

SCHRODERS Q3 Interim Management Statement 2015 conference call

**Michael Dobson
Thursday 5 November 2015
9:00 a.m. GMT**

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Q3 Interim Management Statement 2015. After the presentation today there will be a Q&A session and you will be able to ask questions by pressing star, one on your telephone keypad.

I must advise you the conference today is being recorded on Thursday, November 5, 2015.

Now, I would like to hand the call over to Michael Dobson. Please go ahead, sir.

Michael Dobson: Good morning everyone and welcome to the call. You've seen our nine month management statement. We've had a good performance across the Group in the first nine months, reflecting the strength of our diversified business at a time of heightened market volatility.

Profit before tax and exceptional items was up 12 percent to GBP453.2 million; and profit before tax was up 21 percent to GBP438.9 million.

The cost/income ratio in Asset Management year to date is 62 percent and in Wealth Management 70 percent. And the overall cost/income ratio is right on our target of 65 percent.

We generated GBP8.3 billion of net new business in the first nine months of the year, with net inflows across all channels.

And assets under management at the end of September were up 7 percent on a year earlier to GBP294.8 billion.

Investment performance remains competitive with 72 percent of funds outperforming benchmark or peer group in the three years to the end of September.

Looking at the third quarter specifically, profit before tax and exceptional items was up 3 percent to GBP147.5 million.

Exceptional items were a positive GBP1.1 million, following the write-back of GBP7.2 million of provisions that we previously took in relation to the US Department of Justice Swiss Bank program.

And profit before tax was up 14 percent to GBP148.6 million.

In terms of new business flows in the third quarter, we saw GBP300 million of outflows in Asset Management; GBP100 million in Institutional; and GBP200 million in Intermediary; and we had GBP200 million of outflows in Wealth Management.

We see that performance in Q3 as a resilient performance at a time of significant volatility in markets and a reduction in investor demand in retail and, to some extent, in Institutional as clients deferred some funding decisions. In that context, on October 1 we had an additional net inflow of GBP2.3 billion in our Institutional business.

Turning to the Asset Management business, net revenue in the first nine months was up 9 percent to GBP1.032 billion, including performance fees of GBP12.7 million for the nine months, compared to GBP11.7 million in the first nine months of last year.

Profit before tax and exceptional items was up 13 percent to GBP400.4 million and profit before tax was up 15 percent to GBP391.3 million.

Net revenue margins, excluding performance fees, for the year so far are 49 basis points, compared to 52 basis points in 2014, with that decline being accounted for by business mix, as we've taken on some new businesses this year coming in at lower margins.

Net new business at the end of September was GBP8.1 billion in Asset Management; GBP3.5 billion in Institutional, with strong inflows from Asia Pacific, particularly Japan, and good net flows in the UK, partly offset by outflows in the US and Latin America, and small net outflows in Continental Europe.

This was also the pattern in the third quarter: continuing net inflows in Asia and the UK, net outflows in America and Continental Europe.

By asset class, in Institutional we've had strong net inflows in Fixed Income at GBP2.9 billion for the year to date; net inflows of GBP2.6 billion in Multi-asset; and GBP1.2 billion of net outflows in Equities; and GBP700 million of net outflows in Emerging Market Debt and Commodities.

In the third quarter, that pattern, again, continued: positive flows in Multi-assets and bonds, and outflows in Equities and Commodities.

On October 1, as I said, we had an additional GBP2.3 billion of net new business funded in Institutional, mandates from Asia and the UK, mostly in global Fixed Income, but also in Multi-asset.

Turning to the Intermediary business, net inflows year to date of GBP4.6 billion, with a strong performance in Continental Europe and Asia Pacific, small outflows in the US, which were offset by equivalent inflows in Latin America, and outflows in the UK.

In the third quarter in Intermediary, we had positive flows in the UK and Continental Europe, and we had net redemptions in Asia, slightly over the GBP200 million. So all the outflows were accounted for by Asia, and basically three markets, Hong Kong, Singapore and Taiwan, as retail investors were quite concerned over the developments in Chinese markets and pulled money out of mutual funds.

We also had some net outflows in the third quarter in the US.

By asset class in Intermediary, year to date, we've had GBP2.1 billion of net inflows in Multi-asset; GBP2 billion in Fixed Income; net inflows of GBP1.1 billion in Equities; and GBP700 million of outflows in Emerging Market Debt and, to a lesser extent, real estate.

In the third quarter, we had, in retail Intermediary, inflows in Multi-asset; a flat result in bonds and Equities; and some further outflows in Emerging Market Debt and Commodities.

So the key factors behind the GBP200 million of net outflows in Intermediary in the third quarter are two fold: China and its impact on Taiwan, Hong Kong and Singapore in our case; and Emerging Market Debt and Commodities.

