S1 2019 Earnings Call

Company Participants

- Andrew Croft, Chief Executive Officer
- Craig Gentle, Chief Financial Officer
- Ian Gascoigne, Managing Director

Other Participants

- Andrew Crean, Analyst
- Andrew Sinclair, Analyst
- Colm Kelly, Analyst
- David McCann, Analyst
- Johnny Vo, Analyst
- Jonathan Hocking, Analyst
- Oliver Steel, Analyst

Presentation

Andrew Croft {BIO 5711239 <GO>}

Should we get started? So good morning, everyone, and welcome to our interim results presentation. Adopting our usual format at the half year, I will cover the fund flows, hand over to Craig to run through the financials. I will then finish up on other developments and outlook. We'll follow this with a Q&A. There are also a number of my executive team and non-execs here this morning. Please do look them up over coffee at the end.

So the first six months. It's fair to say that we have witnessed a period of unprecedented political uncertainty in the U.K., coupled with uncertain macroeconomic environment together with a strange trade relationship between the U.S. and China. So unsurprisingly, this is not a perfect environment for wealth management business. But despite this backdrop, I am, however, pleased to report a solid set of results, once again demonstrating the resilience of the business. New gross inflows for the six months was GBP7.4 billion, some 7% lower than the first half of 2018. And encouragingly, the gross flows improved in the second quarter versus the first quarter.

However, let's not forget we have seen a number of years of very strong growth. Looking back just five years ago, gross flows for the half year was GBP3.8 billion. So over that 5-year period, we have achieved compound growth of 15% per annum. Importantly, the continued strong retention of existing client funds provided for net inflow for the period of GBP4.4 billion. That's 4.6% of opening funds under management or 9.2% on an annualized basis. This continues our consistent track record of net inflows every quarter with the period since the start of 2008 shown on the current slide.

It also continues our track record of net inflows as a percentage of opening funds under management over the same period of around 10%, a demonstration of our resilience and consistency in all market conditions. Now we know from history that in uncertain times face-to-face advice outperforms. And looking at industry data from The Investment Association, total retail net flows for the five months to the end of May were GBP2.3 billion, 80% lower than the first five months of 2018. So why is this?

Well, first and foremost, St. James's Place is a relationship business with some 90% of new flows coming from existing clients or introduction from clients. Our partners provide holistic financial advice, helping clients on their life journey. Clients affairs will be structured in a tax-efficient manner and their investments will be well diversified to suit their goals, aspirations, time horizon and attitude to risk. Our partners are there to assist them during more difficult times, helping them to understand and navigate uncertainty. That's the value of advice.

Secondly, whilst our clients have well-diversified portfolios, should they wish to reduce the risk profile of their portfolio, then within our investment proposition, they can do this free of charge and in most cases, free of tax. And thirdly, history tells us that certain categories of our new business remain relatively stable irrespective of market conditions or uncertainty. For instance, the use of annual tax allowances, inheritance tax planning and consolidation of DC pension box, the bedrock of our business. Where gross flows can be impacted is with discretionary investment of, say, a bonus, proceeds from a disposal of an asset or the sale of a business.

Here, we see individuals reticent to invest when uncertainty prevails. Indeed, our advisers would also be cautious in this respect. This is nothing new. We've experienced periods of significant uncertainty before. And looking back to the financial crisis of 2008, our gross flows were down 9%, not too dissimilar to the 7% decline we have experienced in the first half of 2019. And what else can we draw from our experience of 2008 and the subsequent market recovery?

Well, we can be confident that those clients not investing today will invest when the uncertainty clears. You can see the strong gross flows we experienced in 2009 and '10 when stability returned to the market. Those clients would also assume very good investment returns. Another key lesson from prior experience is not to overreact, but carry on investing in the business. These investments pay off in the medium to long term. And again, going back to 2008, our gross flows for the first half were GBP1.5 billion. And to remind you, in the last six months, they were GBP7.4 billion, growth of some 500%.

So that's exactly what we've been doing, investing in the business, and I'll come back to these including the growth in the partnership during my second outing this morning. So we can draw parallels between today and our experience of 2008. However, one difference today is that stock markets have remained very resilient. Our funds under management in 2008 understandably fell whereas in the first six months of 2019, we continue to see our funds grow, reaching a new record of GBP109.3 billion at the 30th of June, up 14% since the start of the year.

However, it's important to note that the level of funds in the gestation period are also increasing. Whilst these funds will generate sustained returns in the medium to long term, in the short term, our profit has been impacted by more modest gross flows relative to our planned higher cost of investment.

And I think this is a perfect time to hand over to Craig to run through the financials.

Craig Gentle {BIO 20095126 <GO>}

Thanks, Andrew, and good morning, everyone, from me. This morning, I'm going to follow the order in which shareholder value is created. I'm going to start by commenting on our adviser growth, which is an important lead indicator. I'll then comment on our gross and net inflows for the first half of the year together with the impact they've had on our funds under management. I'll comment on gestation, then I'll cover our cash results and, where possible, provide guidance on how we see things evolving in the second half. I'll then comment on our EEV results and capital positions.

And finally, I'll comment on our interim dividend that we announced this morning. So our adviser numbers now stand at 4,096, which is 3.6% up from December, and our Academy contributed 59 new qualified advisers during that period. Andrew will comment further on the success we're seeing in the Academy and the enormous contribution it's now making to the business. Our gross flows for the second quarter was GBP3.8 billion, which took total gross flows for the first half to GBP7.4 billion.

This result represents a resilient business model where the fundamentals behind our ability to grow funds under management remain very much in place even when there's political and economic uncertainty. Our retention rate for the first half has remained broadly constant at 96%, resulting in net inflows for the first half of GBP4.4 billion. These net inflows together with the results of market performance have pushed our funds under management up to a record of GBP109.3 billion, which is a 14% increase over the figure we reported at the end of December. I'll now focus on our funds in gestation, which stand at GBP38.1 billion.

Since the pension freedom changes in 2015, we've seen a marked change in our business mix in favor of pensions, and we see this as a long-term change. This means that around 60% of our new business flows into gestation. Whilst this doesn't contribute to the cash result for six years, it does represent an enormous store of value yet to emerge. The gestation balance is now of great importance when assessing future value, so we've refined our disclosures. And the amounts shown in this table are a better reflection of the actual product mix and therefore, the post tax margin embedded within the gestation balance.

