Schroders PLC - Full Year Results 2016

Presentation

Peter Harrison

Group Chief Executive

Welcome to the Schroders 2016 results. What I'm going to do is, I'm going to quickly take us through the high level numbers, and then Richard's going to take you through the detail behind the numbers; the 2017 guidance. And I'm going to come back and talk about some of the longer-term strategy things.

So, overall, we think these are a good set of numbers. Earnings up 5%, net income up 8%, dividend up 7%. Our assets under management grew 27% to £397 billion with significant growth. And, obviously, that's the basis on which we'll earn our fee income next year.

Overall flows; we saw net inflows of £1.1 billion, predominantly driven by the Institutional channel and particularly North America, which is something I think I flagged to you before. But it's very pleasing to see that come through.

We have introduced a new KPI this year, which is assets under management and administration. As a result of the Benchmark Capital acquisition we now have assets under administration. Richard will take you through the detail of that. But I just wanted to flag that that is a new KPI that we've introduced.

We've also said today that we are going to cease quarterly reporting from the first quarter. We think this is a long-term business. We will give you guidance on what our assets are and a statement, but we're not going to produce full P&Ls from the first quarter and the third quarter of this year.

If I could just take you through to investment performance, this, to my mind, is the single most important feature which drives the future of this business. And we think we've had a very strong period of performance.

One-year performance; 53% of funds outperformed last year. This year that number's as high as 75%. But probably most importantly the long-term performance numbers; 85% of funds outperformed over five years, which is a really very strong showing. And I think does justice to active management being a worthwhile pursuit.

Importantly, this performance was spread across the board; in our equities business; in our real-estate business; in our multi-asset business; in our fixed-income business. And it was in the important areas, areas where we've had pressures, in Australia, in our global multi-asset income, in our quantitative-equities area. All of those areas performed very well, which I think has helped the momentum, in those areas.

The – probably two areas I'd draw out where the performance is less good, which is global fundamental equities and parts of the UK equity story. But, other than that, I can see the performance is pretty consistent in most areas of the world. And I think that's a very positive backdrop.

I'd now like to talk about flows across the various, different axes of the matrix, starting with channel. Overall, our inflows are £1.1 billion. That is down on last year. But I would say that gross sales are absolutely flat on last year. So, the difference is a redemption number rather than a gross sales productivity number, which is an important point.

The Institutional channel was positive, with £4.3 billion of inflows. I've mentioned North America, which saw £2.5 billion of inflows. The UK, although a mature market, we actually saw another £2.4 billion of inflows, particularly in the fiduciary channel, which is something we launched last year and has already got very good momentum.

And that £2.4 billion was struck after an insurance mandate in-source of £1.6 billion, so, those numbers are perhaps a little bit better on an underlying basis. Intermediary was more difficult. We saw outflows of £2.9 billion. Pleasingly, we were positive in America, £0.3 billion, and Europe of £0.4 billion.

But the areas of outflows were the UK at £2.2 billion and Asia Pacific at £1.4 billion.

The eagle-eyed amongst you will notice that we've slightly changed the presentation of the Wealth Management performance; the flow data. Historically we would receive dividend income into Wealth Management. And then when we paid that dividend income out to our clients we would call that an outflow.

And we didn't find that was consistent with the way our competition were doing it. So, we've now identified those income outflows and taken those out of the flow numbers, because we're – it's a pass-through of our accounts. So, that has actually reduced the outflow of Wealth Management, from £0.9 billion to £0.3 billion.

And we will – have restated historical numbers. And we'll go forward producing numbers on this basis. If you want any more information, Alex James can give you that.

If we just look now, by region, I mentioned North America. For the first time since 2012 we've had positive flows in both the institutional and intermediary channels. And

I'll come and talk more about Hartford later, but the – that business only came on-stream end of October 2016. So, we think there's good momentum still to come through.

Europe was also positive in both channels; £0.8 billion in Institutional and £0.4 billion in the Intermediary channel. France and Germany stood out in particular. In the Middle East, we saw quite a big outflow in equities which dented the progress in European equity markets.

Asia Pacific, we saw outflows in both the Intermediary channel of £1.4 billion and the Institutional channel of £1.5 billion. But actually, it's very country specific. So, if you look at it, we saw £4.7 billion out in Australia but £2.4 billion in Japan.

And I think, overall, actually that Australian bit which we talked about at this meeting six months ago has really dominated the picture in our Asian flows. And it's the first time we've had outflows in Asia for a very considerable period.

Importantly, I mentioned earlier, our Australian performance was really very strong this year. And I think that's – gives us more confidence that that corner has been turned.

Overall, the UK was flat. We saw £2.4 billion in, in Institutional, and £2.2 billion out in Intermediary. The thing I'd draw out there is the UK market's been going through a difficult transition. And we saw declining outflows in every quarter. Actually, the start of this year we've now started to see good flows in. So, we've gone through the valley and we're coming out the other side now in the UK, which is a good sign.

Just quickly, by asset class, I think this is – really speaks to the way in which the business has changed. A total of £8.9 billion into Fixed Income and Multi-asset, £4.5 billion into Fixed Income, £4.1 billion into Multi-asset. The Fixed Income flow's driven by securitised credit and European credit were the two big areas of inflow.

Multi-asset; particularly pleasing to see a return in demand into the Multi-asset income products and risk-managed growth.

Equity outflows of £6.8 billion, of which £4.5 billion was in the Intermediary channel. There were some areas of inflows within Equities. I'd draw out EAFE, emerging markets where we've seen consistent inflows. We saw further inflows again this year. And US small cap. But it was the de-risking in the Intermediary channel which hurt our Equity business.

