S1 2021 Earnings Call

Company Participants

- Andrew Croft, Chief Executive Officer, Executive Director and Member of Executive Board
- Craig Gordon Gentle, Chief Financial Officer, Executive Director and Member of Executive Board
- Hugh Taylor, Investor Relations Director
- Peter Edwards, Partnership Director & Member of Executive Board
- Unidentified Speaker

Other Participants

- Analyst
- Andrew Baker
- Andrew Crean
- Andrew Sinclair
- Colm Kelly
- Enrico Bolzoni
- Gregory Simpson
- Larissa van Deventer
- Oliver Steel
- Rhea Shah
- Steven Haywood

Presentation

Andrew Croft {BIO 5711239 <GO>}

Good morning, and welcome to our 2021 Interim Results Presentation. I will shortly run through the flows, funds under management, and the Partnership, before handing over to Craig, to cover the financial result. It'd then be back to me, to cover outlook, and lead the Q&A session, with the full executive team.

Having announced on our strategic goals in February, I've hosted an in-depth Capital Market event in May. Today's interim results presentation will naturally be shorter than normal, which will leave more time for questions.

Let's start by recapping on those medium-term targets we announced back in February. First, we aim to grow new business by 10% per annum, supported by a growing number of advisers and increasing productivity. Second, by maintaining strong retention of client investments, we will see net inflows also growing by 10% per annum. These flows, together with modest growth in investment markets would see funds under management reach more than GBP200 billion by the end of 2025. And third, while we will continue to invest in the business to support our continued growth and maintain our market leading position, the technological foundations that we have put in place, over the last few years, provide us with greater operating flexibility and efficiency, such that our controllable expense growth going forward will be around 5% per annum.

We then went on to say that the combination of these planning assumptions, together with the increasing cash emergence from funds in gestation over time, should provide for strong growth in the underlying cash result, over the coming years. So just six months into the five-year plan, how are we doing?

Well, let's start with the Partnership. During the first half of the year, we have a attracted a net, a 139 advisers to the Partnership, through a combination of recruiting experienced advisers and Academy graduations. That's growth of 3.2%. A good start to our 2021 ambition of growing the partnership by 3% to 5%. And this takes the size of the Partnership to 4,477. And I'm pleased to say, we've recently gone past the milestone of 4,500 advisers.

Furthermore, it's very encouraging that the pipeline remains strong, and we currently have 277 individuals at various stages on their journey through the Academy.

Looking now at productivity. After experiencing a tricky external environment over recent years, I'm pleased to say that the productivity per adviser is back on an upward trajectory, having increased by 23%, compared with the first six months of 2020. Although productivity is now more or less back to the highs of 2018, there remains plenty of further potential growth, as Peter Edwards talked about in some depth, at the Capital Markets event.

That strong growth in productivity, supported by the growth in the number of advisers, naturally flows through to new business. So I'm delighted to report that gross flows were up 27% in the first half of the year at some GBP9.2 billion. We have continued to experience strong retention of client funds, providing for net flows for the first six months of GBP5.5 billion, higher by 23% and equivalent to 8.6% of opening funds under management on an annualized basis.

We're often asked, why our retention is so strong? And I put this down to a number of factors. First and foremost, are the excellent partner/client relationships and the high quality advice and service. To pick up on the advice word, our business is advised, part of a holistic financial plan, which includes a steady hand for clients during challenging environments. Furthermore, client investments are both holded [ph] in tax wrappers and long-term in nature. It's not transient money or money following the latest trend or fad.

Then, as highlighted at our Capital Markets event, clients can switch between our funds and asset categories free of charge, and in most cases, free of a tax event. They also have the added benefit of knowing the assets are held on their behalf by SJP, and that we select, monitor, and where necessary, change fund manager. And finally for me, it's important to remember that our client relationships are well-diversified, as indeed are our adviser relationships.

And what do I mean by that? Well, put quite simply, whilst we are disappointed to lose any clients, an individual client withdrawing their investments does not have a real impact on the balance of our funds under management. Translating this into investment speak, I would say that quality of our earnings is very strong.

It also helps to explain, why we can be confident of strong retention in the years ahead, which together with new business will continue that historic trend of net inflows every quarter of every year.

I have to say, this is one of my favorite slides. It clearly demonstrates the resilience of the business, as we have recorded net inflows through all market conditions, including during those challenging years of the financial crisis back in 2008, and of course, the recent pandemic. And if we were to extend the chart back over the years, then the pattern of net inflows every quarter would be the same. I do not recall a quarter throughout our history where we experienced a net outflow.

Now also we're clearly delighted and very encouraged with this outcome. The strong growth compared to the first six months of 2020 should be considered in the light of the particularly difficult trading conditions last year. So perhaps a better measure of our progress is growth compared with the first six months of 2019, a period, where gross flows were GBP7.4 billion and net flows were GBP4.4 billion. On this basis, our gross and net inflows for the first half of 2021 represented compound growth of some 12% per annum over the two-year period.

Turning now to funds under management. Those net flows together with the positive impact of investment markets have resulted in funds under management closing the half, at a record GBP143.8 billion, up 11% year-to- date and 15% compound growth over the two years.

