points of the year-on-year reduction in NIM is due to the movements in derivatives and Novitas. A further 16 basis points of decline reflected margin pressures and lower fee income in the Commercial business.

Notwithstanding these pressures, the margin still remained strong at 7.4% as we remained focused on pricing discipline on new lending and optimising funding costs in the higher rate environment. Looking forward, we are well positioned to sustain the 7.2% NIM delivered in the second half of the year, given our pricing discipline and specialist, relationship-driven model.

Moving onto costs in the Banking division. We saw an 8% increase, driven by higher staff costs from inflation-related salary rises, regulatory compliance and assurance expenses, investment in our strategic programmes and cost saving initiatives, as well as costs related to the acquisition of Close Brothers Motor Finance in Ireland. This growth was partly offset by progress made on our various cost management initiatives.

Our guidance included the adjusting £6.9 million of costs related to motor complaints handling and other operational expenses associated with the FCA's motor review, and excluded the

acquisition in Ireland. On this basis, cost growth was also 8%, at the lower end of guidance. And for FY25, we expect growth in income and adjusted operating expenses to be aligned, as we benefit from the cost savings actions underway.

Now as we outlined in the Half Year results, we are progressing cost actions, as we look to improve future efficiency in the Banking division. We initiated our technology transformation programme back in 2023. This has focused on simplifying and modernising our application estate and making increased use of outsourcing partners. As part of this, we have partnered with a leading technology services and consulting company, have reduced our headcount by approximately 100 and have removed over 115 IT applications.

As I said back in March, we have also mobilised further cost initiatives across Suppliers, Property and People, as we seek to partly offset the adverse impact on the group's income, as a result of the actions that are being taken to strengthen our capital base.

Within Suppliers & Property, initiatives are focusing on rationalising our supply chain, reducing our suppliers and consumption of services, and reducing our property footprint. So far, we have served notice on our Wimbledon Bridge House office, with the removal of approximately 800 desks. Then, on the People side, we have made good progress on streamlining our workforce through the consolidation of roles and the management of vacancies.

And overall, we expect these measures to deliver annualised savings of around £20 million, reaching the full run rate by the end of the 2025 financial year. And we also expect to deliver positive operating leverage in FY26.

Turning now to our credit performance. The bad debt ratio was 1.0% as we recognised £99 million of impairment charges. This primarily reflected loan book growth and the ongoing review of provisions and coverage, partly offset by an improved macroeconomic outlook. We recognised £6 million of impairment charges relating to Novitas due to increased time to recovery assumptions and legal costs. Overall, we remain comfortable with the capital element of the provision.

We continue to closely monitor the evolving impacts of inflation and the cost of living on our customers, but have not seen a significant impact on credit performance at this stage. We remain confident in our loan book, which is predominantly secured or structurally protected, prudently underwritten and diverse. Over Full Year 25, we expect our bad debt ratio to remain below our long-term average of 1.2%.

Turning to Asset Management, which has continued to deliver market-leading net inflows. Managed assets increased 18% to £19.3 billion, driven by strong net inflows, particularly from our bespoke investment managers, and positive market performance.

Total client assets were also up 18% to £20.4 billion. Operating income increased 9% to £158 million, as growth in our AuM resulted in higher investment management income. The revenue margin decreased marginally to 82 basis points, reflecting an increased mix of lower margin products and a move towards a larger client size. Costs rose 13% to £146 million, reflecting wage inflation and the recruitment of bespoke investment managers, which accounted for £10 million of costs. And so, whilst the operating margin reduced to 8%, this would have been 14% when excluding the costs related to bespoke investment manager hiring. Overall, profit decreased to £12 million.

And now onto Winterflood, where the challenging market environment continued to impact investor appetite. Income was down 3% to £73 million, with the decline in trading revenue more than offsetting growth in Winterflood Business Services, where income increased 17%

and assets under administration grew to £15.6 billion. Costs were up 4% reflecting approximately £3 million of one-off dual property running costs incurred by relocating premises. And following a cost review undertaken in the year, we expect to benefit from annualised fixed cost savings of £4 million from FY25, offsetting inflationary pressures. Overall, we saw an operating loss of £2 million. And looking forward, we remain focused on diversifying our revenue streams and expect to grow Winterflood Business Service assets under administration to over £20 billion by the 2026 financial year.

Moving onto our balance sheet, where we continued to follow our prudent approach to managing financial resources. We maintained a strong balance sheet and increased our total funding to £13 billion. We borrow long and we lend short, and we hold £2.3 billion of liquidity, with our Liquidity Coverage Ratio over 1,000%.