This has also and will give us an opportunity to show how the total amounts will emerge relates to the unwind in the cash result, which I know has been a question mark for some of you in the past. The disclosures, therefore, give an improved and more accurate view on a way in which the gestation balance will roll into mature funds under management, which is the key figure for modeling the actual cash results within income. I hope they're helpful, but we will, of course, be happy to engage in any further questions that you might have.

There are some assumptions underpinning this table that haven't changed, but I should remind you of them. Firstly, the table assumes that market values at the end of June stay flat for the next six years. Secondly, we haven't modeled withdrawals, which might typically be an offset against us. Thirdly, we've assumed all new business is written at the beginning of each year rather than being spread evenly throughout. It therefore simplifies the emergence, but serves to illustrate how our stock of gestation balances will contribute to the cash result over time.

Now on to the emergence of cash itself and our cash result. Net income from funds under management is 6.2% higher at GBP199.8 million. This figure represents actual income from mature funds under management. With this in mind as well as being more specific on the margin on funds in gestation, we've also included information in order to understand the way in which the post-tax net income or mature funds under management is likely to evolve. The amounts reported for last year are unchanged, so these should be consistent with your models.

For 2019, we expect the blended post tax rate to be in the region of 63 to 65 basis points. In terms of outlook, there is a modest increase over the next couple of years, and this is largely attributable to the planned cut in corporation tax. We've assumed the current business mix remains constant in the future and that the flows out of gestation are as we've just explained. The margin arising on new business has reduced from GBP70 million to GBP61.8 million, as you'd expect, this is largely a reflection of the movements in gross flows between the two half years, but you will notice the reduction is slightly higher than you might model, just using the 7% reduction in flows, but there's an operational gearing point here that reverses itself in a return to growth.

The establishment expenses have increased by 11%, and this is consistent with guidance given in February. A sizable proportion of our establishment expenses are in support of future growth and involve growing the infrastructure that will drive and accommodate this. We remain committed to growing our advisory capacity and therefore the infrastructure needed in support. I anticipate the final outcome for the year on establishment expense is being consistent with the guidance I gave back in February.

Operational development cost reflects our continuing investments in technology and other improvements in the way our business operates. This is over and above investments in Bluedoor, which I'll come on to in a moment. We announced last year that we plan to invest more in our Academy, and the GBP5 million charge reflects this investment. Andrew is going to say more about the Academy in a moment. I have little to say about FSCS costs, which remain at a frustratingly high level. The increase is largely due to a full year charge rather than the 9-month charge you will recall from last year. Tax relief from capital losses has returned to a more normal level for the first half.

This figure is subject to tax complexity and market performance, but the best way to think about the full year impact is to assume that the historic guidance remains valid, which you will recall is an annualized benefit of GBP10 million to GBP12 million until the current stock of 48 million is fully relieved. Miscellaneous, which for the first half stood at GBP9.9 million, is difficult for you to model because it includes a multitude of cash flows not covered elsewhere in the cash result presentation. But taking all of these items into account, our operating cash result was GBP140.1 million, which is 12% lower than last year.

We've continued to invest in our business in Asia, and we remain confident that this will make a positive embedded value contribution by the end of the year. Rowan Dartington has also continued to grow, and 2/3 of its inflows now come through the SJP partnership. So far as the full year position for these investments is concerned, the guidance issued in February stands, and the net cash impact should approximate to last year's result. Taking our longer-term investment activity into account, the underlying cash result was GBP125.1 million, which is 15% lower than in the prior year.

Our back-office infrastructure costs were GBP22 million. The pattern of expense in 2019, however, is very heavily weighted towards the first half because of the scale of migration activity. So you can still expect the full year charge to be similar to that, that you saw last year, which again is consistent with February's guidance. Now that our U.K. business is being migrated on to Bluedoor, we're going to see this below-the-line costs fall away. I spoke back in February about the likelihood of decommissioning costs flowing into 2020, but these costs will be modest by comparison.

The final migration of U.K. products onto Bluedoor is a huge milestone for the group and one that Andrew is going to comment on more in a moment. I'll now turn to embedded value where the operating profit was GBP465.7 million, which is 5% lower than last year. There are two main moving parts within this change, which to some extent offset. Whilst gross flows have reduced new business margin by GBP51 million, we've seen a positive persistency variance, which is something we've seen before our investment decisions slowed down, and this has largely driven a positive offsetting experience variance of GBP43 million.

The two of the numbers I was planning to comment on was a positive investment return variance, which more than reverses the negative charge that we saw in December as a result of the markets. And finally, the embedded value now per share at the end of June stood at GBP12.45. I've little to say on capital, and the position remains strong as this slide shows. Now on to the interim dividend, which we announced this morning. The fundamentals underlying the business continued to be very strong, which means we have confidence in the outlook. Demand for quality financial advice is high.

We continue to grow the partnership both through recruitment and the Academy. And the financial results are underpinned by the future income that will be released in the next few years from gestation. The interim dividend recognized the challenges in the shorter-term operating environment, but also draws confidence that we have in the prospects for the business.

Thank you. Back to Andrew.

Andrew Croft {BIO 5711239 <GO>}

Thank you, Craig. A solid set of numbers given the external environment. I just want to just reflect on the SJP business model. So we are a long-term business. We build long-term relationships with our partners and clients. Having attracted 26,000 new clients in the six months, we now have over 700,000 face-to-face relationships. Our clients' needs and aspirations are long term, and they're receiving long-term holistic financial advice.

We also build long-term relationships with our employees and those communities in which we live and work. Our investment management proposition is based on a philosophy of time in the market and not trying to time the market, and the emergence of shareholder cash flow is structured for the long term. Furthermore, the size of the market opportunity in the U.K. is large and growing with a GBP300 billion savings gap and an increasing tax burden.