I think – I've tried to put these numbers in a longer-term context, but I think let's just take a look at the Group picture. I think this is a very important chart. When we've spoken in the past about trying to diversify the business we've maintained a solid equity business. But, on top of that, we've now layered rapid growth in our Fixed Income business, our Multi-asset business, and our Wealth Management business.

And if – over this period, five years, our assets have doubled. But Fixed Income has gone from 18% of the Group to 21% of the Group, Multi-asset has gone from 19% to 24% and Wealth has gone from 8% to 13%. But you all know that that comes at a price of margin erosion.

And you can see that mix change has really come through in that line. Some of it is pricing pressure, but an awful lot of it is mix. And I know many of you have commented on that. I think I would like to lay one other line on it, which is the profit growth. It's that diversification which has allowed us to consistently grow the profits and allow us to not be dominated by any one factor.

So, although there is a margin erosion, good cost management and the – has allowed profit growth to keep rising. And I think it's a very important point to make as you look at the margin.

What I'd like to do now is to hand over to Richard. He'll take you through the detailed numbers and the guidance. And I'll come back and talk more about the strategy.

Richard Keers

CFO

Thanks Peter. Well, good morning, everyone.

Picking up on Peter's highlights, let me set the context of our record results, this year. When I reported at the half year it was just after the Brexit decision. Given we are a net exporter of asset management services, primarily from the UK, I anticipated that sterling's weakness would benefit our full-year results. This has been the case.

The rest of the year saw a series of political and economic shocks. And we've all seen some market volatility as a result. Against this backdrop, we stayed on course. We've continued to invest in both organic growth and selective acquisitions. These acquisitions have had an impact, albeit small, on this year's profits. But we believe they're important to our future growth.

So, with that context in place, let's look at our – how our profits have grown. Profit before tax and exceptional items increased by 6% to £644.7 million. All of that increase came through in the second half of the year. This was due to the growth in our AUM, from markets and FX, which outweighed the lower net operating margin we had anticipated.

Net income has increased by £135 million. In July, I reported an £18 million increase in net income. £10 million of that £18 million was due to gains on investments which we hold to hedge employee-fund awards. These gains are matched by an increase in our comp costs.

Given the size of these gains in 2016, this way of presenting is confusing, so we decided to make a change. These gains are now being netted off against the relevant comp cost. To be clear, this change is presentational, and has no impact on our profits.

What this means is around £127 million of the £135 million increase in net income has come through in the second half. Costs have also increased. A lot of this is due to the impact of a weaker sterling. It also includes other increases anticipated at the beginning of the year.

Although half of our costs are incurred in the UK, we've some exposure to overseas currencies, due to our local operations in a total of 27 countries.

The tax rate was broadly in line with last year at 20.5%, taking profit after tax but before exceptional items, to £512 million. Exceptional items were £27 million. This figure is a result of two things, mainly amortisation relating to acquisitions in prior years, as well as transaction costs relating to new arrangements in 2016. Profit after tax was up 5% to £490 million.

Before I take you through the change in net income, let me spend a moment on one of the primary drivers, assets under management. Following the completion of our acquisition of Benchmark Capital in December, we've made a change to our KPI regarding client assets, that Peter's just referred to.

What we've done is add a new category of assets under administration so that these assets are included in our new KPI along with the traditional AUM. The reason is this. Benchmark is a technology-led, adviser-support business. It provides advisory services through Aspect 8, an IFA business, and includes an investment platform, Fusion Wealth.

The clients' assets in both of these businesses are reported in AUM. However, it also provides administration and regulatory services to a number of third-party IFAs, which is a new service for us. We've decided to report these as assets under administration. The total AUA acquired was £11.1 billion. And we expect annualised revenues of £4 million, which will be recorded in other income.

This – we're recording it in other income because this is a very separate line of business and we're not including those revenues within net operating revenue.

Benchmark was the third acquisition to complete during the year. It follows the increase in our interest in Secquaero in February and the purchase of a securitised-credit business in North America, which we highlighted to you in November. We've also announced our acquisition of the Wealth Management business of C. Hoare & Co, which completed on February 17, 2017. This is not included in these numbers.

In total, acquisitions completed in 2016 increased our AUM by £6.7 billion, with about half from securitised credit business and half from Benchmark, plus the £11.1 billion of AUA.

The C. Hoare & Co acquisition has contributed a further £2.3 billion of AUM since the year end.

In terms of business segment, the securitised credit business is included within Asset Management, along with Secquaero. And Benchmark now represents a separate division within our Wealth Management segment.

Turning to our organic growth in AUMA, we split out our estimate on the impact of markets and FX. As you can see, FX has had a significant impact, but we have also seen good market growth. Almost all the market growth came through in the second half of the year.

Peter's already taken you through our net flows, which added a further £1.1 billion of AUMA, in the year. So, let's see how this impacts net income, starting with the acquisitions. As I've already mentioned, these had a limited impact in 2016, but they still contributed net operating revenues of £10 million.

Unsurprisingly, the biggest impact has come from FX. With the weakening of sterling we've seen around £122 million of additional net operating revenue. That's driven by the £42 billion FX increase in AUM I've just shown you.

However, let's not forget, before the Brexit decision, sterling was relatively strong. This means that the full annualised revenue effect of this increase has not yet come through. Since the half year, we've seen strong markets. And, as Peter has highlighted, we've had good investment performance across the year.

However, markets were relatively weak in the first half. And, perhaps counter-intuitively after excluding FX, had a minimal impact on our full year revenues.

We have, however, seen some margin decline come through due to markets and re-pricing. Together these factors reduced our net income by about £14 million. We've also seen a decline in net income due to flows although, overall, we've generated net inflows.

We had outflows in Intermediary and in Wealth Management. Both of which have – sorry. Both of which are higher-margin businesses. And net inflows into Institutional which is, typically, lower margin.