In fact, looking over the longer-term, funds under management have seen compound growth of more than 15% over 5-, 10-, and 15 years, a resilient performance through all market conditions, and another favorite slide of mine. Growth in new business and funds under management have resulted in strong growth in income, whilst controllable expenses for the first six months were modestly-lower than the first half of 2020. The combination of the income and expense outcomes, together with the increase in cash emergence from funds in gestation has resulted in a strong financial result. An opportune moment to hand over to Craig.

Craig Gordon Gentle {BIO 20095126 <GO>}

Thanks, Andrew, and welcome from me too. So this morning, I'll summarize the key areas of our half year reporting, namely the cash result, which should be seen as value emerging in the period as cash; the embedded value result, which gives an indication of value created, which will emerge in the future; and capital, all of which have shown good progress during the first half of the year. I'll also touch on the interim dividend declared this morning.

Let's start with the cash result, where we see a very different profile to that of 2020. Net income from funds under management increased by 27% to GBP278.2 million. This reflects higher mature funds under management, driven by new ISA and unit trust business, that's revenue-generating from day one, as well as funds in gestation maturing and therefore generating income for the first time.

Another key factor has, of course, been the markets, which have been consistently-strong for much of the first half, particularly when compared to the second quarter of 2020. The margin on income from funds continues to be within the guided range of 63- to 65 basis points, and this is the range you should continue to assume in your models.

I've touched on gestation already, but it's worth emphasizing that the first half result has benefited from somewhere in the region of GBP20 million from maturing funds under management. And at the 30 of June, we now have GBP47.3 billion in the hopper, which is yet to contribute. This balance based on some simple modeling assumptions, will generate an income stream of approximately GBP375 million of net income from fund in six years' time, or GBP1.4 billion cumulatively, by the end of year six.

It's worth noting that we're now beginning to enter the period where we will benefit from some of the significant growth years that followed pension freedom in 2015. The overall margin on new business has increased, broadly in line with the growth in new business and stood at GBP73.8 million. In our outlook statement today, we've indicated the potential for growth in new business in the second half of around 20%, and this should, for modeling purposes, mean that the margin on new business in the second half also grows by approximately 20%, compared to the second half of 2020.

Controllable overheads grouped together on this slide, reduced by 3%. It's important to note, however, that the operating environment has impacted on the phasing of expenses in 2021, and the full year outcome is still planned to be in line with the commitment that we set out in February. For your models, you should still assume 5% controllable cost growth for 2021.

Putting aside this, phasing of expenses, we made a good start to the cycle of investment that, Ian Mackenzie, outlined at the Capital Markets event, with a number of areas of focus, including the launch of Salesforce within the Partnership, and the development of our Next Generation Client Experience. Beyond that, we've also launched OPAL across the Partnership, which is a goals-based planning tool, that helps advisers support clients in defining and prioritizing their financial goals. All of these projects will support a superior partner and clients experience, and make SJP easier to do business with.

As we look to the second half, we have plans for further work on intelligent automation, on decommissioning peripheral legacy systems, as well as making further headway on our Salesforce roll-out.

Net investments in Asia is lower by GBP4.3 million, and this reflects good cost control, stronger markets and stronger flows, which were up by some 20%. This marks a further step towards breakeven in 2025. And in your models, you should assume a net investment for the year of approximately GBP14 million, which will be 20% improved on 2020, and will be in line with the path to breakeven, that Iain Rayner set out at the Capital Markets event.

Net investments in DFM is lower by GBP0.5 million. DFM has also benefited from strong gross inflows, up by 33%, and an increase in funds under management to GBP3.2 billion. At the same time, we've continued to invest substantially in futureproofing DFM operations. We've now agreed a deal to outsource our DFM back office to SS&C, which will be a game changer for this part of our business.

Further investments is planned over the next 18 months, which will influence the shape of the path to breakeven in 2024. But this is within the plan, and the expected outcome for 2021 is expected to be approximately GBP10 million with a similar amount for 2022. We will then see a sharp reduction in the net cost in 2023.

Taking all of this into account, the underlying cash result for the first half was GBP189.3 million, up some 65% half-on-half . If you ignore the outcome in 2020 as an exception, this represents compound growth of around 23% since the first half of 2019, which shows there's no sign of 2020 having impacted on our long-term growth trajectory.

The restructuring cost below the line of GBP9 million is the full charge for the year. And this, together with reversing variances takes our total cash result to GBP175.8 million. That's up by 41%.

I'll just pause here to mention the FSCS levy, which continues to be very high, and a real source of frustration for all adviser firms that work hard to do the right thing for their clients. Although, there's no sign of any short-term improvement here, we are, nonetheless encouraged by the attention this is receiving at the FCA. And we welcome their commitment to reduce the cost in the medium- to long-term.

I'll turn now to the embedded value, and there are a number of noteworthy impacts on the result for the first half. Firstly, in recognition of the fact that over time we've been keeping business on the books for longer-than-anticipated within our modeling, we've reviewed our persistency assumptions. As a result, we've booked a positive assumption change of approximately GBP250 million. Our revised assumptions remain prudent, but now reflect the gradual lengthening of contract duration that we've seen over the past few years, as highlighted by a steady stream of positive experience variances that we've been reporting.