There's also a growing need for advice together with a significant intergenerational transfer of wealth in the near term. And then at the same time, they are not enough advisers in the U.K., resulting in an advice gap, a gap that we can only see getting bigger in the short term. And outside of the U.K., we see exciting incremental opportunities for our Asian business. And more on that later. So it makes total sense to look through short-term market conditions and Investor Day for the creation of long-term shareholder value.

Foremost is our investment in growing the size of the partnership, which, as you know, we do organically not through acquisitions, with an objective of a steady 6% to 8% increase per annum so as not to cause the company indigestion or cultural issues. As Craig has already mentioned, the partnership increased by 3.6% to 4,096 during the first half. This was through a combination of recruiting experienced, high-quality advisers together with 59 individuals graduating from the Academy. There are now 518 Academy graduates in the partnership.

This continues the sustained growth in the partnership over many years and provides us with confidence in our ability to both service existing clients well and attract new clients to SJP in future years. Increasing the partnership requires continuing investment in the supporting infrastructure. Consequently, we have recently opened a new office in Cardiff and will shortly be consolidating the London Academy, our existing city office, and a number of corporate functions into a new office in Lombard Street. And as aside, both of offices have very good environmental credentials.

We continue to invest in the professional development of the partnership and take pride in the fact that last year, one in four of all new qualified chartered financial planners were SJP advisers. We now have over 800 chartered financial planners across the partnership. And turning now to the Academy. During the first six months of the year, there have been five intakes for the Academy and two intakes for the Next Generation Academy attracting a combined 125 individuals. We have a further 7 intakes planned for the second half of the year, which we expect to attract a further 120 to 130 to the program.

There are currently 446 individuals in training across the Academy programs with a gender split of 68% male, 32% female and at average age of 34. This provides a strong pipeline for growth in the partnership in the years ahead. And as an aside, if after graduating these 446 individuals were to form a stand-alone business unit and in terms of number of advisers, they would have created a top 10 advice company in the U.K. With an average age of 34, they would also be by far the youngest advice company. Such is the scale of the Academy today. It has also been a good six months for growth in the SJP Asia partnership with a net increase of 17 partners and advisers, taking the total to 150, a 13% increase since the start of the year.

In addition, there's a strong pipeline of individuals that have applied to join our Asia business, boding well for future recruitment. Gross inflows for the business were GBP122 million in the first half, lower than the corresponding period in 2018, having also being impacted by client concerns over heightened market volatility and the U.S./China trade rhetoric. However, with stock markets haven't recovered since the start of the year, the St. James's Place funds under management increased to GBP800 million.

Work has continued broadening the client proposition across the Asian offices with the introduction of discretionary fund management into Shanghai and regulatory approval received for license to offer the same service in Singapore. Furthermore, the range of external providers of products and services has been widened in support of the greater client offering across our Asian operations. We're also investing in our discretionary investment management operation, Rowan Dartington. Here, gross new business for the half year was 11% higher at GBP303 million, taking the total investments introduced from the partnership to over GBP1 billion.

Total funds under management were up 17% for the six months to GBP2.71 billion. The number of investment executives remained stable during the period and is expected to remain so in the short term as we focus on increasing the quantum of funds managed by each executive. Now you'll be familiar with our investment in the back-office infrastructure system called Bluedoor. The first half of the year saw an intense period of activity as we come to the end of migrating all our U.K. business to the new platform.

In May, we completed the migration of our older pension plans. And over the weekend of the 20th and 21st of July, we successfully migrated a GBP22.2 billion tranche of investment bond business to the platform. All our U.K. business is now processed on a modern 21st IT platform, which provides us with the scalability to accommodate our growing business needs and greater operational resilience. It also will enable us to offer an improved service to clients going forward. We need to complete a number of internal system changes in the second half of the year before we can decommission the legacy system.

As Craig said, this will be a significant milestone for the business. The whole project team have done a terrific job completing what has been a complex multiyear project with little disruption The success of St. James's Place is built on establishing and maintaining long-lasting, highly personal relationships with our clients through the St. James's Place partnership. It is therefore pleasing that our clients tell us that they value our service. 89% of respondents to our biannual client survey, which accompany the clients' annual wealth account together with the new MiFID II disclosures, tell us that they were either satisfied or very satisfied with their overall relationship with St. James's Place.

Encouragingly, more than 93% said they would recommend St. James's Place to others and 54% suggested they had already done so. Furthermore, when asked to describe our proposition in terms of value for money, 96% of clients who responded said reasonable, good or excellent. And these results were on a par with previous client surveys. We've already responded to the feedback with further improvements in our service and proposition.

In the first half of the year, for example, we broadened access to the Flagstone cash management service, which provides a simple and secure solution for clients wishing to hold cash savings. To date, clients have placed some GBP700 million with this facility. We've also added new propositions relating to lifetime care plans to help clients ensure care fees can be met if the need were to arise in the future. In addition, more and more clients are expressing an interest in the important matter of how their investments are managed from a responsible investing point of view.

We continue to make good progress on our responsible investing approach and build on our integration of environmental, social and governance factors into our fund managers' investment decision-making. It is therefore pleasing that we have recently been awarded an A+ rating in the latest United Nations Principles for Responsible Investment annual assessment. Now the first six months of 2019 have seen a strong performance across major investment markets, reversing the falls experienced in the final quarter of 2018. Against this backdrop, our clients have benefited from very good returns with all our portfolios delivering strong growth.

In passing, I would remind you that a considerable proportion of our funds under management are invested in non-sterling assets, which will be benefiting from the recent weaker currency. In early June, we took the decision to move the investment management of our segregated mandate from Woodford Investment Management to a combination of RWC and Columbia Threadneedle. This was possible as the core tenets of our investment management approach is to appoint managers to manage our own funds through a sub-advisory mandate rather than investing into third-party funds.

Our segregated mandate limited the investments to liquid stocks and did not allow investments in unquoted stocks. Consequently, our clients continue to have full access to their investments. A good client outcome. I'm also pleased to report that St. James's Place has once again received numerous awards. A particular highlight was being voted the City of London 2019 Wealth Management Company of the Year. We have now received this award seven out of the last eight years, and I would like to thank our clients who voted for us. I'm also delighted that Ian Gascoigne received an individual award as Wealth Advisors' Personality of the Year.