The impact of this mainly came through as a result of Intermediary outflows in the first half. Overall, the flows impact was an £11 million decrease, in net income. Performance fees were £41 million, which is £5 million higher than 2015. That's better than we expected and reflects the strong investment performance later in the year.

As you know, performance fees are difficult to predict, but we're again budgeting for £40 million in 2017.

Putting this all together results in a £112 million increase in net operating revenue.

Finally, we've seen a £22 million increase in our other income, and that comes through in the asset-management line. About half is due to FX gains and settlement of fees and expenses in other currencies where we benefited from exchange rates. And the rest is mainly due to one-off gains from various items which will not repeat.

So, net operating revenue is up 7%, to £1.7 billion. And total net income is up 8% to £1.8 billion.

Turning to this by segment and channel, starting with Institutional, total net operating revenue was up £64 million, with performance fees up £1 million to £27 million. The increase was driven by higher average AUM, which was up £27 billion. That's a combined impact of four things; markets, FX, new business flows and acquisitions.

Peter's already taken us through our inflows in Institutional, which totalled £4.3 billion for the year. The flows over the last few years have been into lower cost products. And that has reduced the margin by just over one basis point this year. The rest of the two basis point decline is principally due to lower transactional fees.

So, the growth in average AUM has been partially offset by this margin reduction, with some other one-off fees pushing up net operating revenue compared to last year.

Looking forward, we see a continuing trend towards Fixed Income and Multi-asset products. And this may well push our average fee margins down further, perhaps another basis point, to 31 basis points.

As Peter has already discussed, for us it's important to make sure we are building scale in the right products and driving profit growth in the Group. We've seen this coming through our Fixed Income and Multi-asset businesses. The result is some reduction to the average net margin, but higher absolute revenues and profits.

Turning to Intermediary. Net operating revenues were up 4% to £797 million. And we generated £12 million of performance fees. This increase was also driven by higher average AUM, which was up £7 billion in the year. That's the combined impact of markets, FX, and acquisitions.

As Peter has already said, we saw outflows of £3 billion. The macro uncertainty certainly had an effect. We saw a one basis point decline due to changes to our fee structures which came through in the second half. We expect to see a further impact from this in 2017 along with removal of UK unit trust transaction fees.

These transaction fees are not significant. They represent less than 0.5% of our revenues, since only 20% of our UK fund range is dual-priced. We may also see a two basis point decline from net flows and changes in business mix. As a result, we are currently budgeting for an Intermediary margin of 69 basis points. But this could be impacted by markets and investor demand.

Moving to Wealth Management. Net revenues were up 8% to £223 million. Management fees were up 4% to £162 million. And we generated performance fees of £2 million.

At the half year, I explained that our net banking interest had increased as a result of higher cash deposits and enhancements to our treasury activities. We've seen further benefits from this in the second half.

And we've been able to increase our returns as a result of an increase in US rates since 2015. Net banking interest has – for the year, as a whole, was up £5 million to £21 million. We've also seen a small increase in transaction fees which, as you know, are activity-based.

The net operating revenue margin for Wealth Management was unchanged at 65 basis points. This is better than the guidance I gave you, reflecting the benefit of higher net banking interest and transaction fees.

As I've already mentioned, the Wealth Management business – segment, sorry, not business, now includes Benchmark. This business is at a lower margin and we expect the overall Wealth Management margin will reduce by about two basis points in 2017 as a result.

Right. Let's look at our operating expenses. Comp costs, as you know, are the largest component of our expenses and we manage these to a total-comp ratio. We target between 45% and 49%. At the beginning of the year we budgeted at the lower end of the range.

Given the unusually large impact of FX, and the need to maintain our cost discipline in these uncertain markets, we've concluded on a total-comp ratio of 44%. This is in line with 2015 and is also better than our KPI target. Our fixed-comp costs have increased this year because of higher headcount. This is linked to the growth opportunities we've talked about previously. And Peter is going to talk more about these in a moment.

I should add, FX has also impacted these costs. For 2017, I would expect us to be towards the bottom end of our target comp range of 45% to 49%.

Non-comp costs were £357 million compared to £315 million in 2015. That is £17 million higher than the – than I guided to you this time last year. This is due to FX. It means a total cost ratio of 64%, which is better than our long-term target.

So, we maintained good cost control, and this continues to be our focus. All the more so as we look at the headwinds facing our industry. On a like-for-like basis we expect that our underlying costs will be broadly flat in 2017. Whilst there are inflationary increases we are keeping a very close eye on controlling them.

As I mentioned, FX increased costs in 2016. And if sterling remains around the same level we see a similar impact in 2017. We still believe it is important that we continue to invest where we see growth opportunities or the ability to achieve longer-term efficiencies. We are streamlining our processes and deploying technology to automate to the maximum extent possible, which will give us scalable future growth, and generate future efficiencies.

Based on current FX rates and reflecting these investments, along with the acquisitions we made in 2016, we're anticipating total non-comp costs before exceptional items of £380 million in 2017. As such, we continue to target a cost ratio of no more than 65%. We had £27 million of exceptional items in 2016, including £2 million in respect of associates. This is a little higher than I guided you to due to the acquisitions we completed in the year.

We are budgeting for £31 million in 2017, reflecting the further impact of the acquisitions we've made, including Benchmark and C. Hoare & Co.

Finally, let's turn to capital for a moment. We continued to maintain a strong capital position, which we believe provides competitive advantage, particularly in these challenging markets. It means we can invest where we need to and take advantage of opportunities as they arise.

Sorry. Regulatory capital has increased, reflecting the growth in the business, and the introduction of the EBA's market-wide capital-conservation buffer this year. You can see we've deployed more seed capital for organic growth.