Secondly, our EEV new business margin increased from GBP365.3 million to GBP525.6. This increase is primarily driven by a higher new business volumes but there's also a positive gearing effect as a result of lower expense growth. Added to this, is the benefit of longer estimated investment lives.

Finally, you'll see that since embedded value is a forward-looking statement, we've made an adjustment to reflect the effect of the tax rate change or the opening position, and this amounted to GBP408.5 million. We've also reflected the new rate in the operating profit after tax for the year, and this has amounted to an additional amount of around GBP50 million, which is in the main tax charge shown.

Taking all of this into account, the EEV net asset value per share at the 30 of June stood at GBP15.31. That's up 20% from the same point in 2020. And it's worth remembering that this doesn't take account of the additional embedded value of around GBP400 million that falls outside the current contract boundaries, and doesn't, therefore, get included. If it was, this would amount to an additional GBP0.74 per share.

Turning to capital. Given the simplicity of our business model and our prudent approach to capital management, our capital position remained strong. Our reported ratio has been somewhat distorted by the effect of the equity dampener over the past 18 months, which has little bearing on a unit-linked business such as SJP. Fundamentally, however, the structure and resilience of the business model means that we remain and we'll continue to be in a strong position.

Turning finally to the dividend. Back in February, we announced a simplification of the way in which we plan for interims, and these are now set at an amount equal to 30% of the prior year full dividend. In line with this approach, the Board has declared a dividend of GBP0.1155 per share or 30% of the total dividend for 2020 of GBP0.3849 per share.

Well, that's it on the results. Overall, this was not only a strong first half for new business, but also a strong first half generally, for the delivery of our financial results. A good start to 2021 that shows the business is in great shape and it bodes well for the full year.

With that, I'll hand back to Andrew.

Andrew Croft {BIO 5711239 <GO>}

Thank you, Craig. Strong gross inflows, strong retention, and strong expense discipline, combining to drive a strong financial performance. These results show, we have made an encouraging start on our journey to achieving those ambitious strategic goals.

But what is the outlook? Well, let's start by considering the remainder of 2021.

The pandemic, the various lockdowns and changes in investor sentiment have had a profound impact on the timing and value of flows in 2020, and in the first half of 2021. This will naturally result in a variable pattern of year-on-year growth and normal phasing of business.

Taking this into account, together with a strong start to July, we anticipate growth in gross inflows of around 20% in the second half, despite strengthening comparatives in the latter part of that year.

Looking further ahead, we remain convinced that the market for trusted financial advice continues to grow, whilst at the same time, there remains an adviser gap to meet this growing demand. Through the Partnership, we are ideally-placed to take advantage of this situation.

The Partnership continues to grow. There's a strong pipeline of industry-experienced recruits and 277 individuals training in are well-established Academy. We also consider there to be considerable scope for continued growth in productivity; all bode well for the future.

However, our progress will not be linear. It's important to remember, as I said back in February, and to repeat, there will, of course, be years, when new business is better or perhaps behind the medium-term target.

As we progress through our planning horizon to 2025, it's important to measure success on a cumulative basis, rather than discrete months, quarters or years. And what do I mean here? Well, let's take gross inflows. If we were to achieve our 10% annual growth goal in a linear manner, then the cumulative goal year-on-year would look like this: to achieve 10% growth in 2021, we would need gross inflows of GBP15.7 billion, the bottom segment of the column on the slide; then as we go forward, we would see a further 10% increase in gross inflows, in each of the subsequent years, providing for cumulative flow objective for the five-year period of around GBP96 billion. It really doesn't matter how we get there. Any variation from year-to-year is second order. Although, of course, the strong first half performance is an encouraging start and increases our confidence.

Now, I will finish with a summary of the results, which you can see on the current slide. A very pleasing, strong operating and financial performance by our business that is in great shape. And as demonstrated by these results, the combination of achieving our goals, together with that increasing emergence of cash, from funds in gestation, means, we will deliver strong growth in the underlying cash result, and consequently return to shareholders.

That's it. Thank you for your attention. And as a reminder, the live Q&A starts at 9:30 a.m.

Operator

Ladies and gentlemen, welcome to the St. James's Place 2021 half year results Q&A session. My name is Nadia, and I will be coordinating the call today. (Operator Instructions) I will now hand over to your host, Andrew Croft from St. James's Place to begin. So Andrew, please go ahead.

Andrew Croft {BIO 5711239 <GO>}

Thank you, Nadia, and good morning everyone. Welcome to the Q&A part of this morning's announcement. Now we set out our clear objectives back in February and we hosted the in-depth Capital Markets event in May. Clearly, we're really pleased that we've made a very encouraging start to meeting those objectives in the first six months, and also that July has started strongly. I'm also here today with my executive team who are on the call. So I think, at that point, we'll hand over to the first question.

Questions And Answers

Operator

Question And Answer

Thank you. Our first question comes from Andrew Sinclair. Andrew, please go ahead. Your line is open.