There's a joke in here somewhere. But seriously, congratulations and well deserved. He didn't know I was going to be doing that. Before turning to outlook, a few words on yesterday's FCA papers on pensions including one proposing a ban on contingent charging to defined benefit transfers. Although this is a small part of our business where we have remained cautious, we will nonetheless be analyzing the detail of the consultation paper and responding in due course.

The FCA themselves reconfirm that a causal link between contingent charging and unsuitable advice is difficult to prove. Indeed, it is important to remember that the test of suitability, which of course is a key customer protection measure, must be met regardless of how the fee is charged. For these reasons, we are concerned about the potential for unintended consequences such as access to advice from the proposals.

Let's finish now on a few words on outlook. Experience tells us whilst inflows may be impacted from time to time by external factors that are beyond our control, our clients' financial planning requirements remain unchanged. And if anything, the need for advice is more pronounced in times of uncertainty. Therefore, in the short term, as the current external environment remains uncertain, confidence towards investing may remain tempered.

However, it is in times like this that the relationship between the client and the adviser are strengthened. But looking further ahead, the fundamental financial planning requirements of individuals remain considerable whilst at the same time the availability of high-quality professional financial advice continues to be limited. We are therefore confident that the strengths, depths and quality of the growing partnership together with the investments we are making in the business and our distinctive investment management approach, means that we remain well placed to continue to grow our business.

In addition, we have a strong balance sheet, and let's not forget there is GBP38 billion of funds not yet contributing to the underlying cash result. These funds will increasingly do so as each cohort of funds mature over the next six years. So that's it from me. Thank you for your attention.

And can I ask Craig and Ian to join me for questions.

Questions And Answers

A - Andrew Croft {BIO 5711239 <GO>}

We've got a few from the front here.

Q - Oliver Steel {BIO 6068696 <GO>}

(Technical Difficulty)

A - Andrew Croft {BIO 5711239 <GO>}

Is the mic on?

Q - Oliver Steel {BIO 6068696 <GO>}

Yes.

A - Andrew Croft {BIO 5711239 <GO>}

Yes. Okay.

Q - Oliver Steel {BIO 6068696 <GO>}

(Technical Difficulty) most of the funds in gestation by about 2 bps. And your guidance for the full year, net of gestation funds, is also up to 2 bps lower than for last year. You -- in the past, you've never ever guided to lower margins at the revenue level, so I'm just wondering what is driving that reductions in gross or net revenue margins. Second question is on Woodford fallout. I know it's too early to have seen anything by the end of June, but what's been happening in your funds since the end of June? And then the third question I've got is really on the dividend. So you're holding the dividend unchanged, which is insensible, but I'm just sort of wondering what sort of comfort you give on that dividend if looking forward over the rest of the year you actually see underlying cash flow falling year-on-year?

A - Andrew Croft {BIO 5711239 <GO>}

Okay. So I'd pick up the Woodford one to start with. We, as you know, have a segregated portfolio. So even if clients were concerned, they can switch out of that fund into different funds. We've seen, therefore, no fallout from, to use your words, all over from the Woodford position. And in fact, we've received quite a few positive comments from clients that they have found themselves in a different position to have some other friends of theirs. So there's no fallout there. On the dividend, do you want to say something first, Craig? And then I'll come and say something as well.

A - Craig Gentle {BIO 20095126 <GO>}

Yes. I think it was a forward-looking question. It's a tricky one to answer, of course, because we're thinking about the future. But if I think about the three pillars of confidence that we have, which is the demand for face-to-face advice, a proven capability of growing the partnership and the existence of that gestation balance, they're not going to change. They are with us. I can only really go back to the uncertainty. I don't think anyone in this room is in a position to give a description of what will happen over the next six months. And if anything, the emergence of certainties seems a little further away than it might have done when we stood up and had a similar conversation in February. But I really wouldn't underplay the importance of those pillars of confidence that we have. And I'll go further with the gestation. We've -- because of our business model and because of the inevitable pullback effect that it has on today's cash result, we've got a store of value that will emerge that I don't think any other business has. And that's incredibly important when you think about the medium to long-term. That GBP300 million will double the cash result in a six-year period.

A - Andrew Croft {BIO 5711239 <GO>}

And I'll add to that, and I'm going to go back to 2008, which is probably again the last period of this uncertainty. We didn't need to cut the dividend in 2008. We allowed the payout ratio to increase because, as Craig says, we have that certainty of the funds coming through gestation. We're also coming to the end of the Bluedoor project, so that sort of large number sat below underlying cash is going to disappear if not on the 31st of December, then hopefully shortly afterwards. But yes, that runs through the margin as well.

A - Craig Gentle {BIO 20095126 <GO>}

Yes. Obviously, Oliver, I can't comment on your modeling, but I suppose the important thing is, we've got different wrappers and there are different tax regimes that supply to each wrapper. It is fair to say those tax regimes are quite different. So if anything, what you have to and will see is a movement in that mix. So if we think about the fact that we now have a significant amount of pensions business, which will be a long-term change, although we are still writing a lot of investment business, that as a percentage is moving. So what you'll see is this thing morphing. And one of the reasons we've put the increased disclosure in is we believe there might be a better way of trying to get to a forecast of what that cash result might do over the next couple of years. Because in the past, I think what we've done has been good enough, but it's always been a little bit more than 77 or a little bit less. And what the 77 has done in the past is it kind of masked the complexity that sits beneath us. And one of the things that's always struck me is that we've given a guide on the gestation figure using 77 bps because it's consistent, but that's actually underplaying the value that is yet to emerge. And by the time you take all of the sort of mix of new business and the fact that that's coming into mature fund, the message we're giving is that you see something that looks actually broadly stable at the margin on mature fund level.

Now I appreciate this might involve some follow-on conversations with individuals. But the information that we've always published is in the report, but there's more there, and I think an easier way of getting our heads around how that will influence future results. Importantly, I made the comment that when you look at the rate -- the margin that we're now applying to gestation, the figure at the bottom of that table will now be the same figure that you see as the second line in the cash result. So it will be far more intuitive because I think, at the moment, people are modeling lots of different numbers, and then they all sort of come together. But if I use really, really simple language, our future cash result will be this is what we would have got if gestation wasn't a factor for the business. This is what we didn't get because of gestation. The note will explain how that will mature. And therefore, this is what we did get, and it will roll through. But yes, you'll see differences, but they're not differences in headline rates. They're mix differences.