I should mention that we've seen some challenges in China, but I might mention in passing that our joint venture in China continues to perform extremely well. GBP9.6

million of post-tax profit for us year to date from our China joint venture and, despite the challenges, net inflows year to date.

Turning to Wealth Management, net revenue for the first nine months was GBP157.3 million, down 3 percent on the first nine months of last year, which was GBP162 million. But that GBP162 million included the release of a GBP7.5 million loan loss provision and one-off performance fees of GBP2.8 million.

Profit before tax and exceptional items was GBP46.5 million, down from GBP49.2 million for the first nine months of last year.

Exceptional items year to date are a positive GBP1.2 million in Wealth Management, which is made up of GBP6 million of amortization of intangibles, offset by a write-back of GBP7.2 million of the provision we made in 2013 in relation to the DoJ program for Swiss banks.

And that led to profit before tax at GBP47.7 million for nine months, up from GBP33.6 million in the first nine months of 2014.

Net inflows in Wealth Management year to date are GBP200 million. That's to say GBP400 million in the first half, offset by GBP200 million of net outflows in the third quarter. That GBP200 million reflects continuing small quarterly outflows in Switzerland as we restructure our business; and in the UK, new clients deferring decisions at a time of market uncertainty.

In terms of new clients won in Wealth Management versus clients lost, we have a very positive picture where we've seen some significant net outflows from existing clients, which reduced that net outflow picture in total, or rather, net flow picture in total.

These are clients withdrawing funds to finance tax payments, to purchase property, for example. They continue to remain clients of the firm, but we've seen some quite, and we continue to see, some fairly significant withdrawals and inflows from existing clients and that tends to offset the very positive picture we're seeing in terms of new clients won versus clients lost.

On a long term basis, we continue to target net new business in Wealth Management of 2 percent to 3 percent as starting assets under management each year.

In the Group segment, profit before tax and exceptional items for the first nine months was GBP6.3 million against GBP400,000 in the first nine months of last year. And after exceptionals, the loss before tax was GBP100,000 for the nine months against a loss in the first nine months of last year of GBP11 million.

We've had a good start to the fourth quarter on the Institutional side, with some significant new fundings, but our sense is that while we have a good pipeline of net new business which we've won but which has not yet been funded, market uncertainty may delay some of those funding decisions; they may get pushed back into 2016. We don't know that, but it's quite possible.

On the other hand, we have limited forward visibility on possible client losses, for example, for asset allocation reasons. We don't see anything significant at the moment but, of course, that could change.

On the Intermediary side, we've seen small net inflows in October. Again, it's difficult to predict the trend in, obviously, a fairly uncertain market environment, but long term, we continue to be of the view that we have significant growth opportunities right across our business in Institutional, in retail Intermediary and in Wealth Management.

I'll now hand it over to you for questions and Richard Keers, our Chief Financial Officer, and I are very happy to take those questions.

Operator: Thank you, sir. As a reminder, the participants may ask questions by pressing star, one on your telephone keypad and waiting for their name to be announced. Star and one for any questions on the phone lines.

And the first question is from Haley Tam from Citi. Please go ahead.

Haley Tam: Good morning, Michael. Good morning, Richard. Two questions, please. Firstly, on the Intermediary flows in Q3; obviously, you've been very clear that that's been mostly due to the China and the EM debt and Commodities effect. Could you clarify for us what the end of September level of AUM actually was in those two areas in terms of Chinese clients and also, in terms of products, the EM debt in Commodities?

And the second question really was much more granular. In terms of Wealth Management, it looks to me as though the costs in Q3 were perhaps 8 percent lower than the previous quarterly run rate and I just want to clarify whether that is actually

due to these write-backs you've talked about or whether there's something else going on there that's more sustainable. Thank you.

Michael Dobson: OK. So, Hayley, in Intermediary, AUM in Commodities is quite low, it's GBP400 million; in Emerging Market Debt, it's double that, it's GBP800 million.

In terms of our Intermediary business in Asia Pacific as a whole, it is about GBP27 billion and by -- of that, GBP6.7 billion in Hong Kong; in Singapore, it is GBP4.9 billion; in Taiwan, GBP3.3 billion.

We are market leaders in both Hong Kong and Singapore and we have a very strong business in Taiwan. I wouldn't do a read-across from that and say that -- I don't regard that business as particularly vulnerable.

I'm simply saying that in Q3, the industry, this is nothing to do with Schroders, the industry saw significant redemptions from those three markets which was driven by concerns over China. But we are very happy with our very strong position in those three markets on the retail Intermediary side of the business.

Richard Keers will answer your question on costs in Wealth Management.