Our funding base is diverse, across wholesale markets and a mix of retail and non-retail deposits. In line with our strategy, we continued to actively grow our customer deposit base throughout the year, with retail deposits up 36%. The investment in our customer deposit platform has provided scalability and has enabled us to expand and diversify our products, with Easy Access now complementing Notice Accounts and Fixed Rate Cash ISAs. At the 31st July, we had around £540 million in Easy Access account balances. And in line with our conservative approach, our deposits are predominantly term, with only 8% of deposits available on demand.

We repaid £490 million of the TFSME this year, ahead of maturity, with our remaining drawings under the scheme at £110 million. Our average cost of funds increased to 5.5%, reflecting the higher interest rate environment. And our credit ratings continue to reflect our inherent financial strength and diversified business model, with Close Brothers Limited rated A1 by Moody's.

Turning to our capital position. Our CET1 capital ratio was 12.8%, with the reduction mainly driven by loan book growth, offset by capital generation from profit. This includes the benefit of slightly lower loan book growth as we seek to build capital, as well as the non-accrual of the FY24 dividend. And over the second half of the year, the CET1 ratio was broadly flat when excluding the adjusting items.

We saw an increase in RWAs, driven by particularly strong growth in Property, which carries the highest risk weighting, along with good growth in Commercial and the Irish motor finance acquisition. Our headroom was 310 basis points above our applicable CET1 requirement of 9.7%.

And earlier in the year, in line with our strategy and capital management framework, we issued £200 million of Additional Tier 1 securities, further optimising our capital structure and increasing our Tier 1 capital to 14.7%.

Our leverage ratio increased to 12.7%.

On Basel 3.1, the implementation date has been set for 1 January 2026, which is six months later than previously expected. We expect the rules to have a less significant impact on our capital headroom position than previously anticipated, as whilst implementation is expected to increase RWAs by up to 10%, the PRA is proposing to apply an SME lending adjustment as part of the Pillar 2A, to ensure overall capital requirements for SME lending do not increase.

Finally on IRB, our application remains in Phase 2 of the process and engagement with the regulator continues.

We have maintained a strong capital position and are on track to deliver against the capital actions outlined in the first half. Over the medium-term, we remain committed to our previous

CET1 capital target range of 12 to 13%, although we have the potential to increase the CET1 capital ratio to between 14% and 15% at the end of the 2025 financial year, subject to those actions.

I'll now give you an overview of the developments since the FCA initiated its review of the motor finance industry in January. On 30th July 2024, the FCA announced that it now aims to set out next steps by the end of May 2025, rather than by September 2024, as previously expected. It stated that this extension to the review timetable is due to delays in collecting and reviewing historical data, as well as a relevant ongoing judicial review and cases at the Court of Appeal. If they determine that firms owe redress to a large number of customers, this will be followed by a consultation on their proposal to deliver this. The FCA has also indicated that the final rules are expected to be announced by December 2025, with implementation by lenders expected from January 2026. Therefore, there still remains a significant uncertainty for the industry regarding any potential remedial action as a result of the review.

The estimated impact of any redress scheme is dependent on a number of assumptions, for example, we don't yet know the time period covered. We also don't know about the parameters that could be used in any potential redress scheme, such as the appropriate or fair reference commission rates, and whether it would be a proactive or reactive industry-wide scheme. Therefore, it would be premature to predict the outcome or estimate the potential impact on the group. So no provision has been taken at this stage.

And as I just described, the uncertainties arising from the FCA's review of historical motor finance commission arrangements, will likely be with us for some months to come. While we cannot change the environment that the group finds itself in, we're taking a series of clear, proactive steps to safeguard and strengthen our valuable franchise.

In March 2024, we announced a range of management actions which have the potential to strengthen the group's CET1 capital by approximately £400 million, by the end of the 2025 financial year. And we've made significant progress since then.

The first action – the group has a strong, long-term dividend track record. The decision not to pay a dividend in the FY24 year was not made lightly. However, as a result of this decision, we retained around £100 million of CET1 capital in the 2024 financial year.

Second action – in addition, we announced steps to optimise our risk weighted assets, which could enhance CET1 capital by up to around £100 million. The impact of our actions to selectively grow the loan book was reflected in the slower growth rate of 2% delivered in the second half, and we currently plan for low single digit percentage growth in the loan book in the 2025 financial year.