A - Andrew Croft {BIO 5711239 <GO>}

And I think that's the important point is that the -- it's a mix issue if you see, and it could reverse if different things come into play.

Q - Colm Kelly {BIO 19140684 <GO>}

Thank you. Colm Kelly, UBS. Just two questions again on the margins and probably a follow-up to the last answer. So as was one of the benefits of the old disclosure was the resilience of the 77 bps on total AUM, which gave a lot of comfort to the market. Can you just give a little color on how the new margin on the cash that are on the assets that is generating cash has progressed in the last few years? I suppose my rough numbers, they have reduced consistently over the last three, four years. So should we be expecting that 65 bps on the assets that is generating cash to be moving down in line with -- structurally in line with the increasing mix of pensions business? That's the first question. The second question is on the margin that is assumed in the cash estimate from the assets in gestation, I think the assumption previously was always the 77 bps on those assets. I'm just wondering has there been any change on that assumption. And they are the two questions.

A - Craig Gentle {BIO 20095126 <GO>}

So two -- is that mine, Andrew?

A - Andrew Croft {BIO 5711239 <GO>}

Yes, it's all, I guess.

A - Craig Gentle {BIO 20095126 <GO>}

There's two aspects to that question. So we've now put in a number that you should probably recognize from your own model for 2018 for the mature -- the bps against mature fund, and we've given an estimate of what we think this year will be. It's very difficult to give long-term forecast, but I would see that being a stable figure over the next few years. And I made the point in the presentation that, if anything, that will go up a notch because of changes in plan, changes in corporation tax. I think it's something we'll update on frequently because there are lots of moving parts, but I see that as being a stable figure.

The question on the 77 bps, the short answer to the question is yes, it has changed. It's changed because if you ring-fence the wrappers that have gone into gestation, actually it's higher than 77 bps. So therefore, what the disclosures reflect are the actual amounts that will flow from gestation, not just the sort of a modeling perspective. It's the actual cash flows. And that's exactly why that table in future and end of the half year because it's simply half the amount -- the cash result is half the amount to emerge will be exactly the same figures. So they are the actual amounts that are not hitting the cash result as a result of gestation.

Q - Colm Kelly {BIO 19140684 <GO>}

Yes. I suppose just a follow-up again. There's always been that 77 bps assumption. So it's just whether that has changed, just to get clarity.

A - Craig Gentle {BIO 20095126 <GO>}

Well, the problem with 77 bps is that it is a very high-level composite modeling assumption. So the answer is it changes every year. Some years -- I mean I've had conversations with a number people in the room. Some years, it's probably understated it. Some years, it's probably overstated it. If I look at the way the mix is likely to evolve in the future, if anything at the moment, it overstates it. But I think the problem with trying to give a rational explanation as to what's happening, we've outgrown that method of communication, which is why I think we need to look at two component parts, which is the mature fund and the yet to mature fund. They are the two big components that I think we should be focusing on.

A - Andrew Croft {BIO 5711239 <GO>}

To reiterate, there is no change in margin at the gross level. This is all business mix, and that sort of stuff. Do you want to just pass it forward to Jon first because I did promise I'd get to Jon next?

Q - Jonathan Hocking

Good morning. Jon Hocking, Morgan Stanley. I've got three questions, please. Firstly, on the new business margin in the cash statement. Craig, you mentioned that there was operational leverage impact there. Can you just unpack that a little bit and explain to us what the some non-variable expenses are within that? Because that's, again, more than you expect from the level of gross flows year-on-year. And then coming back on the dividend, which Oliver asked about. I think, historically, you have tagged the dividend to a sort of payout ratio on the cash result, and that we also had a period where, post crisis, you built up a cash buffer at the holdco. Can you talk a little bit about whether those linkages actually still exist or not? Because you keep talking about uncertainty with the dividend. But actually in terms of value drivers long run, the adviser can set up the funds and set an all-time record levels. The operational leverage you've seen is negatively impacting the numbers, it seems to be on the gross flows rather than on the fund. So just trying to understand what the linkage is for the divi going forward, that would be helpful. And then just finally to come back on the sort of the 77 bps point again. So is the message here, the pensions business, basically has got lower revenue yield than the rest of the business? What makes you shift in that direction?

A - Craig Gentle {BIO 20095126 <GO>}

Okay. So there's three questions there. Shall I pick up the dividend one?

A - Andrew Croft {BIO 5711239 <GO>}

If you want to.

A - Craig Gentle {BIO 20095126 <GO>}

So both. I'll do the -- the new business margin, I made the point that if you do a really simple piece of modeling and just assume that there's a 7% movement, you would come up with a new business margin that's couple of million higher than the one we're reporting. And the reason for that is that, each year, we have to make an assessment of the -- some of the amounts.

This is by no means all of the allowances, but there are some things that part of the practices have to commit to ahead of time, which means that the when you set allowances, it's based on that years worth of performance, but that's relevant to the following year. Now in years of consistent growth, you never really see that. It's a constant small benefit. When you reverse from the level we were at in 2018 to 7% down, it just highlights that small amounts of gearing.

Q - Jonathan Hocking

So that's target-related commissions or...

A - Craig Gentle {BIO 20095126 <GO>}

No, no, I wouldn't describe it like that. It's a method of making sure that we pay an amount into the individual partner practices, reflective of the overall deal we have on reward, but there are small elements of it where you can't fix these things on a daily basis. You have to make a planning assumption that the business will grow by a certain amount. And every now and again, you find that the planning assumption doesn't quite work out. And yet, these are fixed commitments that businesses have, so it just rolls up. So it's something you only see in the maths when new business is lower than it was in the period where it was used to set some of that expense.

A - Andrew Croft {BIO 5711239 <GO>}

On the dividend, the -- our policy remains to pay out 80% of the underlying cash, knowing that actually there's some headwind if we need to use that headroom to go up. This is what's happened at the half year. I think it's gone up to about 90%. Is that like 90%?