Other items have increased, principally due to the additional goodwill and the intangible balances, arising from the business acquisitions we've made in the year. This leaves a modest increase in investment capital in line with the overall growth in the business.

So, in summary, net income was up 8%, or £135 million, partly offset by increases in operating expenses mainly driven by FX. Profit before tax and exceptional items was, therefore, £644.7 million. And basic EPS was up 5% to 186.3 pence before exceptional items.

The Board is recommending a final dividend of 64p, bringing the full-year dividend to 93p. That's an increase of 7% and represents an increased pay-out ratio of 50%.

So, a strong set of results, against a backdrop of an unusually uncertain market environment.

Peter, over to you to talk about our strategy and our priorities.

Peter Harrison

Group Chief Executive

Thanks, Richard. Many of you have written a lot about the industry headwinds we face. And I think they're all very fair and well-known to people in this room. What I want to do is talk about how we're moving our feet, both to address these and to capture some of the tailwinds, because there are plenty of tailwinds out there. And I think we don't spend long enough talking about those.

For me, we're quite well-positioned, for many of these. There's a very big change in Asia going on. I mean, particularly in Japan, actually, in the way in which Japanese regulators approaching how products are distributed but also in second generation of wealth coming through. And the opportunity in Asia I think is still very significant.

There's a really significant opportunity in US, Canada and Japan, where they – those pension funds go through the same de-risking that we've seen in the UK. And we've started to see some of the benefit of that from our liability-cognisant strategies in the US this year. But I think there's a lot, lot, more to go for. And then, ultimately, the annuity-buyout market.

Technology is often posed as a threat. I see it as a very significant opportunity, both on the productivity side, but also on the client engagement side and the investment insights. And we'll talk more about that.

And, finally, the really significant shift of client assets, particularly in the institutional world, towards private assets that's gone on over the last five years, is giving rise to a whole series of asset classes which are not seeing the pricing pressure of passive. And, again, I think that's another major opportunity.

So, at our last results you saw that I laid out seven areas where we wanted to get behind the growth drivers that we see for the future. And what I want to do now is just spend a little bit of time saying what we've actually done against each of those this year, because I think that's an important set of priorities for us.

Number one is product, because product is – if passive is the big bogey, moving our product range so that it's not in the line of passive products is absolutely critical. You'll have seen one of the charts that Richard put up showing that we've increased our seed capital very significantly. That's seeding a new range of funds which cannot be mimicked by passive.

You've seen us buy a securitised credit business. You've seen us come out with a whole series of fiduciary offerings for the UK pension fund market. All of those things will change the nature of the products we're offering in the future.

We're also going to change the way in which we describe what it is we do. Historically this industry has always talked about equities, fixed income, multi-asset. In other words, the way we manufacture it. That's not how the client sees it. And we've articulated, I'll come back to it later on, the franchises which we stand for, which I think are very significant.

And we've also created a separate solutions team. And that for me is where the puck is going. Everybody wants a bespoke solution. And having a team which can specifically address that is going to be very important, looking forward.

You've seen in these figures the growth of Fixed Income and Multi-asset of £8.9 billion for the last period, but, also much longer-term growth. We don't see that trend changing. We see the full impact of Solvency II coming through. We see obviously the de-risking. Having world-class capabilities in these areas is critically important.

I think there's a big shift. When people talk about passive we talk about the underlying building blocks of UK equities, European equities, US equities. Somebody needs to combine those into solutions for clients; into things that people can relate to. And that's a multi-asset business.

And that requires active decision making and ensuring that we're able to do that is critical. And I think we've got a good position there.

North America I've talked about here in the past. It – 48% of the world's investable assets are in the US. Within our business, it's less than 10%. What I – for me, there's a whole series of positive developments, which we've put – got behind this last 12 months.

Hartford was a move we made in the Intermediary channel, rather, to combine with a sales force of 80 people selling to very, very, large number of advisers to distribute Hartford Schroder funds. We have already seen significant shift in our flows.

We saw – we report £300 million of inflows in this period. But that fund range was launched on October 24th. And, looking forward, the rate of inflow is consistent with about a £2.5 billion net flow into the US Intermediary channel alone. And obviously we've significantly increased our Institutional sales team over the last period.

So, North America for me, for the first time we're reporting positive flows in both channels, but there's also very good momentum, going forward. And I see significant opportunity, including in the de-risking area.

Asia, I've touched on already, but I do see Asia as being where Schroders' really strongest point is. We've got a position number one in many of the Asian markets. Japan is a market which is changing very quickly. £2.4 billion of flows last quarter.

You'll recall that we hired the CFO of Nomura, Kashiwagi-san, to come and join us. That business is on a growth trend. We're significantly investing in the Intermediary channel there because we see significant opportunities. And we've also seen good growth in the Institutional side.

Looking outside of Japan, markets like Malaysia, offering good opportunity. And even the Chinese sovereign-wealth funds where there's very significant activity. And recent survey showed that we were – had a leading position there. So, Asia will continue to be a growth driver, for this Group.

A lot is said as technology. I see the drivers are going to be very, very, significant. We've made a significant step on our investment platform through the implementation of Aladdin but, to me, that's very much a first step.

The productivity tools that we're getting from robotics, the data insights that we're getting from better insights to our investors from fundamental understanding of big data, will significantly change the way in which we're going about our business.

And I see many more opportunities in technologies than I do headwinds. So, it's a long road to travel, and there's a lot of upfront investment required before you can leverage those things. But, at the end of the day, we are a data-processing industry. And this is the most significant tool to enhance the quality of data processing. And I think that's much underrated.

We've talked in the past about the opportunity within Wealth Management. As margins move downstream closer to the consumer we want to make sure that our business is close to the consumer.