Demand from customers has remained strong. Whilst we've written £8 billion of new business this year, we estimate that at least £570 million in additional loans meeting our credit and our pricing requirements could have been underwritten in the current environment. And approximately £220 million of those would have been drawn by the year-end. Whilst this is disappointing, we're confident that we will be well positioned to capture this demand and accelerate the growth over our loan book as soon as feasible.

We've concluded our work in preparation for a significant risk transfer of assets through a motor finance securitisation and are ready to launch a transaction at the optimal time. We'll aim to maximise the peak capital benefit from a transaction and align it to the revised timetable for the FCA's work in the motor finance market.

As I mentioned earlier, we have also progressed the delivery of the additional cost management initiatives previously announced and we recognise there is more we can achieve in enhancing our future cost efficiency. We're aiming to generate annualised cost savings of around £20 million, reaching the full run rate by the end of 2025 financial year. And we are exploring the use of partnership opportunities, including capital efficient government lending schemes in Commercial and Property.

The third action – we continue to progress a range of other management actions, which include potential risk transfer of other portfolios through securitisation and a continued review of our business portfolios and other tactical actions. As part of this initiative, today we have announced the sale of CBAM, marking a significant milestone in the delivery of our capital plan. The transaction is expected to increase the group's common equity tier 1 capital by approximately 100 basis points on a pro forma basis.

Potential action 4 – finally, as our business continues to organically generate capital, the retention of earnings could potentially further strengthen the group's available CET1 capital in 2025, if required.

Subject to the execution of these management actions and capital generation, we have the potential to increase the group's CET1 capital ratio to between 14% and 15% at the end of the 2025 financial year. And while these actions will adversely impact the group's operating profit in the next financial year, we have accounted for this anticipated impact in our updated guidance, which you can find in the Appendix of this presentation. We're confident that these actions leave the group well positioned to navigate the current uncertainty.

I'll now provide a brief update on each of our businesses and cover some highlights from the year.

In our Commercial businesses, while we've seen market uncertainty, testing the resilience of SMEs, customer demand has remained robust, with average monthly new business volumes broadly stable year-on-year. In Asset Finance, we are now starting to see the benefits of our transformation programme. We've seen particularly strong volumes this year from our Contract Hire, Energy and Material Handling books, helping drive loan book growth. In Invoice and Speciality Finance, strong new volumes supported 8% loan book growth, as well as a slight uptick in utilisation levels. We also completed our second syndication deal. And both Asset and Invoice Finance have been approved to lend under the UK's Growth Guarantee Scheme.

Turning to our Retail businesses. In Motor Finance, we've seen strong new business volumes and benefited from expanding our routes to market, and our ability to partner with finance technology providers, as part of our strategy to be where the consumer chooses finance. We also acquired, and subsequently integrated, Bluestone Motor Finance in Ireland in October 2023, which we've since rebranded to Close Brothers Motor Finance. We've been focusing on aligning our pricing and underwriting standards in Ireland and plan to launch new products and services, as we take advantage of opportunities in the Irish market.

In Premium Finance, we operate in a mature and competitive market. And whilst the loan book declined 3%, new business volumes remained broadly stable, and we've continued to deepen and evolve our proposition, to best meet the needs of our customers and support our broker partners.

In the second half of the year, we integrated our Savings business into Retail, as we look to leverage established shared operations, whilst supporting the continued expansion of our retail deposit offering.

And now onto Property. Despite the mixed backdrop, we've seen a more positive sentiment return to the UK residential property sector, with a more stable economic backdrop, a competitive and liquid mortgage market, increased demand for new housing stock, and a new government focused on housebuilding. We delivered a strong performance in the year, with a 15% increase in our Property loan book, reflecting healthy drawdowns from our pipeline of new business, which stands at approximately £850 million. Despite the market challenges, house prices have proved to be fairly resilient and we're now starting to see some uplift, driven by customer demand and ongoing under supply. We've continued to focus on supporting SME developers across the UK and Northern Ireland, with particular growth across our regional loan book, which makes up over 50% of the portfolio. And we're seeing benefits from initiatives such as Tomorrow's Developer.

Close Brothers Asset Management has a strong track record of growth, with a consistent healthy net inflow rate, delivered from both new and existing clients. During the year, we completed the acquisition of an IFA business in Dorset, bringing £220 million of assets, and hired 12 bespoke investment managers.

Moving onto the transaction announced this morning. We've agreed to sell CBAM to Oaktree for an equity value of up to £200 million, including a contingent deferred consideration of £28 million in the form of preference shares. This represents a multiple of 27 times CBAM's statutory operating profit after tax for the 2024 financial year. This sale not only marks significant progress towards the capital plan we outlined in March 24, but also represents competitive value for our shareholders and allows us to simplify the group, focusing on our core lending business.