Richard Keers: Haley, in terms of costs in Wealth Management, I think the key thing here is one of the rationales of the transaction was to find integration synergies. And you're seeing some of those, the costs that we highlighted 12 months ago, coming through in the numbers.

So what you're seeing is now the new normal level of operating costs in Wealth Management.

Haley Tam: Thank you, that's very clear. Thank you.

Operator: Your next question is from Daniel Garrod from Barclays. Your line is now open.

Daniel Garrod: Good morning, Michael, Richard. A couple of questions from me. First, it looks like, in terms of moving into a small net outflow in the Q3, it was driven by a slowdown on the gross sales side, you can see that in the picture of your gross sales development, rather than a huge spike in redemptions. So I wonder if you can provide any color around what you're seeing in Q4 on recovery of the gross sales, rather than just the

redemptions slowing a little bit. Are you seeing a recovery there in what you're selling at a gross level?

Second question, just technical on performance fees. You detailed them for the nine months. Can I just cover -- I think for the Q3 it means you got just shy of GBP7 million of performance fees coming in. I think in the past you've indicated there were certain funds that did have the September quarter-end as the point at which they crystallized fees but still the majority come in in Q4. Could you provide any colour around that, if that's correct, and what this might mean for expectations for the full year?

Michael Dobson: OK so on, Daniel, performance fees, GBP6.8 million in Q3 and it was GBP6.1 million in Q3 last year. So similar. I think Richard has given you a number, GBP40 million, in the past as being a central assumption and I don't think we're changing that number.

Richard Keers: No, that's right. No, I talked at the interim about GBP40 million being our central assumption but I indicated at that time that there was probably more downside risk than upside potential. And the majority do come through at the end of the year. I don't know what that number's going to be but I would still say there's more downside risk in not achieving GBP40 million than overachieving GBP40 million. But I don't have a number because I haven't got it.

Michael Dobson: OK, and then on inflows, or gross flows, you are -- you're basically right in that assumption. So we've seen in Q3 a fall-off in gross flows in Institutional. Actually, we've seen a reduction in gross outflows as well. And we've seen a fall-off in gross flows in Intermediary. And again a reduction in gross outflows.

So the net deterioration, if you like, you're exactly right, it's quite a significant reduction in gross inflows.

In terms of October, we have seen something of a pickup in -- obviously with that big Institutional inflow we've seen a significant pickup in gross inflows in Institutional and to some extent we've seen a pickup in Intermediary as well.

Daniel Garrod: Thank you, very clear.

Operator: Your next question is from Peter Lenardos from RBC. Please go ahead.

Peter Lenardos: Hi, good morning, Michael and Richard. It's Peter Lenardos from RBC. I just have a question on the revenue margin. I was curious -- I know you detailed what the revenue margin was during Q3, but if your exit rate was any different, your exit from Q3 was any different than the average rate that you experienced in Q3. Thank you.

Michael Dobson: The answer to that, Peter, is no. There's no meaningful difference.

Peter Lenardos: Thank you, Michael.

Operator: The next question is of Arnaud Giblat from Exane. Your line is now open.

Arnaud Giblat: Good morning. A couple of questions, please. Could I just check on your cost guidance? If we take your GBP315 million other cost guidance and your -- I think it's 45 percent staff cost to revenue guidance, basically -- implicitly you have -- following that guidance we should expect a pickup in costs in the fourth quarter. Can I confirm that or is the cost guidance changing here?

And secondly, on Multi-asset, could you maybe give us a bit more detail around recent performance in Multi-asset and what that does to the outlook on -- in terms of flows in that product? Thank you.

Michael Dobson: So on Multi-asset we've got a very broad range of strategies, obviously, within our own Multi-asset business. In some of our Multi-asset income funds, which have been very successful, we've lagged some of our competitors recently. That is partly or I think principally due to the fact that we've got a higher target yield on those funds than some of our competitors, materially higher in some cases. And that has caused us to, for example, have higher weightings and higher yields which has been a negative.

So I think where we've had underperformance against some, not all competitors, recently in our Multi-asset income fund, it's accounted for by the fact we have higher target yield, which has been core to that offering.

Elsewhere in Multi-asset, in our diversified growth funds for example, we've outperformed, I think, many of our competitors. So it's a range of different outcomes as you would expect.

On costs, I'll hand over to Richard to deal with that.

Richard Keers: On costs, I'm not 100 percent sure what the question is. We gave guidance at the beginning of the year and at the half-year that our non-comp costs would be in the order of GBP315 million, and I do not see that guidance being unreliable as you sit here today. There might be a slight uptick but nothing significant as we continue to invest in our IT and operating systems.