A - Craig Gentle {BIO 20095126 <GO>}

Yes, over 90%.

A - Andrew Croft {BIO 5711239 <GO>}

And we can carry on using that, Jon. So as I've said, if we go all the way back to 2008, then we carried on the dividend. Anyone has -- I'm sorry, one more or not?

Q - Jonathan Hocking

Just a question on the mix.

A - Andrew Croft {BIO 5711239 <GO>}

The mix.

A - Craig Gentle {BIO 20095126 <GO>}

So if you picked up our product literature, you would see that there is different pricing. The tax complexity changes that as well. But if you were to look at individual components, the -- what you're really seeing is that Unit Trust, the nicer business, on the one hand, has a lower charge attached to it. But on the other hand, it starts hitting the cash results on day 1. So interesting. When you look at it on an embedded value basis, you're able to take the position we take, which is that this is going to be client-needs-driven.

At the other end of the spectrum, bonds are complicated because you've got different years and different tax regimes, and you've got pre RDR and post RDR. But in a nutshell, by the time you've taken the tax regime on bonds into account, that's probably a little higher. And then you've got pensions in the middle, but what's important is when you throw all of that into the mix and you see new business coming in and gestation maturing, you get stability in that mature fund margin.

A - Andrew Croft {BIO 5711239 <GO>}

Just pass it over your shoulder. Thank you.

Q - Johnny Vo {BIO 5509843 <GO>}

It's Johnny Vo from Goldman Sachs. Just a couple of questions. The first question is just if I look at the shareholder cash position, which you showed, and I look over a number of years, it's gone from a net cash position to a significantly net debt position, taking into consideration how much borrowings you've taken. Also, your borrowings have gone up quite dramatically in, your debt to debt plus equity is quite high by historic standards. And it's also consistent with your cash flow statement, which if you remove your financing, it's negative or 0.

So can you tell me what's going on with that? The second question just relates to -- in terms of the shareholder loans that you provide to your partners, how much of that is for assets that are internally managed versus assets that you are effectively acquiring externally? And of the loans, how much assets are the loans effectively backing? So if you get the question.

A - Craig Gentle {BIO 20095126 <GO>}

Should I get this?

A - Andrew Croft {BIO 5711239 <GO>}

Yes. We're going to have to get a question for Ian later.

A - Ian Gascoigne {BIO 4439479 <GO>}

I'm very much...

A - Craig Gentle {BIO 20095126 <GO>}

You can do these ones. So let's think about the whole, the sort of movement in the balance sheet and what the key drivers for that are, and also a reminder on this. So in no particular order, we plan some time ago to invest an enormous amount in our back-office infrastructure. That was planned. It was controlled. And what you see in terms of balance sheet evolution is the end result of that investment. So an important to make, we often talk about the end of the back-office migration and everything else resulting in that figure.

The bottom of the cash results no longer appearing. Well, importantly, what it also means is that we're not putting resource, cash resource into that project. So it was always part of the plan. It's happened, but that will cease to be the case once the project is complete. There's a little bit in there about growth of partner loans. If you get into the data, there's also some complexity because we have now something like a couple of GBP100 million worth of facility in some securitizations, GBP90 million of which is currently held by third parties. We have GBP30 million to GBP40 million, which we hold in notes.

So we still have the capacity, but the accounting rules require us to recognize all of this on the balance sheet. But at the same time, we also choose to originate loans on the shareholder balance sheet. And at some point, it's quite possible that those will move into new facilities that we've organized. So when you take all of this into account -- but also remember that as a business, we are different to some other businesses. And as much as we have at the heart of the group, a life company that generates a significant amount of profits that we generate. And it's different to any other company because the only really pay one dividend a year in a life company.

So you go through a whole year of generating -- I won't quite say the group profits, but a substantial element of group profitability and cash on the other side of it is generated during the course of the year, but you only pay the dividend in the following March or so. So there's always that stage. If you see the resources within the life company, you get a slightly different view. So it's a complex mix, but I think I've given you the sort of overall...

Q - Johnny Vo {BIO 5509843 <GO>}

So we shouldn't see the debt going up anymore?

A - Craig Gentle {BIO 20095126 <GO>}

I think in the past, if you go back to sort of pre-Bluedoor days, if anything, our debt looked a little on the low side. I think that the debt will evolve as we choose different funding strategies for the business loans, which I know I'll have to come on to in a moment. But I don't think I'll say it will go down, but where it is at the moment is where we plan for it to be.

A - Andrew Croft {BIO 5711239 <GO>}

Do you have any questions for Ian?

A - Craig Gentle {BIO 20095126 <GO>}

Can I just answer the question which I haven't answered, which is on the business loans? The best way to think about this is there's no -- there is an asset there, and the asset is our entitlement because of the way the plumbing works. So the cash flows from that partner practice. So it's basically secured on income that we know is going to happen. And unlike a third-party lender where they're dependent upon the borrower deciding whether or not to make a loan repayment, the way it works is it comes to us, and it makes the loan repayment and then the surface goes to the partner practice, which is one reason why if you look at the performance on that debt over the last number of years, it's -- there's been virtually no impairment at all. So it's all for the purpose of growing the business, safeguarding the business, and it's all secured on those future cash flows.

Q - Johnny Vo {BIO 5509843 <GO>}

And just the answer to the last question, of those loans, how much assets is it backing internal assets?

A - Craig Gentle {BIO 20095126 <GO>}

I couldn't give you the number of the assets that says backing because we don't necessarily think of it in those ways.

Q - Johnny Vo {BIO 5509843 <GO>}

Okay. In better value?

A - Craig Gentle {BIO 20095126 <GO>}

We will fill it more in the ways of how much of it is secured in terms of loan-to-value ratio on cash flows that we know will emerge. That's the important...

A - Andrew Croft {BIO 5711239 <GO>}

We got to bear in mind, it's not backed on our assets. It's backed on the future income of the partner's assets, okay? So you'd have to grow both sides of the balance sheet if you want to do that, that makes sense. Could you just pass over to Andrew, and then there's a few more over here.