CBAM is a well-regarded UK wealth management franchise, with a strong track record of growth. However, to realise the potential value of CBAM to the fullest extent possible, we would need to continue to invest to accelerate its growth strategy in the short and medium term, including via acquisitions against a consolidating market backdrop. Under the new ownership, CBAM will benefit from additional resources to increase its presence in the wealth management sector. I would like to thank our CBAM colleagues for their dedication, professionalism and exceptional service to our clients.

The transaction is expected to complete early in calendar year 2025, and is subject to regulatory approvals.

Turning to Winterflood Business Services, which has continued to see good momentum, with its focus on developing client relationships and investing in award-winning technology to build scale and further enhance its proposition. Assets under administration grew to £15.6 billion, and income increased to £17.3 million. We're confident that WBS is well positioned for further growth and expect assets under administration to grow to over £20 billion by Full Year 2026, supported by its healthy pipeline of clients.

Whilst performance at Winterflood reflected the continuation of challenging market conditions, we've focused on diversifying revenue streams and exploring growth opportunities. Our Investment Trust Corporate business grew income 60%, in spite of low issuance and transaction volumes. We've also developed the Winterflood Retail Access Platform, or WRAP, enabling retail investors to participate in capital market transactions. And since inception, WRAP has raised over £47 million from retail investors and in 2024, has been mandated on 17 transactions. And so, whilst short-term trading conditions remain challenging, we are confident Winterflood remains well positioned to retain its market position and benefit when investor appetite returns.

That brings me almost to the end of the presentation. I hope that in the past few slides I've given you a clear sense of our resilient performance in 2024 and the encouraging strength of demand in our core businesses. The uncertainties arising from the FCA's review of motor finance will likely be with us for some months to come. While we can't change that, we're taking a series of clear, proactive steps.

Our top priority has been to strengthen our capital position and protect our valuable franchise, while continuing to support our customers. We're making significant progress against the actions previously outlined, which have the potential to strengthen the capital position by up to £400 million by the end of FY25. That will, in turn, ensure we can best meet the eventual cost of a redress programme, if required. These actions have inevitably entailed some hard choices. But we believe that acting decisively now leaves us well placed to navigate this uncertainty.

Our core strengths remain our extensive long-term relationships, our long-standing expertise, and our commitment to excellent service. These strengths have ensured that we've prospered through many business cycles, and will do so again.

Thank you, and I'll now be happy to take any questions.

Q&A session

Question 1

Benjamin Toms, RBC

Good morning, both. Sorry, morning, Mike, and thank you for taking my question. Your guidance for corporate centre net expenses of £55 to £60 million in 2025 is above consensus expectations. But I'm just interested in how much this guidance is one-off in nature and could reverse? I think the admin costs in relation to motor finance restructuring are going through the Banking division rather than the corporate centre. So, I suspect that the conclusion is that the 2025 guidance for the corporate centre is not being inflated by one-offs, but some clarity here would be great.

And then secondly, on the near final rules on Basel that were published last week. Today you've reiterated your 10% RWA inflation guidance, but are hopeful that there's a reduction in your Pillar 2A to offset the impact, and that staying true to the regulator's guidance, there shouldn't be an increase in capital for lenders in respect of the removal of the SME support factor, albeit that does imply quite a large reduction in your Pillar 2A requirement. When are you expecting to hear about any changes to your Pillar 2A, and if the Pillar 2A is coming down? And will you review your medium-term capital guidance of 12% to 13%, freeing up capital for distribution if your Pillar 2A comes down, or are you likely to run with a higher buffer versus requirements in the future?

Thank you.

Mike Morgan

Thank you for the question, Ben. I'll take the group question first of all. Yes, you're absolutely right. There are the majority of the costs in relation to motor commission sits within the businesses, but at a group centre we require guidance from a number of organisations and support consultancies. So we typically will be using solicitors, we will be using accounting

professionals and banks as well. And that increase that we're seeing at the group level is a feature of those services that we require as we navigate through this at a group and at a central level. So, they are one-off in nature and I would expect to see those go away. But nevertheless, we believe that it will be necessary to incur those costs over the next 12 months.