A - Andrew Croft {BIO 5711239 <GO>}

Good morning, Andrew.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks. Good morning, everyone. Well done, really good results. Today, the business really seems in great shape. Three from me as usual, if that's okay. Firstly, just on cash new business margin in percentage terms. Last year, I think I was a bit depressed because expenses were being spread across less new business than planned. We didn't seem to see a big pickup in the new business margin in percentage terms this year. Looks like flat year-on-year. Just wondered if you could get a little of that color on this and what we should see in terms of going forward in business margin, in percentage terms.

And the second is looking a little bit further forwards in terms of the tax rate change that will be coming in 2023. Insurance tax accounting figure is always pretty difficult for us to interpret, really wondered if you can give us any idea of what the impact that will be in both in terms of the new business margin and also that 63 -- 65 bps margin on mature from over the next few years.

And thirdly, just on recruitment where I thought the figures were super impressive, just really wondering if you can talk a little bit about the pipeline at the moment and further you're seeing a boost from advisors re-evaluating models after the turmoil of COVID, looking to join showing the support that someone like STJ can give them.

A - Andrew Croft {BIO 5711239 <GO>}

Okay. So let me pick up on the recruitment one first, and ask Peter to come in and support me. Look, we're very pleased with the start on the recruitment, and will always use opportunities to recruit high quality advisors, and you know we're six months into our five-year plan.

So, our objective is still to grow new business by 10% per anum, supported by experience recruitment, supported by the academy and supported by productivity. But as you say, it's an encouraging start, particularly with the 277 individuals currently in the academy. But I might just hand over to Pete just to talk about what we're seeing at that sort of (inaudible). Pete, if you're still there. Pete, you still there?

A - Peter Edwards {BIO 20875780 <GO>}

Hi, Andrew can you hear me?

A - Andrew Croft {BIO 5711239 <GO>}

Yep. We can hear you now.

A - Peter Edwards {BIO 20875780 <GO>}

Yeah. Sorry, hi. Thank you, Andrew. Yeah, with regards to the question around advisors having a look at the models and making decisions about their future, those of which are currently industry professional, so to speak. I think that is normal, that's something that advisory businesses would do on an ongoing basis. I think the pipeline for existing industry professionals is very strong.

Our selection criteria, as you will know, is high. We take a great deal of care with the people that we bring into the partnership, but we're very confident that the blend that we have, all people who are existing industry professionals alongside the academy, will help us achieve our medium-term growth target. So, yeah, lots of people reassessing their situation, but that is normal in financial services.

A - Andrew Croft {BIO 5711239 <GO>}

Thanks, Pete. And the first two questions, I'm going to hand over to Craig, very much the financial ones. Yeah. So, there were two there. One was on the new business margin. As we said before, this is a margin that has two key inputs as all margins do, costs and income, but the relationship between those isn't linear. So we do have an element of fixed cost within that and you're quite right as business came under pressure in 2019 and 2020, it did more to reveal some of those fixed costs.

We also have what you might describe as a semi-variable cost, say for instance, performance-related bonus schemes might fall into that category. So, you've actually got quite a mix of income and expense. The key thing that happened in the current period is that we clearly benefited from 27% growth, and that's driven an increase in the value of new business margin of about GBP13 million, and it just so happens that it has moved broadly in line with the growth in new business, but the net effects of all of those moving parts mean that the actual margin itself has stayed fairly constant.

It is worth saying that even if you take accounts of some of the ebbing and flowing of the margin, we're talking about relatively small numbers in the cash result and I think that's what we're going to see in the future. The guidance, I would offer for the second half in our outlook statement, we've said that we believe growth in gross inflows of around 20% half year on half year is realistic. And therefore, what I would say for the second half is that we should assume that the new business margin, half on half increases by 20% in terms of the value that that will deliver. But it is a margin that will ebb and flow in the future, because it's not linear. But I wouldn't expect much deviation from where we are at the moment.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Okay. Thanks.

A - Andrew Croft {BIO 5711239 <GO>}

And the second question, Andy was on the tax rate change. I'd be the first one to agree with you on the complexity of life accounting, but the good news is when it's -- when it's a fixed input, such as the rate of corporation tax, although there will be some complexity and it won't be a perfect adjustment if you just look at the change of the rates of corporation tax. Broadly speaking, if you just take the differential and apply it to each of the line items within the cash results, you will pretty much be there.

We're going to put something on the website later today, which brings that to life, and there will be no rocket science in there. It will be pretty, pretty intuitive, but that would be my starting point in terms of working out what the future of the cash result holds. For those people on the call to follow embedded value, obviously, because that's a forward-looking statement, you have to incorporate known changes at the points at which they're substantively enacted and that is the case with this tax rate change.

See, what you will see is that we've made an adjustment to what you might call the opening position in the embedded value, but we've also put an additional tax charge in to reflect the high rate of tax that will be in place as some of the value that's being created actually arises in the embedded value. And again, that's all within the report, but we'll make that clearer on the slide that goes onto the website later. So I think the good news, if there is good news attached to this, is that the impact will be relatively simple to model.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Okay. Thanks. Very helpful. (multiple speakers) very much.

A - Andrew Croft {BIO 5711239 <GO>}

Thank you, Andrew. Nadia, could we have the next question, please?