We've mentioned Benchmark Capital. Benchmark allows us to get into the UK adviser network. It also allows us to have a low cost platform to deliver to that network with very, very, good technology. And, for me, it's the combination of being close to the adviser with good technology which allows us strategically to grow in the Wealth Management channel.

C. Hoare was a great opportunity. Sadly, I don't think there's going to be many like that, that come along. But being able to add 1,800 clients and £2.3 billion of assets was a nice opportunity.

And, finally, private assets. We made a number of steps this year. There was a – both in the infrastructure area we – you'll recall that we launched an infrastructure debt team. That team took in £700 million – £600 million of assets during the course of the period.

We increased our stake in Secquaero, which is insurance-linked securities. Again, that team took in new assets. And we're just in the process of launching a direct-lending fund with NEOS into the European market.

So a number of activities in private assets. We see there's more to go for in that area. We're moving into the infrastructure equity business, the margins with our infrastructure team. And you'll expect to see more activity in this area as we find strategies which our clients are moving into themselves.

So a lot of strategic activity. To my mind, this is the bit which is going to drive earnings in the future. Ensuring we move our feet and reallocate assets to these seven areas is probably the most important thing that we can do over the course of the next 12 months.

So, in summary, we really need to move to get the product set absolutely right and fit for the next period. And to that end, I mentioned we've identified the core franchises, which we want to get behind and be known for and stand up and represent our products in this way. So these are the nine franchises which we've identified. You'll be hearing more about those. But to my mind, areas like income, emerging markets, stewardship and ESG, credit retirement, target return, these are all areas where there is a very significant opportunity beyond passive.

I would be the first to say there are market headwinds. I think there's going to be uncertainties, there's going to be continued insourcing, there's going to be a continued shift to passive. I don't think that trend is going to slow. I do think that active managers that can add value will do well in that environment. But one needs to be capable of moving one's feet and focusing absolutely on investment performance, which is what we've been doing.

We will see some inorganic opportunities. That's not central to the strategy. They're opportunistic. As you saw, we've done some last year and we will continue to do them if opportunities should arise.

And I've mentioned quarterly reporting.

So in short, I think a strong set of results. But frankly, the bit that matters most to me is getting us right and in position for the next 12 months, 18 months and three years beyond that. And I think that's the bit this year where we've made really good progress.

Over to you. I'm very happy to take any questions. If you could just give your name and firm when you start, that would be great.

Q&A Session

Chris Turner (Goldman Sachs)

Thank you, and good morning. It's Chris Turner from Goldman Sachs. A couple of questions if I may. Firstly, in your outlook statement you talk about, quote, a good start to the year. You speak about a pipeline of institutional business. Could you maybe just provide some colour around that, please?

Secondly, on the topic of regulatory capital, you outline a figure. I think in the slides I saw £814 million is the new reg cap figure. That looks to be £100 million increase quarter-on-quarter. Can you just elaborate how much of that is from M&A from acquisitions and how much of that is the underlying inflation and maybe some colour on where you see that going, going forward? Thank you.

Peter Harrison

Let me take the first one, Chris, and I'll get Richard to do the second. The year has started well, both – we've seen flows into the Intermediary channel which have been strong, and flows into the UK which have been strong. I always am nervous about extrapolating a straight line through two months. I think that's not the right – particularly in the Intermediary channel.

But as I said earlier, a number of the areas where we were seeing outflows last year. We have seen a very strong period of performance and those trends have been reversing. So our emerging market debt and commodities area is a good example where we've outflows for five years and now we're seeing inflows.

So the year has started well, but you know better than me not to extrapolate that trend.

Richard, do you want to…

Richard Keers

In terms of our capital, if I look at it year-on-year rather than quarter-on-quarter I think it would make the point. So we started the year at £653 million and we've ended at £814 million as a requirement. The introduction of the EBA's capital conservation buffer, which it's phased over four years, is £50 million a year. So that's £50 million of that increase.

£110 million increase is due to a change in risk-weighted assets, and there's two components there. That's the size of the bank's balance sheet. We've got more cash deposits and more client assets there. And our investment capital has also increased, so there's a significant increase in risk-weighted assets as a result of holding more capital. And that's always been counterintuitive. The more assets we have, the more risk-weighted assets we have the more capital we have to hold. We've debated that long and hard with the PRA. They understand, but that's the rules, so it has that perverse effect.

Does that answer your question?

Chris Turner (Goldman Sachs)

It does. Can I just check, on the £50 million step-up, I think you said it's phased over four years of £50 million. How many more years of that do we have?

Richard Keers

Two more years.

Chris Turner (Goldman Sachs)

Two more years. Thank you. And that's it. Thanks.

Mike Werner (UBS)

Thank you. Mike Werner from UBS. Two questions, first on, yes, the UK transaction income. Is that something that you've already phased in, in terms of the elimination of that or is that something that's going to be coming in the next couple of quarters?

And then second – sorry, I guess – and also, what was the motivation behind that? Was it tied to the FCA market study and what we heard from the FCA with regards to their concerns about that area of income?

And then second, with MiFID II coming into place, how are you looking at your research payments? This is something that's very dear to all of our hearts. Is this something that you will be adopting the RPA approach or putting onto your P&L? Thanks.

Peter Harrison

It surprised me it took for the second question to get to MiFID. But, Richard, do you want to take the impact?

Richard Keers

In terms of UK transactional income, it's effective January 1 and it's within the margin guidance I've given you.

Peter Harrison

MiFID II, obviously it's a very important issue. We made – we started putting CSAs in place in 2006 and we've got well over 50. We feel – you will all be aware we've been quite early and aggressive in making sure that we get good value for our research and we've put a lot of systems in place to make sure that we're clear about where research is being consumed, what value it is and which clients have been benefiting from it.