In terms of Basel 3.1, I mean, there are several parts to this. I mean, we obviously had the initial announcement in terms of market risk, which you'll recall came out some time ago, and that has an impact of 30 basis points on us. And then we've got the second part that's come out in the last week. Now, the first part of that relates to committed facilities and we think that's probably about another 15 basis points. So, you've probably got an impact there of about 40-45 basis points. And then you get onto this interesting bit that you're talking about and you're absolutely right, it's very fluid. Our teams are in dialogue with the regulator at the moment. I mean, as you quite rightly point out, the risk weighted assets will increase and so naturally, our capital ratio will come down. But from what we have seen in the documentation, we expect the requirement to be taken down through Pillar 2A and those discussions are ongoing at the moment, so we will look at that.

In terms of the ongoing forward range, I think once we have worked through this, we will then come to a conclusion whether we think the 12% to 13% is still appropriate. But I'm not going to be drawn on that right now, not until we've done the work.

Question 2

Robert Noble, Deutsche Numis

Morning. Thanks for taking my questions. Just to pick up on the cost in the corporate centre again, I guess why, if they are temporary in nature, why have you not put them as below the line, whereas you chose to put some others below the line? What's the reason behind that?

Similarly, I think the net expenses guide includes the bond in income. So by 2026, I presume that swapped a variable rate, right, so that cost comes down in 2026 as well.

And then your NIM guidance, you point to an SRT potentially next year, quite a large benefit to capital. Does your NIM guidance incorporate the potential negative drag if you do that issuance or not?

And then lastly, just on growth. So what's the overhang do you think? If you didn't have the FCA issue, what growth do you think you'd actually be able to hit in 2025? What are the types of loans you're currently turning down and does that change your behaviour, have any impact on customer retention at all? Thanks.

Mike Morgan

Thank you for that. I'll work through those. If I start with the last one first of all. The growth that you saw, we grew 4% in the first half. And actually, on an underlying basis, that was 5%, because we've obviously got the Irish book in run-off at the moment. And as we said at the half year, we need to moderate that in the second half, and so, we saw 2% growth come through in the second half. Of course, we highlighted in our presentation there, that whilst we wrote £8 billion in the year, we could have actually written a further £570 million of loans, of which £220 million would have gone on the books. So really in the second half there, there's probably, you could have said at a headline level, sort of, 4.3% and then there will be other loans that didn't work their way through. So my sense here is that, this could have been for the year around about 10%. And the real point of making that is that, there is a lot of demand

for our products out there and that's good, and that's good. So as we moved into 25, I believe, we could still see good levels of demand, certainly above the low single digit level that we're providing guidance on.

What we will do as part of the capital exercise and the capital build is look at other opportunities that we've got. And if we can identify other areas that we can raise capital, it then may be possible for us to allocate some of that towards increasing loan book growth. But for the time being, our guidance is that it will be low single digit.

The types of loans that we're offering are the typical loans that we would offer across the book. As a general rule of thumb, I would say that we're tending to lend to existing customers, so new loans to existing customers as opposed new new loans. I mean, clearly we do do new loans, but generally speaking we're tending to support existing customers. So that would, that's that one.

The SRT point. Within the capital build, we build in the costs of that based on estimates, but until I get final terms of the SRT, then I can't give you that information. I just want to reiterate that that SRT is ready to go. Had the FCA not changed their timing from September through to May, we would have probably gone in August. But there is not much sense in raising capital and having the drag on the firm until we actually need it. So we will look at that between now and May, and initiate that as and when we need it. But in terms of the P&L guidance that you've got, that doesn't include the SRT effect there.

You talked about the bond issue. Now the issue here is that this sits in the group and historically we have downstreamed that into the bank and held it there and the group has received an income for that. Clearly, at the moment, as we build capital within the bank, we are not paying dividends up to group. And therefore, group has had to retain that bond and therefore is retaining the cost that sits alongside that. And that is at 7.75% coupon, as you can see. So that's the reason you're seeing that interest charge at the group level go up quite significantly year-on-year.

And then to £55 to £60 million in the group cost, the one-off in nature. Yes, I would argue they are one-off in nature, but there are very strict accounting definitions about what can go below the line and what should stay above the line. And so, if you actually look at our results this year, although we've only put £6.9 million of motor commissions costs below the line, there have been a lot of other costs incurred that link to that, but which haven't gone below the line. So that's the reason for the decision to treat them within the £55 to £60 million.

<u>Question 3</u>

Gary Greenwood, Shore Capital

Hi. Sorry about that. It's Gary at Shore Capital. I just have a question about the disposal of the Asset Management business. I think you described it as competitive value. And I know obviously the business is in a somewhat difficult position at the moment, but, I mean, the sale price to me is less than 1% of AuM, which, when you compare it to sort of other similar disposals in recent times, looks very low. So I'm just sort of trying to pick beneath, really, your sort of description of competitive value and sort of why this is good for shareholders? Thanks.