Operator

Yes. Thank you, Andrew. Our next question comes from Colm Kelly from UBS. Colm, please go ahead. Your line is open.

Q - Colm Kelly {BIO 19140684 <GO>}

Thanks very much, and again, well done on the results today. And just, first question on business mix. I think the first half, we saw higher proportion of ISA, unit trust, or investment business, relative to pension business that we've seen in recent periods and that's always important, because it becomes -- it generates more assets that are more cash generative straight away.

In terms of our product mix, that's just something you feel it will fluctuate from period-to-period, the balance between pensions and other products, or within the growth targets that you have to 2025. Do you have different expected rates of growth on those product lines, such that we should expect to see some sort of mix effect continuing into the future? And that's the first question.

Just a second question on solvency, and don't think there would be a Q&A session if it's not going to involve solvency, just a live operating entity solvency was 119%, which is well above the target of 110%. You do mention though that there's a management action taken in the first half, related to the modeling of market risk capital. I'm just wondering if you could explain that in a little bit more detail, what the change is there? And also how big an impact or benefit did that have on the life solvency ratio in the first half? Thanks a lot.

A - Andrew Croft {BIO 5711239 <GO>}

Okay. Thank Colm. And I'll take the business mix point and then hand over to Craig on the solvency. And just, -- let's talk about the 2025 role for a minute. We're not targeting specific business mixes, because it really is an advice business and the business mix will be driven by the advice. Clearly, over the last five or six years, we've seen a bigger swing towards pensions, and this year we've just seen more ISA business in the first quarter, and you will always see more ISA business in the first quarter.

I would say there is an element this year of people putting more money into ISA, because they had more savings. But we kind of expect the business mix to stay more or less the same throughout the planning environment, unless there's changes to legislation, changes to regulation, changes to the advice. So hopefully, it helps over to the solvency, great.

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yeah, thanks Colm. It's always difficult to keep Solvency II question-and-answer brief, isn't it, but I'll do my best. Principally, the management action lies in the fact that whenever you go down the routes of setting up a whole series of Solvency II standard formula model, you make certain assumptions around what happens, for example, in the end -- in the event of a 40% equity downturn and it's one of the various stress tests that you have to perform.

When we first put together our Solvency II, we made various assumptions which I would say were prudence assumptions, but enabled us to work through the Solvency II data in a straightforward manner, but we always knew would have resulted in, if you like a slightly more hair shirted answer, than would actually reveal itself in the event of a 40% downturn. And one example, might be the use of derivatives across our investment management's approach, which are there to provide for certain outcomes if the markets do behave in that way, and the important thing with all of this is to end up in a situation where you can point to one of those tests, that is what actually would happen and what we did with the benefit of better data, because as time goes on, there's always better data. I think Bluedoor has a role to play in that, for us in providing us with that sort of granular data.

We're able to take a more sophisticated approach and actually take advantage and take the benefit of some of those things that perhaps in the past we haven't, and that's work that's been ongoing, preparation for that was during the course of 2020, and the benefit has been booked in 2021.

In terms of quantum, I would say, it's not a sizable as the sort of volatility that the Equity Dampener offers, but it has resulted in a few percentage points of improvements in that ratio, and that's something I would expect to hold.

One of the reasons we did this is really very much linked with the reason why there -- there's plenty of consideration of Solvency II at the moment. What we've seen over the last two years is quite a lot of volatility coming out of the standard formula, that means that this sort of activity has greater value.

Q - Colm Kelly {BIO 19140684 <GO>}

Okay. Thanks a lot. (multiple speakers)

A - Andrew Croft {BIO 5711239 <GO>}

Could we go to the next question please? Nadia.

Operator

Of course. Our next question comes from Andrew Crean from autonomous. Andrew, please go ahead. Your line is open.

Q - Andrew Crean {BIO 16513202 <GO>}

Good morning, all. A couple of questions from me. Firstly, I think, historically you talked about the business -- business coming from SME's from people selling their businesses and then investing with you. I just wondered where we are on that cycle, in terms of the recovery from lockdowns, whether you're beginning to see material amount of business coming from people selling business or whether that's still up the line.

And then secondly, I think you talked about 277 people in the academy. I think if you go back over time, you had up to 400 people in the academy. Is there an intention to build the academy to a bigger number?

A - Andrew Croft {BIO 5711239 <GO>}

Okay. Thank you, Andrew. I'll answer both those, and perhaps ask Peter to come in and support me on the academy again.

As far as SMEs are concerned, you are correct, we do work with SMEs when they sell their business, because they're growing their businesses, is their retirements so to speak. And when they sell the business, they're looking for that financial planning for their retirement. There hasn't been much of that in the last two years, because of Brexit and obviously COVID. There's certainly indications that more activity is around with respect to that.

They tend to be I mean that's not masses and masses of these cases, but they tend to be large, sort of one-offs coming in from time to time, and when I say large one-offs, usually sort of 15 to 30 million, something along those lines. But definitely more sense for the people that are getting back into that sort of selling their business.