So looking forward, we actually feel we're in a really good place to deal with the changes that are in MiFID II. There will be some nuance required. We – there is a certain amount of research which we already pay for ourselves anyway and there is obviously a very significant investment in data that we're also making through our data insights team, which we feel has been a supplement too.

But as regards to the street, we see the status quo as something that is sustainable because we've made the early investment. I think if you hadn't made the early investment you're more tempted just to take it off the P&L. But we've been in dialogue with the FCA throughout and we feel it's the right place to be, although we will – we're not saying everything is forever, but at this point in time we feel pretty good about where we are.

Mike Werner (UBS)

Thank you.

Hubert Lam (Bank of America Merrill Lynch)

Good morning. It's Hubert Lam from Bank of America Merrill Lynch. A couple of questions, firstly on risk appetite. Have you seen any changes to risk appetite for equities so far year to date? Flows have recently been more into fixed income and multi-asset just with the stronger US market. Has this led to any change?

Secondly, in terms of the pay-out ratio, it seems like you're at 50%, which is the top of your target range. I'm just wondering if there's any thoughts about potentially moving that higher in the future. Thanks.

Peter Harrison

First of all, on the risk appetite, actually the flows at the start of the year have been – a good portion of them have gone into equities. I think you'd expect that because markets have generally been fairly low vol and fairly consistent in terms of the deliveries.

So the mix has actually been quite positive from a revenue perspective. Whether or not that will be sustained, I don't know. But certainly there is an element of risk appetite out there which is being – which is coming through, and I see that in the industry numbers as well.

Richard, do you want to talk about pay-out?

Richard Keers

In terms of pay-out, no changes in our dividend policy. So yes, 45% to 50%, [we'll clear] 50% the top end of that. It's a progressive dividend, and no change to give you.

Anil Sharma (Morgan Stanley)

Morning. It's Anil Sharma from Morgan Stanley. Just a few questions, please. I guess the first one is just on Hartford. I think you mentioned annualising it around 2.5 billion, but I missed whether it was pounds or dollars. And just in terms of the revenue margin on Hartford, is it different to typical Intermediary margins?

Following on from that I guess, in the US Intermediary channel, is there more distribution agreements you can do with people like Hartford or how should we think about the growth there? You mentioned you've got quite an ambitious target.

And the final one, in terms of the private bank, obviously there's been some change to management. I just wondered if you could talk us through some of the rationale behind that. And then in terms of the new leadership, is there any changes in strategic direction we should be expecting or how should we be thinking about, yes, the management of the private bank?

Peter Harrison

That one's – Andrew Ross took over running that business back in April/May last year, and you should expect to see that strategy continue. We feel that we're doing the right things. We've globalised the operating model. We've functionalised IT operations, et cetera, which I think is going to give rise to efficiencies as that moves through. But I think the strategy is there and working.

We've come out of a period when we've gone through the integration of Cazenove. We now feel much more on the front foot, and I think driving growth – volume through that is a key priority for the coming period. So that's on that one.

Hartford is pounds, £2.5 billion is the opportunity. And part of the reason there is that we've not got any redemptions is because our current business is quite small, so pretty well gross sales equals net sales for a period. There's a little bit that –

And I would like to add other distribution partnerships like it. I think it's a really good demonstration where you get still very good margin business. It's not quite full flow because it is a sub-advised mandate, but it's still good margin business. But it allows us to really get scale into the marketplace. And I think there are other jurisdictions where a similar type of transaction would work if we can find the right partner and the right compatibility.

Hartford I think was a particularly unique opportunity because Wellington had done a really good job, but they were out of capacity on a lot of the strategies. So we sat very well alongside it and the brand proposition was very similar. So that – there won't be many, but I think where we can find them, we're well placed to offer the range of products that distributors want.

Anil Sharma (Morgan Stanley)

Thank you.

Peter Harrison

Any more?

Arnaud Giblat (Exane)

Good morning. It's Arnaud Giblat from Exane. Three questions, please, firstly on the scalability of your business. You've seen quite a bit of inflows into Fixed Income in Multi-asset. I'm just wondering how to think about the extra profitability of those inflows. Presumably you have built out the distribution and the manufacturing capacity for Fixed Income, so I'm wondering if the incremental operating margin on these inflows are higher than your current rate of business.

And secondly, I was wondering if you could run us through the breakdown in your guidance in Intermediary margins again, attributing what bucket is coming from, both profits and other elements.

Finally, are there any potential sizeable deals that you could be looking at to accelerate your growth in real assets?

Peter Harrison

First of all, the scalability of Fixed Income and Multi-asset, a really good point because there's a lot of complexity that comes with running a wide range of Fixed Income and Multi-asset products. And you put in vast numbers of ISDAs, you put in all sorts of plumbing, and as you hit critical mass you do get a margin pickup. And I feel that we're getting to that point, both in terms of scaling the amount of assets that individual fund managers run, but also scaling the architecture that we've put in place to support it.

So there is an incremental pickup as that goes through. And our businesses are big, but they're nothing like big in the global context, so there's an awful lot of opportunity to scale them. And we – that's one of the things which we're pursuing most aggressively, is that gearing as that comes through to the bottom line.

On the – I'll pass over the Intermediary one to Richard in a moment, but on the real assets, there aren't big transformational transactions, frankly. I – there aren't big beasts out there that would be culturally suitable to us and have the right mix of assets that would be relevant to our clients.

There are smaller boutiques, second-generation businesses, which actually have got some very interesting dynamics. And they tend to be more single-product shops, where if we can draw those together and be able to offer a more holistic capability, I think you'd get leverage and distribution and leverage from the longevity of the underlying assets, because I think the key thing here is that we have gross sales at the moment of £80 billion. We have to run quite hard to stand still. There you're taking in locked-in assets at 10 years, 15 years and therefore your sales effort gets rewarded on a much higher NPV and the real attractiveness of those assets.