Mike Morgan

OK so, yeah, so, good morning, Gary, as well. I mean, we do believe it's a competitive valuation. If I look at the sum of the parts valuations that I see across the market, I know you

were at the higher end, but this is much more in line with what I've seen from other analysts across the sector. You're right, you're looking at 1% of AuM and on that measure, you may take a view that's lower than transactions that you've seen elsewhere. However, I'd say it's 27 times earnings, which I think would put it very favourably against other transactions in the sector. So, it's where you pitch it on that spectrum, Gary. We think £200 million with £172 million upfront is a good deal for our shareholders, it's good for Oaktree, it's a good business for them, and it's good for our people as well.

Gary Greenwood

OK, thank you. I just had one additional question, just coming back to the sort of NIM and loan book growth. Obviously, if you're, sort of, holding back loan book growth relative to what you could potentially achieve, is there not a trade-off there in terms of being able to be a little bit more selective in terms of the business that you write and therefore potentially more supportive to net interest margin?

Mike Morgan

Thank you. Yeah, I mean, theoretically, you're correct. You're only going to pick the business that's got the highest margin on it, but in practice, it doesn't work like that. We want to support our customers and help them get through this cycle. And what we have seen is, in the Commercial business, if you think in very simple terms, sort of 5% cost of funds, 7% NIM, you're paying double-digit nominal rates on loans. That has been very challenging for a number of SMEs, and we've wanted to support them and help them. So, that is what has caused the compression on NIM in the Commercial business.

The other angle, as well, is that we have seen very strong growth in our Leasing business, very strong growth in our Wholesale motor finance business, the leasing part of the motor finance business. And that is typically lower margin – it's good returns, because it has very, very low bad debt, but it is lower margin. So, you've got a structural effect coming through there as well. But really, it has been our decision to support our customers through this stress with interest rates going from 0% to 5% and taking a little bit of pain that has caused the problem. And that's where we get to the guidance for next year of 7.2%.

<u>Question 4</u>

Ed Firth, KBW

Yeah, morning again, Mike. I just had three quite quick questions, actually. The first one, if I'm looking at the Property book, Stage 3 loans were up over 30% in the second half, and I'm just wondering what you see in terms of what was driving that and do you have, sort of, concerns about certain elements of that book, or is that a, sort of, temporary thing and we should expect to start seeing that coming down during the course of this year? So that was my first question.

The second one was about dividends. When should we think about, when does that sort of come back on the table? Is that something you can do ahead of any fine, or do we have to wait till we've got an articulation of the fine before you think you'd be in a position to start thinking about restarting those? So is that like a, sort of, Full Year 25 thing, or do we have to wait till 26 for that?

And then my final question is, how should we treat CBAM as we look into 25? Is that going to just go down into a discontinued business? Are we going to have like, an adjusted earnings, ex-discontinued business. Is that, so it's a very boring question, but I just want to get that clear in terms of modelling? Thanks so much.

Mike Morgan

I'll take the CBAM one first. I'll be honest, I need to work through that. We only signed the deal at 4 o'clock this morning, so we weren't really getting into the, sort of, accounting technical stages at that. But I think we will clearly be moved to one side in some shape or form. But when my accounting team wake up, I'll ask them that question.

If I go down the other questions, Ed, Property Stage 3. I mean, I think it's important to understand what property is for Close Brothers. Primarily it's residential property, it's family housing on the outskirts of major conurbations around the UK, with unit prices in the order of sort of £400,000, £500,000, £600,000. And what we see is, as schemes are built out, sometimes we need to restructure them if they're not selling as quickly. But as you know, we have a 60% maximum LTV that we build up to. And so, we have a tremendous amount of security in there. So, they may well go into Stage 3 from a sort of technical perspective, because of restructure or forbearance. But they're not something that I would be particularly concerned about and I would expect to see those unwind as we move forward.

In terms of the dividend, you'll see in March that we put a statement out which made it very clear that we would pay no dividend in FY24 and then we would only reinstate that in FY25 once we got clarity. Now, the reality of the situation is, we are not going to get an update until May. And so the very, very earliest we will understand the implications for this organisation will be at that stage. And, clearly, we do want to restart a dividend at some stage, but we can only do that when we understand the facts and circumstances and the implications of doing so. And that's really going to be really towards the back end of this financial year, possibly going into FY26. So, as we say, we will restart, or we will give some consideration to restarting the dividend once we get greater clarity.