In terms of the academy, obviously, last year we suspended the academy which would have reduced the number, but what we've been able to do is use COVID as a big sort of learning lesson in terms of how the academy works, and there's a lot more online if you like, which means that the academy that used to be a series of places in London, Manchester, and it's adding (inaudible). We're now able to reach across the whole of the UK, because it can be done online. And at that point, I might just ask to -- Pete, just to come in and say a few other words.

A - Peter Edwards {BIO 20875780 <GO>}

Yeah, thank you, Andrew. So, the way we adapted and I made reference to this at the Capital Market's Day, the way we have adapted the training of the students in the academy has led to a blended approach of face-to-face training and virtual, as Andrew has alluded to. We do have a number of people in training at the moment as you said, it's about 277. However, we have intakes throughout Page 2 of this year and into H1 of next year, lined up in that free training engagement phase. So, we will see the numbers of academy students and then academy graduates increase over time, but one of the things we are very conscious of is taking our time with the growth of the academy to get back up to full speed, as the country emerges from lockdown and we're more able to do things face-to-face.

A - Andrew Croft {BIO 5711239 <GO>}

Thank you Peter. Nadia, could we move to the next question, please.

Operator

So, our next question comes from Louise [ph] Miles. Louise, please go ahead. Your line is open.

Q - Analyst

Hi, good morning, well done on the strong [ph] set of results as well.

A - Andrew Croft {BIO 5711239 <GO>}

Thank you, Louise.

Q - Analyst

And just three questions from me -- just three questions from me, please. So what would the proportion of flows that came from new clients versus existing clients in the first half? And how does this compare with like the normalized level that you see? I'm just trying to get a feel of how well advisors have done in the first half for attracting new clients? And then a question on inflation. How confident are you on the 5% growth in control of the expenses after 2021, even given the outlook for inflation that we're seeing? And then finally, a question on strategy. And in particular, on your proposition aimed at women specifically. I read somewhere that 53% of UK millionaires will be female by 2025, how well placed is (inaudible) to serve this growing segment of the market? Thanks.

A - Andrew Croft {BIO 5711239 <GO>}

Okay. Thank you, Louise. I'll probably take the proportion of flows and the diversity question, and ask Craig to pick up the inflation question on expenses. In terms of the proportion of flows, these are very round numbers and nothing's really changed over the over the years. But what you tend to find is about 50% of flows come from existing clients, and that's people on their financial journey, if you like to retirement or inheritance. 35% to 40% will come from introductions and referrals from existing clients and then the balance comes from other marketing client acquisition, if you like, initiatives.

Nothing has much really changed over the years. I don't think too much has changed recently other than those last year, those other marketing initiatives that might be a seminar about inheritance tax, because of the social distancing, they clearly -- we weren't able to have those. But it's small in terms of the sort of size of the numbers that we're talking about now. Very, very good question on diversity. So, thank you for that.

Now being a face-to-face advice business, there is no doubt that the people bond and transact with similar types of people, and so if we want to get more female wealth if you like, then ultimately we will need more female advisors. Now in terms of recruiting experienced advisors, there's a finite pool there, but this is where the academy comes into play and there's no reason why the academy cannot be producing 50% female, 50% male. And equally across all categories of diversity, and that's the (Technical Difficulty).

A - Craig Gordon Gentle {BIO 20095126 <GO>}

The inflation question?

A - Andrew Croft {BIO 5711239 <GO>}

Yeah.

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yes. Thanks, Louise. I would say that the start point to the answer of that question is that I'm certainly not planning any change in guidance, based on what we see on inflation at the moment. There's that killer question out there, is this short-term or long-term. We've planned on the basis that we've planned.

The other thing I would throw in there is that yes, there's inflation, but also as we increase our scale, we have better purchasing power and that is something we've experienced. So, we've got clear plans, we got a clear financial envelope and I'm not planning on any change of that guidance at the moment. If God forbid, we end up in an hyperinflationary environment, then there may be another conversation. But as we see things at the moment, the plan is the plan.

Q - Analyst

That's great. Thank you.

A - Andrew Croft {BIO 5711239 <GO>}

Thank you, Louise. Nadia, we could move onto the next set of questions, please.

Operator

Yes. So, our next question comes from Andrew Baker from Citi. Andrew, please go ahead. Your line is open.

Q - Andrew Baker {BIO 3694545 <GO>}

Hi, everyone, and thanks for taking my questions. So, just two left for me, please. First one is on retention. So, I understand you're confident in the retention outlook, but I don't believe that includes withdrawals. So, are you including or are you expecting any structural increase in the withdrawal rate over the longer term as your customer base ages? Or are you adding enough younger clients to offset it?

And then just secondly on the controllable expense. I know, you sort of reiterated the 5% growth in 2021. Previously, given sort of underpinning this was (inaudible) establishment expense growth, 25% growth in operational and strategic development costs, and 15% in academy expenses. Is there any change to this view based on sort of what you've seen in the first half? Thank you.

A - Andrew Croft {BIO 5711239 <GO>}

Yeah, I'll ask Craig, just to pick up the expense question first, then.

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yes. Put simply, there's no change. The point we're making is that half year, the impact of the operating environment has had an impact on phasing. But the guidance we put out at the beginning of the year remains very much in place and for anyone who has that hand, we pull together a table within the slide deck back in February, setting out what we expected the outcome to be on controllable expenses. And I would still assume that that's the case in any modeling you do for the remainder of 2021.