So no big lumps, but a mosaic is certainly possible and that's something that we're working on.

Richard, do you want to do Intermediary margins?

Richard Keers

Yes. In terms of margins, I'll give you some precise numbers. But they're precise, but they're also guesses because I don't know precisely what's going to happen because they're forward looking. So if you look at 2016 actuals, which is a precise number, which is certain, it's 72.6 is our margin.

We are reducing our OCF charges in some of our fund ranges, and that has a 0.9 impact. Removal of UK unit trust transaction revenue reduces it by a further 0.8. And those two numbers are relatively certain.

The next one is a guess, flows, acquisitions and mix, so that's the impact of acquisitions in the year and forward-looking mix changes. And I'm assuming, making a best guess of minus 1.7 there. So that gives a forecast revenue margin of 69.2.

But as said, they're forward looking, so I can't be certain they're right.

Arnaud Giblat (Exane)

And then on pricing pressure?

Richard Keers

Well, the pricing pressure is in the OCF. So we've reduced the OCF charges, so we made that reduction, so about 0.9.

David McCann (Numis)

Morning. It's David McCann from Numis. The first one's a technical question just on margins again, Richard, you gave some guidance in the Wealth Management division of 62 bps. I just wondered, just to clarify, is that 62 bps on the AUM plus £4 million for AUA or is it 62 bps on AUM plus A?

Richard Keers

It's - can I just check with Wayne? That's AUM, isn't it? That's AUM.

David McCann (Numis)

Just AUM, and the £4 million is separately recognised?

Richard Keers

So AUA we're taking out of operating revenue and including that, essentially, in other income to arrive at operating income so that we don't distort that revenue margin number. But Benchmark is a lower margin. We're assuming, the like-for-like – our

Schroder Cazenove wealth management business I'm assuming is broadly flat year-on-year.

David McCann (Numis)

Okay. Thanks for that. And the second question, obviously given the capital position, as the mix has changed somewhat over the year, for the reasons you've answered in another question, I just wondered how much we should think – available capital you have for things like acquisitions.

And then in addition to that, I noticed one of the acquisitions this time was partly funded for a very small amount of issuance of shares. Should we think about that as a possible option for Schroders given that it hasn't really been a feature historically? Thank you.

Richard Keers

We'll be buying those shares back. So in a way, the vendor wanted to have exposure to Schroders, but they're non-voters, so we will be purchasing those back to maintain our four to one ratio. So in a way, it is shares, but it's really cash.

I've always – the way I present the capital numbers – and I haven't got the slide back on. Yes, if we can get the slide back on. Investment capital is how we think of things internally as what's available. That's true surplus that sits in our Group treasury and is there to be deployed, so that's just over £1 billion.

David McCann (Numis)

[Inaudible] we should think of as available?

Richard Keers

Yes. But that's what, internally, we look as our war chest, if you like.

David McCann (Numis)

But there is a fair amount of that, is it fair to say, that is quite locked up in a longer-duration product that would be harder to liquidate or –?

Richard Keers

No. That's largely invested in investment grade credit.

David McCann (Numis)

Right.

Peter Harrison

What we have done this year is stepped up the seed capital because we think that's an opportunity for us to – and we will step it up further from here because actually it's a competitive advantage that we can seed a whole range of new funds and then grow organically rather than growing at fancy acquisition multiples. And I think that accelerating growth through seed capital is also relevant in this.

Richard Keers

Yes, you'll see quite a step-up at the half year when we disclose our seed capital numbers then.

David McCann (Numis)

Okay. Thank you. That's very useful. Thank you.

Daniel Garrod (Barclays)

Good morning. Daniel Garrod from Barclays. A couple of questions from me. Back to the asset management market study, that was pretty critical around lack of alpha generation being disguised to retail investors and also lack of performance against fund objective.

You're outlining in your strategy of moving even high alphas as a key component of your strategy. Do you think, at an industry level, that criticism by the regulator is valid? Is it possible that they could take draconian steps of forcing increased disclosure on fund factsheets around where the fund does not deliver against its objectives or underperforms? Could that be a good thing for a house such as you're going higher up the alpha chain, as it were? That's the first question.

And the second, the fact that you break out now AUA as a new KPI, are we right to infer in that – from that, ambition to expand further in that area? Obviously you've done it through more of a technology-based acquisition with Benchmark. Any ambition to look at more traditional models in that advisory space?

Peter Harrison

Fair question. Just to take that second one, not particularly. That was a unique opportunity. And I think the – for me, getting hold of a platform and that ability to deliver product at a low cost base to advisers was the real opportunity, and get the technology with that, which is wired into all the underlying data. So an individual can have full transparency on all the holdings underlying in his portfolio and really see how – what's going on. That was the opportunity rather than the AUA per se.

So I think I'd just caveat that slightly saying the landscape is changing and I don't see today there are specific opportunities. But I think if you'd have asked me a year ago would we be able to find something like Benchmark Capital? Which wasn't on the market and wasn't easily dislodgeable, I'd have said no. So I think moving our feet dynamically at this point in time is really important.

Just going onto the asset management study, the industry did come in for some stick. I think that actually we will constantly see more and more pressure on transparency, and you've got it coming through with PRIIPs at the moment. We measure pounds of alpha and are we really delivering a growth of wealth after fees for clients? And that to my mind is the single most important defence an active manager has. And being able to say that and being able to evidence it is really very important.

So where people aren't doing that, I think you will get more pressure. And I think that's very good for firms that have got 85% of funds outperforming. For me, it's that balance that's right. But where all this comes out in terms of the fine print I think is going to be a combination of the market study, the final PRIIPs analysis and then probably another set of legislation beyond that.