Question 5

Portia Patel, Canaccord

Good morning. Thank you for taking my questions. I've got two, please. Firstly, just revisiting the NIM again. Thank you for explaining the dynamics this year. I just wanted to ask again, what gives you confidence in being able to maintain a 7.2% NIM for the year ahead, given the declining trend that we've seen over the last couple of years and since the NIM seems to have continuously surprised to the downside versus guidance?

And secondly, following the disposal of the Asset Management business, you've talked about focusing the business on the core lending franchise. So, I wonder whether we should read anything into implications for Winterflood place in the group henceforth? Thank you.

Mike Morgan

OK, let's take the NIM one first. I mean, I explained the reasons for the NIM moving south and I think you accepted that. And we have provided guidance – we exited the year at 7.2% and we've given guidance that we will deliver 7.2% going forward. I think, given where we are, I mean, clearly interest rates have, to all intents and purposes, peaked now, so we should see

those starting to come down over the next 12 months, two years. That will obviously help the situation there and that gives me confidence. We see the demand in the business there, there is a real demand for our products and our services. And as interest rates come down, there will be less stress on our business, our SME customers, and that will allow us to at least maintain a NIM of 7.2%. So that's what gives me the confidence.

In terms of the group and the structure, the group structure and Winterflood and any business within the group. I mean, we said very clearly in March that we were going to review all of the businesses in our portfolio and look at the returns they made. And the transaction with Asset Management came about as a result of that review. We will look at all of our businesses and we will take similar decisions and thoughts around them. At this stage, I'm not going to be drawn on any particular business. I mean, you picked out Winterfloods, but what I would say about that business is, it's extremely well run. It's got an excellent management team and an excellent trading desk in there. It is well known around the city. It is a particularly tough time for it at the moment. But that isn't peculiar to Wins. It's a challenge for the whole industry. And I am very confident that when the ingredients from the market come back, more activity in AIM and Small Cap, we'll start to see good performance come through from Wins. It's an excellent business.

Question 7

Autonomous Research

OK. We've got two questions that have come through from Autonomous Research. The first is regarding growth in RWAs. So how much is growth and how much is weaker asset quality?

The second question is then in relation to the provision charge, so how much of that was the release of management overlays, i.e. what was the gross cost of risk before any releases?

Mike Morgan

OK. On the second one, if you strip all of the overlays out, you would have had a headline 1.2%. But I think it's important to understand that those overlays are there because they recognise the circumstances that are in existence or foreseen. And so using them up makes sense as you move through that economic backdrop. So the provision, the gross provision, in answer to that question would have been 1.2% rather than 1%.

In terms of the RWA growth, I mean, you've seen the loan book growth of 4% in the first half, 2% in the second half. I'm not sure which particular half you're referring to in there. What you are seeing in terms of risk weighted asset density is that increasing as we see CBILS running off, so you have to bear that in mind as well. That's a factor. But otherwise, we're broadly growing, I'd say, in a relatively balanced way, probably a little bit more emphasis in the higher density books, Property and Commercial, but not hugely out of kilter. But you will see the CBILS run-off come through, which gets the density higher.

Question 8

Investor

OK, we have another investor question that's come through. We see that you haven't taken a provision estimate in relation to the FCA's review on motor commissions, but we do know that FirstRand came out with an estimate last week. So why have you not included a provision

estimate? And is the FY25 14% to 15% versus a steady state of 12% to 13% a good indication?

Mike Morgan

Well, the 12% to 13% would be that, in a normal environment, that would be the capital range that we at Close Brothers would want to have at our CET1 level at. So the 14% to 15% reflects the fact that we are building capital to deal with any redress, should there be redress, and that gives us a buffer and over and above that. So those numbers are slightly different and shouldn't be compared.

The reason for not, I mean, it's interesting with a provision, because clearly it's something we've been through and we have seen examples. Lloyd's made a provision last year and we've seen some very small provisions being made. But I'd say, on balance, the vast majority of banks have not made provisions. I don't know the rationale for why FirstRand decided to make a provision and why they arrived at the number they did. All I can do is comment on behalf of Close Brothers.

And first and foremost, there is no constructive obligation to make a provision at the moment. There is no certainty that redress is going to have to be paid and we will need to wait to hear from the regulator on that part. And then even if there was, there is still a question around how we would estimate what that provision might be and can you make a reliable estimate. And again, there would be question marks around that. So if you actually put those two things together, I think it's very sensible and impractical for us to be able to put a provision together. And that's the conclusion that many of the banks in the UK have reached as well.