A - Andrew Croft {BIO 5711239 <GO>}

Thank you, Craig. And in terms of the withdrawals, again a great question. Thank you, Andrew. So, there's two answers to it, short-term and a longer-term answer.

If I do the short-term first, what we saw sort of roundabout, July-August last year was people reducing the income that they were taking from their plans, because quite simply they weren't spending it. So, therefore, you saw a pickup or a reduction in withdrawals. We expect that to -- that's going to reverse back to where it was previously. So that's the short-term one. And clearly, as people enter into a time, and they're going to be taking withdrawals from pension plans, et cetera, but the advantage of being a growth business, like ours, is that we're constantly adding a greater number of flows going in each year from younger clients. So, therefore, it's not shifting the dial at all. I hope that sort of makes sense.

Q - Andrew Baker {BIO 3694545 <GO>}

Great. Thank you.

A - Andrew Croft {BIO 5711239 <GO>}

Nadia, can we go to the next question, please?

Operator

Yes. So our next question comes from Oliver Steel from Deutsche Bank. Oliver, please go ahead. Your line is open

Q - Oliver Steel {BIO 6068696 <GO>}

Hi, there. Three questions from me. And the first notwithstanding what you said in your presentation, Andrew, is really about the (inaudible) flows from here. I mean June in particular, was an enormous month relative, and even if I go back to 2019, to go back to some sort of normalized year, you had, I think 39% or 34% growth. I can't even read my own writing, (inaudible) growth, June 2019 to June 2021. And how much both sort of A and B on that one? How much, given that you're going for only 20% growth in the second half of the year, you're clearly expecting significant slowdown in the growth rate versus the 2019 in the second half of the year.

So, I'm just sort of trying to sort of work out here on how much of the sort of exceptional surge we've seen and how much is still out there in the future. And then I suppose, the part B question is, if we do issue 17.7 [ph] billion net flows in the full year (inaudible) only with guidance. Is that a sustainable number? Is that a number you can grow from next year?

Second question, rather more quickly is turning back to Colm's cons question about ISA and Unit Trust growth. That -- I mean, that's basically been sort of minimal growth over the last three years, and suddenly we're seeing the surge. Is that element of the first half growth perhaps where we see the most exceptional element? Is that where we're sort of -- is that where there's basically being a sort of holding back of cash, as of the last 12 months, which was then just like a surge into the flows in the first half of this year.

And then the third question, I've got is about academy productivity. So something like half of the net increase in agents came from the academy as far as I can work out in the first half. And it's pretty important I guess to understand the academy's productivity. So the question I've got is, the big guidance you definitely experience you gave us in 2018 in that Investor Day about academy graduate productivity, beating average productivity. Year five or six, I think it was. Does that show -- does that still hold true or if not, how has it changed?

A - Andrew Croft {BIO 5711239 <GO>}

I suspect, I'm going to be picking up all these questions. I can see a big smile on Craig's face though. So, there you go. Let's do the academy productivity first. But nothing has changed, from sort of 2018 guidance. It takes people a little bit longer understandably, because they're establishing a business, they need to build a client bank, but after four or five years, they tend to cross over. But two other points fit in there, Oliver.

Firstly, is the sort of two strands to the academy that we've always spoken about. One is next generation. So, next generation will be sons and daughters, nephews and nieces working in a existing business. And then the second one is people establishing their own business. And I think we're mainly talking there about people who established their own business.

And then the other really important point is the average age is a good 10, 12 years younger than, might be even a bit more than that, than an experienced recruit. So, the economic value these individuals will add, will probably be for a longer period of time. So, hopefully, that answers that one. On the ISA and Unit Trust growth rate, I mean, a couple of things there and again it was probably 2018, I forget the dates now, but George Osborne increased the ISA allowance by 33%, and then it stayed flat since then.

So historically, what you would always seen is the ISA business as a minimum would be growing as the ISA allowance went up. So that's been some of the challenge over the last couple of years. There was no doubt in my mind, that people have put more into their ISA this year, because they've not been spending the money, which I think feeds into your first question.

And I want to go back to what I said in my presentation, is that the pandemic has really thrown up in the air, normal business patterns and comparatives. It's dangerous in my view to compare percentage growth with periods of the pandemic. If we look at the remainder of the year, then the third quarter is -- I don't like to use the word, but I will to sort of softer comparative of the year, and we've said that we got off to a good start in July, but then the fourth quarter is we started seeing business picking up in the fourth quarter.

So that's why we believe 20% is the right number. That isn't what we're targeting. If we can do 25, we'll do 25 in that situation. So how can (multiple speakers)

Q - Oliver Steel {BIO 6068696 <GO>}

Can I -- Can I just come back to you on that one though, because I was comparing the numbers to 2019, so pre-pandemic. Your June figure is up 39% versus June 2019. Your guidance of second half is up 9% or 10% of the second half '19. So I'm just wondering, are your numbers just exceptionally conservative? Or is there sort of something exceptional in the first half that we should be aware of?