Q - Andrew Crean {BIO 16513202 <GO>}

It's Andrew Crean from Autonomous. A couple of questions. For as long as I can remember, your establishment expenses grow at 10% per annum. And yet, you fund the Academy and you fund the IT outside of that. Your partnership, if you take out the Academy, is growing about 5% per annum. I don't understand why a large company like you should not get operational leverage by growing expenses as a lower rate than you're growing the number of partners you have. Why is that? And when will that change so you can get positive not negative leverage there?

And then secondly, you've talked for a while about publishing the consensus underlying cash EPS on the website so that Bloomberg can use it, so the market can have a reliable figure for your consensus earnings. Are you going to deliver on that in the second half?

A - Andrew Croft {BIO 5711239 <GO>}

I think they're both yours again, I'm afraid.

A - Craig Gentle {BIO 20095126 <GO>}

So establishing -- you're quite right. There are certain elements of our cost base that we've disclosed separately because in their own right, they've been quite significant developments and quite significant commitments of shareholders funds. I don't think it would be rightly to assume that once you take the Academy out of the equation, there's little else for -- to support growth or little else going into support growth. There's an enormous amount of activity that goes into recruiting experienced IFAs, for example.

So the Academy is an important part of our recruitment, but it's by no means the only part of our recruitment. And the bigger the numbers get, the more people we need to bring in and the more people we need working towards that objective. I'd also say that we -- I used the word infrastructure. This isn't about bringing people into the SJP fold and then looking elsewhere. Every time an adviser joins the SJP fold, we have to think about how are they going to be supported, how are they going to be supervised, in some cases, how are they going to be accommodated, how are they going to be integrated.

And every time those numbers grow, again, the level of activity changes. And then you have to think about the fact that we've got 2,000-plus of our own employees, most of whom have fallen to the definition of professionals, and you have professional wage inflation in that mix as well. So my main point there I think is I wouldn't underestimate how much of the residual amount within establishment expenses goes towards growth. And I would also say that it is almost spot on in line with the guidance that we put out in February because we made those decisions to invest even knowing that we were facing some uncertainty.

A - Andrew Croft {BIO 5711239 <GO>}

And in terms of your gearing point, I'm going to try and do these numbers from memory. But if we go back to 2017, business was up 27%, partnership was up 10%, establishment expenses was up 14%. So you saw gearing when you're getting high levels of new business in, but you see some negative gearing when obviously business isn't coming...

Q - Andrew Crean {BIO 16513202 <GO>}

It's just a straight thing. I mean the leverage of cost versus the growth in partner numbers. Yes, sometimes the partner is selling lots and sometimes less, but just big organizations tend to get operational leverage.

A - Andrew Croft {BIO 5711239 <GO>}

Yes. So the three drivers to the establishment expenses are the number of advisers, absolutely. And as Craig said, you've got to put infrastructure in for a pie pin. You've got normal inflation, and I think for that, you couldn't say professional wage inflation, but also you've got volumes of business as well to generate expenses.

A - Craig Gentle {BIO 20095126 <GO>}

Can I just make one rider point on that? And I'm sorry to emphasize gestation, but it is one of the things I'm quite keen to emphasize. When you look at the cash result and you think about what it all means, I think it's really important to remember that the nature of our business model, and there's no change here, is that the expenses you see this year are actually the sort of business-as-usual expenses together with investment that ultimately support all of that income coming through in six years' time. And although I think -- I'm trying a lot in the mix here.

You can almost get a false impression by looking at establishment expenses and they're looking at the GBP199 million that flows through from the top line. It's important to remember that the actual costs of building the partnership and supporting the partnership, doing everything else that's needed within the business come through immediately, but then you have that deferment within gestation, which I think paints a different picture.

A - Andrew Croft {BIO 5711239 <GO>}

Could we bring the mic over there? I think David and Andrew, I think.

Q - Andrew Crean {BIO 16513202 <GO>}

There's still an EPS question.

A - Andrew Croft {BIO 5711239 <GO>}

I'm sorry. I wasn't -- yes, I -- so in terms of delivering on a commitment, I certainly said I would consider that, and I am still considering it. So in terms of commitment, I think I am delivering on that. I think there are some real pluses we've spoken about them to doing this, and I'm very clear about that. But I also think there are some negatives as well when it comes to stale information or what have you. So we are progressing that. We are considering it. We can see the pros and the cons. And at some point, we will make a final decision, but I understand the sentiment behind the point.

Q - David McCann {BIO 15885639 <GO>}

Maybe this is one for Ian actually. Obviously, Andy made a couple of comments at the end about the contingent charging thing from the FCA yesterday. I mean if the proposals were to come in as opposed a pre shift, this is consultation at this stage, but if they were to come in as it suggests, I mean do you think you could adapt your charging model to accommodate what they're proposing, i.e., move contingent to a fixed fee type of arrangement for anyone who engages on advice? And then what might that mean for kind of flows kind of going forward and kind of the ongoing margins that the new business margins and the -- ongoing margins that might be expected from that business?

That's the first question, say, possibly for Ian. Second question, probably not for Ian. The miscellaneous items in the cash numbers. I mean this obviously moves around quite a lot. Is there a number that you can kind of guide us towards in the same way you do instead of deferred tax number, the GBP10 million to GBP12 million? Is this some kind of medium, long-term average number that you say is now a reasonable kind of baseline expectation that we could use there?

A - Ian Gascoigne {BIO 4439479 <GO>}

I'll take the first one. I think as Andy said, I think the paper only came out yesterday morning. For us, I think the issue is about suitability and quality of the advice first before the method of payment. And I understand what the regulators are trying to do here, but our immediate response will be the most important thing is the suitability of the advice and the quality of the analysis. Our concern at this stage would be unintended consequences of people pulling out of the market because if they're going to set the kind of bar of what they think is an acceptable level of payment for the quality of that advice, you may find people moving out of the market and therefore access to that advice being denied. And that's what we mean by unintended consequences.

We will be involved in the consultation. We will be speaking as and when things change. Maybe we will have to adapt our charging model in that particular area of our business if our partners want to partake in that particular part of the business in relation to the amount of work that's involved to do the job properly, and that's the reality of the market.

Q - David McCann {BIO 15885639 <GO>}

Maybe just a quick follow-up. I mean, Andy, you kind of suggested there was a small part of the pensions business. I mean could you elaborate on more precise kind of quantum we're talking about here.