Question 9

John Cronin, Seapoint Insights

OK, we've got another question that's come through on the webcast from John Cronin. First question is, can you please give us some colour in relation to the extent of the progress that you have made in the last six or so months with the regulator in relation to your Phase 2 IRB application? For example, how quickly are things moving along? And are there any specifics you can call out with respect to outstanding workstreams at your end, and perhaps broadly on general expectations in relation to PRA decision timing expectations?

And then the second question is roughly what kind of contribution to the Banking division operating profit is the Close Brothers' motor finance business in Ireland expected to make in the medium term, post the intended expansion efforts that you've called out of?

Mike Morgan

Thank you, John. Thank you for that question. On the Motor Finance Ireland, we don't split out our contribution from our various businesses, so we won't be providing that detail in tremendous detail, but we may look to provide loan book. I mean, the opportunities in Ireland we see as very strong. We had a big presence there. We had a partnership with First Auto Finance and the loan book, at that stage, got up over £0.5 billion. In time, you would want to see the business get there, but it will take some time to get to it. But the opportunities in Ireland are great, and that's why we bought the business there. We think it provides real opportunities for us going forward.

In terms of IRB, it's a good question. This is a very slow burn. I mean, just to give a little bit of background, you have to submit 50% of risk weighted asset models in the initial submission. So, for us, that's our Motor book, that's our Property slotting book, and that's our Energy book. Those were submitted three or four years ago, quite some time ago in some instances. We've had feedback on those, we've dealt with those. We have moved into Phase 2 over the course of this year and we are making progress, but I don't feel able to give time scales on where those might be for acceptance of the application and approval.

Question 10

Robert Sage, Peel Hunt

We've got three questions that have come through from Robert Sage at Peel Hunt. Firstly, when you launch the SRT, could you provide some guidance on how much income and profit could be foregone as a result of this? Could this be material for the Banking division? Secondly...

Mike Morgan

The answer to that is yes.

Robert Sage

Secondly, Novitas provisions have increased. Is there any possibility of write backs in the future, in your view, or could there be further provisions?

And thirdly, could you comment on shorter term trading conditions in Winterflood? And if you think a scenario of falling interest rates and inflation could stimulate a recovery in volumes?

Mike Morgan

OK, thank you. Thank you, Robert, that's great. Yes, as I say, SRT, yes, we will provide you with that information. Obviously, I need the term sheet to be able to share it with you and we'll get that when we decide to go with it. So, we'll share that, so you can model it.

In terms of the Novitas provision, yes, it has increased, but that's not the capital element. It's the time value of money. Clearly, if money, if you're going to get that back a little later, you need to increase the provision on that. I mean, you say to me, is there the possibility of write backs? I'm not going to speculate. We are obviously involved in discussions with the two insurers. We have a legal action against AmTrust, the main insurer, because we want our money back and we will make sure we get as much of that back as possible. What I would say is, I'm still very confident with the level of provisioning. I think it's appropriate and so, overall, I'm comfortable there.

The shorter-term trading at Winterflood. Clearly, it's quite volatile, day on day, we can see it move really quite dramatically. We have seen a little bit of a slowdown in the last few weeks, really with the budget coming up and conversations around inheritance tax, which clearly have implications for the AIM market that I won't go into.

There's also been a lot of discussion around pension reforms and investing 5% of the pot into UK assets. That could be beneficial as well. So, I think we need to get through this, the short-term period leading up to the budget, and then we'll see where we get to from there. But you're

right, lower interest rates should be beneficial. And I think it's fair to say that, and certainly I hear this, that there is a generally a more positive view on UK markets from international investors now. So, the more money coming into the UK market, the better it is for all participants. So that would be my view on Winterfloods.

Question 11

Investor

OK, we're running out of time, so we're just going to take one more investor question that's come through. And that is, how will the future diversification of the group be impacted by the sale of CBAM?

Mike Morgan

Yeah, I mean, we set out in March that we needed to raise £400 million of capital. And you'll remember the buckets that we set out, and the third bucket had the review of the portfolio of businesses within there, CBAM was one of those. And that transaction came out on the back of that.

We will review all of the businesses, we will be looking at the returns of those businesses. We have excellent businesses. And then we'll make decisions as appropriate at the time. So I'm not, at this stage, going to be drawn on future group structure. Right now, we like our businesses, but we will continue to review them in the current market.

OK. Well, if there are no further questions, thank you very much, and thank you for attending.