Arnaud Giblat: OK, maybe I can be a bit more specific. Basically if I look at how the costs have been spread out through the quarters should we be -- is the spending going to be more lumped into Q4 basically?

Richard Keers: I've just said, I gave some guidance as to the whole year number; there might be a slight uptick on that but that gives you the answer, I think.

Arnaud Giblat: OK, thank you.

Operator: Once again, please press star, one on your telephone keypad if you would like to ask any questions.

The next question is from Anil Sharma from Morgan Stanley. Your line is now open.

Anil Sharma: Good morning, guys. Just a couple of quick questions, please; so just following up on the Multi-asset. Obviously it's quite a big or has been a big driver of growth the last few years and is now a big portion of the AUM. Can you just try and help us think through or size what proportion of that AUM is more the Multi-asset income and where the performance is perhaps a bit weaker? What proportion is still relatively outperforming peers?

And then the second question is just I just wanted to get your view really. We've obviously got an upcoming FCA sector review coming in January; they've got competition authority powers. Just wondered what you think may or may not come out of that review, please. Thank you.

Michael Dobson: Income is GBP7 billion in Multi-asset, and total Multi-asset is probably -- sorry, total Multi-asset is indeed about GBP72 billion, so it's about 10 percent. I wouldn't over-emphasize this because -- actually we recouped a lot of our underperformance in the month of October and we're not seeing outflows in that business. But the reason I said for the higher target yield, we haven't done as well as we might have liked in the last -- first nine months of the year or so.

As far as the FCA review is concerned, I think that was your question wasn't it, the impact of that?

Anil Sharma: Yes, yes. Thanks.

Michael Dobson: Obviously it's too early to tell. I think there's going to be a focus on costs, on margins. It's a competition review and is -- do high margins in the industry reflect the fact that competition is lacking? It could be a question or could be an assumption. There certainly are high margins in the industry but it's a highly competitive industry as you know with very low barriers to entry and multiple competitors and providers in just about every asset class and every strategy.

I think there will be a significant focus on charging, on fee structures, on transparency, on differential charges in Intermediary versus Institutional for example, all those sorts of things, which is already there and it's already a focus of the regulator and others. And we're seeing the impact of that in declining fees, which we've seen for the last four or five years across the industry and I think we'll continue to see. I think this could be another part in that process, but too early to tell, I think, much beyond that really.

Anil Sharma: Great, and if I just quickly follow-up, just to check the Institutional mandate that's been won in October, that's at similar fee rates to the existing Institutional?

Michael Dobson: It's in Fixed Income and Multi-asset, which are lower fees than Equities as you would expect in Institutional. So to start with -- very roughly our average fee's about 35 basis points in each of those asset classes, Equities and -- sorry, Multi-asset and Fixed Income. And these two -- these mandates come in that area.

Secondly, they're significant mandates, obviously, in size terms and therefore you would expect a low fee on that. So if you take those two things into account, they're going to come in clearly at lower margins than our average.

Anil Sharma: Understood, thank you.

Operator: Your next question is from Hubert Lam from Bank of America. Please go ahead.

Hubert Lam: Good morning. Most of my questions have already been asked, so just one follow-up question. In terms of fee margin for the year, I think you said that you expect the second half to be similar to the first half, about 49 basis points. I guess in Q3 you've

held on to that. Given you're at the large Institutional mandate, maybe there should be some pressure in Q4, do you think, on the revenue margins? Thanks.

Michael Dobson: Well, there might be but I think it would be very marginal. We're winning a lot of business. We're growing our Fixed Income business, which is performing extremely well and has now somewhat overtaken Multi-asset as our fastest growing business. But Multi-asset continues to perform very well and we see some big opportunities out there.

But the corollary of that is these businesses -- these mandates are coming in at lower margins. We're winning buy-and-holds, buy-and-maintain bond mandates, for example, on lower margins. We like this business, we think it's a very high quality, decent longevity business, which we want to be active in.

But quite apart from the pressure on fees across the industry, which we're feeling like everybody else, as we drive our business in these areas we're taking on business at lower margins than we've seen in the past. We think that is a significant net positive because it adds to scale, it adds to diversity and we're reaping the benefits of the investment we've made in Multi-asset and Fixed Income over several years and seeing significant growth come through. And we think that will continue but it is on lower margins. So we may see a marginal erosion in the fourth quarter, I don't think it's going to be significant.

Hubert Lam: Great, thank you.

Operator: And once again, please press star, one on your telephone keypad if you would like to ask any further questions, star and one.

Michael Dobson: OK, well thank you very much for joining us and if you've got any follow-up questions, then by all means give us a call. Thanks a lot.

Operator: Thank you. That does conclude our conference call today. Thank you everyone for participating, you may now disconnect.

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