A - Andrew Croft {BIO 5711239 <GO>}

We haven't disclosed that. We're not proposing to disclose that this morning same as we don't disclose how much inheritance tax business we do, et cetera, et cetera. Clearly, we may need to at some point in the future.

Q - David McCann {BIO 15885639 <GO>}

And then some miscellaneous items.

A - Andrew Croft {BIO 5711239 <GO>}

Miscellaneous.

A - Craig Gentle {BIO 20095126 <GO>}

Yes. So as I said earlier, miscellaneous is a pretty, pretty significant part of debits and credits, but I understand the sentiment behind the question. And I think the best answer to give will be that, if you go back a number of years that the guidance given will be that this might be a small positive, it might be a small negative. What we've seen over the years is that business has grown and what have you, is that, if anything, there's been a drift into this becoming a net charge.

So without lifting a lid on a huge number of individual amounts, some of which you might recognize, but I suspect the best guidance I could give is model for a large figure. I would always want it to be contained at the kind of level we're seeing because when it goes up above that level, I think then it's time to have a look and see if there's something else that needs to be pulled out if it's recurring. The challenge comes when it's not recurring, and you just got other items. So I think that's probably the best I can say at the moment.

Q - David McCann {BIO 15885639 <GO>}

By the current level, do you mean -- so we had that GBP10 million in the first half, so annualizing that to GBP20 million or...

A - Craig Gentle {BIO 20095126 <GO>}

Yes. I mean if you ask me do I expect it be another GBP10 million in the second half, I don't. But the nature of some of these things is that it's quite difficult to button down the moving parts. But I think what I am saying is that if I hear that somebody's modeling it to be nil because it might be a positive, it might be a negative, I think what I would say is that history tells it's probably not going to be nil. It's probably going to be more than that.

Now whether it's 7, 8, 10, 12, that's a degree of precision that I think I'll be unwise to try and guarantee that. So I think the general gist is that it probably -- you probably need to expect a higher level than perhaps people on average have done in the past.

A - Andrew Croft {BIO 5711239 <GO>}

David, do you want to pass it forward to Andrew?

Q - Andrew Sinclair {BIO 17749036 <GO>}

It's Andy Sinclair from BofA Merrill Lynch. Three for me, if that's okay. So firstly, just going back to dividend, just to clarify that. Would you be happy to or willing to go slightly above 100% of net cash given the outlook for the business and growth in the coming years to drift above 100% in that short term? Secondly, just going back to FCA publication. I'm looking at slightly different element, which is the discussion of up bridge device and for that, it could actually offset a lot of the discussion about contingent charging being removed.

And thirdly, apologies to go back to the guidance on margins. It feels to me that a lot of the confusion here is actually between multiple things being conflated, that we can't see the mix shifts going on. Would you be willing to give the margins product by product rather than actually -- and giving the guidance at that level rather than actually conflicting more together with both the runoff of surrender penalties and the gross revenues being conflated into one piece of guidance?

A - Andrew Croft {BIO 5711239 <GO>}

Should I pick up the dividend one first? I think, yes, we would be -- I got to mind the next exit in front of me here, sort of waiting to see what I'd say. Yes, I think we would be willing to go above 100%, depending upon where we could see that economic cycle in our -- if big business was picking up, markets were strong, then we would do, absolutely. Craig, do you want to do the net margin by product again? I think we talked about it.

A - Craig Gentle {BIO 20095126 <GO>}

Should I pick up the dividend one first? I think, yes, we would be -- I got to mind the next exit in front of me here, sort of waiting to see what I'd say. Yes, I think we would be willing to go above 100%, depending upon where we could see that economic cycle in our -- if big business was picking up, markets were strong, then we would do, absolutely. Craig, do you want to do the net margin by product again? I think we talked about it.

A - Andrew Croft {BIO 5711239 <GO>}

On the bridge, Ian might want to say a few words. Look, this paper came out yesterday. We've obviously got to study and look at it and figure out what it means. So I wouldn't want to try and answer anything now. But, Ian, I don't -- what do you...

A - Ian Gascoigne {BIO 4439479 <GO>}

Well, the only thing, Andrew, that strikes me is the issue over advice, guidance, abridged advice. I think that creating a confusion as to what process is there. And again, we'll be involved in the consultation, but I think that it needs to be really clear. There's too many potentials for confusion both for the client and the adviser and the business. So again, it is early to say, but my immediate reaction when I saw the term concerned me a little bit.

A - Andrew Croft {BIO 5711239 <GO>}

I think we're about out of time. But I'm conscious that a lot of the questions this morning have been financial questions, which I'm sure you can follow up with Craig and Hugh. I'm also conscious that we're all very much talking about the here and now. What we've got is the largest advice with the people, we've got the Academy. And I just want to finish up perhaps with, same to Ian, just want to talk about -- something about the partnership.

A - Ian Gascoigne {BIO 4439479 <GO>}

Yes. It was interesting. I was thinking, listening to Craig's presentation about -- and we talked about the value of gestation and our funds. And I actually looked at the partnership at the moment, and I see a kind of -- there's a gestation in a community of our advisers that is -- that you see when you walk around the place because the -- for example, the average age of the partnership now is 45, and it's come down from 48. Now I joined the business, I joined here 28 years ago when the average age of the partnership was 48, 28 years ago. So how do we get it down to 45, 28 years later? It's quite a grappling concept.

But we have a generation of what I would call brighter things than we've ever had before coming into this business. And if 800, 900 of them are the kind of start-up businesses and if we kind of think about the way we approach them and the long-term value of those businesses, they themselves are a form of gestation period but in a different part of the business. So we talk about the Academy as a training school, people come out, 517 graduates performing really well for us. But what we also know from all our experience is their average productivity increases with their experience post graduation.

The average age is 45. Peak age for advising is between 48 and 55. So again, productivity increases over time for that generation. So I think it was kind of hidden behind the numbers, but I just thought I'd share that with, very confident about the vitality that we've got in the partnership at the moment.

A - Andrew Croft {BIO 5711239 <GO>}

Okay. So I'm going to call it to a close there. So thank you very much for your time.