Paul McGinnis

Good morning. Paul McGinnis from Shore Capital. A question on Wealth Management. With the business experiencing net outflows in the year, that's in stark contrast to certainly the majority of the UK wealth management businesses. Could you just give us a little bit more colour on how the geographic split of those outflows looks and whether you would expect 2017 to be a year when that flips back into positive territory?

Peter Harrison

Yes. I would say I'm not happy that we've had outflows whilst we've seen other people have inflows. And I think you've got to be quite careful of looking – a number of particularly the big bank competitors have taken – made great strides to move people onto IMAs, where they basically putting a discretionary wrapper over what's effectively an advisory relationship. So you see a big number, but you don't actually see the revenue move. So be careful what's going on.

I think the outflows in Switzerland and a little bit in the US have been behind our numbers. But do I expect it to flip? Absolutely, yes. We've deepened some relationships. We've broadened the business. We've got more people coming in. We're hiring more people now. I think the organic growth in that business will turn around. And you can kick me next year if I'm wrong, but that's certainly a key priority for me.

Peter Lenardos (RBC)

Good morning. It's Peter Lenardos from RBC. A question about one of the headwinds that you brought up in passive investing and US concerned highly, US asset managers, about a 30% market share from passive. And I think in Japan it's over 50%. I guess just thoughts on Europe and why we're not seeing massive penetration here yet. And any strategy besides continued outperformance to help battle the anticipated market share gains in passive investing in Europe? Thanks.

Peter Harrison

Peter, yes, that's a – it's a really good point. I think the first thing to say is the European distribution model is very, very different and you've got a lot of bank distributors. And the way in which those products get to individuals is different and I think it's sustainably different.

So the level in Europe is, what, 15%, 16%, 17%, depending on how you measure it. It is creeping up, but it's creeping up no faster than the US is creeping up. So I would expect to see those progress in parallel, not that the European number would rapidly catch up to the US.

I think the other point to make is there's a lot more fixed income and multi-asset activity in Europe at the moment. And passive has not worked in fixed income to anything like the same extent. You still see very good flows into active fixed income because the ETFs, et cetera, often trail behind the underlying indices.

So, I think if you – in markets where solutions are more important and where fixed income is more important, you will see passive becoming a slower take-up. So I think it is a sustainable thing. It's not going to grow in Europe. It's just going to grow at a slower pace.

Peter Lenardos (RBC) Great. Thanks (multiple speakers).

David McCann (Numis)

It's David McCann again. Just one more question. I just wanted to follow up on the 85% outperforming, the point that was made a couple of times. Firstly, is that net of the fees that clients are actually paying in the actual share classes they're in or is that based on representative share classes? And secondly, is that compared to benchmark or is compared to peer group averages? Obviously, the former being harder to beat generally.

Peter Harrison

It depends on what it's being – what its objective is. So if it's against a peer group, it's a peer group. If it's against an index, it's an index. It's gross for those mandates where we can make comparisons with benchmarks. But hence the reason we do – and it's obviously very complicated. You've got a mutual fund with 40 share classes. You could never give a simple number. Hence the reason we do a lot of work on pounds of alpha.

And I think it's the – there's a huge complexity with that, but in our submission to the FCA it was all about, are you growing the real wealth of the people who are investing in those funds after all the fees that you're charging? And it's the pounds of alpha, i.e. money-weighted returns, not time-weighted returns, which I think is the more important number, which is a positive.

David McCann (Numis)

And it is net of charges that figure on a…

Peter Harrison

Well, in the intermediary – where you've got peer-group-related funds, those are all including the charges. Where you've got institutional mandates against benchmarks, those are ex charges, those are gross.

David McCann (Numis)

What would you estimate it might be if you were to net off the charges?

Peter Harrison

I think we would – it's a hugely – the reason we don't do it is it's hugely complicated because you've got so many different share classes, et cetera to do. Because it – we – you bill outside of the mandate for an institutional mandate. So the billing – the fee number is often a different number, so it's actually quite a hard – it sounds simple, but it's actually quite a hard number to get to.

David McCann (Numis)

But even if you were to take, say, a representative charge, take off, say, your 30 basis points institutional average margin, would that –?

Peter Harrison

Yes. That number would still be a high number.

David McCann (Numis)

It would still – and it would still be above 50%?

Peter Harrison

I think it would be. I haven't proved it, but I – because our pounds of alpha is a very positive number, then I'm confident that will be a positive number. Whether – what the exact percentage is, I don't know.

David McCann (Numis)

Okay. Thank you.

Peter Harrison

Any more?

Gurjit Kambo (J.P. Morgan)

Hi. Good morning. It's Gurjit Kambo from J.P. Morgan. Just in terms of the private assets, private markets' area, if I look at some of the more dedicated private market managers, I think one of the things they are seeing, clearly, is good demand from institutional clients, which I think you're saying as well. What they're saying is more challenging is actually trying to get the assets because more and more are off auction. What are your capabilities of being able to get off-auction assets?

Peter Harrison

It's a really good point. And in our infrastructure debt team – I think you need teams who are in the flow of seeing the assets. And both in insurance-linked securities and infrastructure debt we've got a decent market share, so we do see those assets. What we're not in the market for is big-trophy assets, where there's real competition, particularly from the sovereign wealth funds, et cetera, who are all trying to do it themselves.

So it's about being targeted at saying, these are the types of transactions you want, and being able to be meaningful and have the capital to put to work quickly. And I think they're – we're not finding a problem in that area. But I think if you're trying to buy trophy assets, you've got a problem.

Any more? Great. Thank you all very much. Thank you.

[End]