A - Andrew Croft {BIO 5711239 <GO>}

I think there's definitely that pent-up demand in the first half. I mean, if you look at the first quarter this year, it was up 18% on the first quarter last year, that wasn't lockdown, sort of for first quarter, very, very strong.

Q - Oliver Steel {BIO 6068696 <GO>}

Thank you. Thank you very much

A - Andrew Croft {BIO 5711239 <GO>}

I answered all that. (Inaudible) Okay. Thank you, Oliver.

Nadia, can we turn to the next question, please?

Operator

Yes. So, our next question comes from Greg Simpson from Exane BNP Paribas. Greg, please go ahead. Your line is open.

Q - Gregory Simpson {BIO 18850594 <GO>}

Good morning. I just want to talk to a broad question on COVID and productivity. So productivity advisor has returned back to H1 2018 levels, but I'm just wondering what's your sense on the current COVID impact on advisors, presumably there's still not many face-to-face meetings going on, but it seems like advisors are quite well adapted to seeing clients virtually and maybe that allows them to have a broader client really.

So the basic question, do you think productivity is still being held back by a lack of face-to-face meetings or not so much? That's the first question. And just secondly, quickly on DFM, you mentioned, contracting DFM for outsourcing and it sounds like that's an important (inaudible) for reaching past break-even. Just to check with 2023, that you expect the impact on the cash results to be visible and is it something that's quite straightforward to implement that you have that existing relationship with (inaudible). Thanks.

A - Andrew Croft {BIO 5711239 <GO>}

Yeah, I'll pick up the productivity, and pass over the DFM question to Craig. Look, productivity is always an interesting one isn't it, and I'm going to refer back to what Peter Ed was saying at the Capital Market. We see plenty of scope for increased productivity going forward, partly because as you sort of pointed out there Greg, people are able to use more online stuff, making it easier for us to do business.

I don't get any sense of productivity as being how bad this particular point in time, by people not being able to meet, and indeed there are being plenty of face-to-face meetings in a socially distanced way, probably over the last quarter. But again we feel very strongly, some great scope for productivity gains in the future. Craig, do you want to do the DFM?

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yeah. So I mean, I use the expression game-changer, and I really think it is. What you might see as one of the final areas of substantial investments, and the reason we're doing it is what we have at the moment is a business that essentially has the same back office and IT systems as it did when we made the acquisition. So this time is always going to come.

You're quite right, I think you used the expression sort of tried and tested with SS&C. And boy, has that been tried and tested, as we went into lockdown and went through one of the most challenging operating environments, you can imagine. So we're very clear that we've got the right partner here and we're very clear that they've got the right back office infrastructure for us to use. And this is really about future scalability and efficiency.

And it just so happens, as the cost surpasses through and for that reason, having started and having planned to get the job done over a sort of 18-month time horizon, I would expect the DFM result to be somewhere in the region of net investments of 10 billion for '21 and '22, but because that then -- that period of investment comes to a sharp closed, you should then see in '23, a sharp reversal of that towards break-even in 2024. So absolutely no change to the break-even point that we talked about at the Capital Markets Event.

A - Andrew Croft {BIO 5711239 <GO>}

Okay, thank you. Right.

Nadia, can we go for the next question, please?

Operator

Of course. Our next question comes from Larissa van Deventer from Barclays. Larissa, please go ahead. Your line is open.

Q - Larissa van Deventer {BIO 21570130 <GO>}

Thank you. Just one quick question from me on Solvency II, you reported a ratio of 119%, recognizing that cases business was very different to your typical life insurance. Can you give us some color on how you think about the levels where the ratio should be? And what's the risk of (inaudible) being more severe than those that you model?

A - Peter Edwards {BIO 20875780 <GO>}

It's my turn to smile at Craig.

Okay. I'll take that up. So you're right. So, in the first instance, it's always slightly dangerous to compare solvency ratios between different life companies, because different business models will carry with them difference inherent risks and I would assert that we're at the lower end of that risk spectrum, because we're basically asset-backed and unit-linked.

So the risk that we think about as we work out, what's an appropriate ratio is, is operational risk. And all of the work we do is all geared towards scenarios that could result in some kind of operational stress and we often talk about a management solvency buffer. And the reason we think about that is it's very important to turn complexity into reality, and the reality is that as aboard on a life company, you have to figure out how much cash you want? How much reserve do you want? And, of course, liquidity within that, in order to solve a problem. And the problem that you're solving comes out of all of the scenario planning that you do and you are essentially come up with a lump of assets that is there to be deployed.

What we then do is think of that in the context of the Solvency II regime, and that's what's driven us to a conclusion over the years, which again is tried and tested at a 110% is the level that we would seek not to go below, which is lower than you'll see in another life companies. But you would be comparing that with other life companies that carries substantial risk.

The other thing that's just worth flagging is that this isn't the only thing you have to have on your dashboard in front of you. So as well as the Solvency II measure, obviously, because you always have to think about liquidity, and then you have to think about IFRS. And we had a number of conversations at this time, back in February, around the dividend guidance, where we thought very long and hard about the long-term impact that IFRS has, and that resulted in a deduction of a different dividend payout ratio. So all of that is in front of you, but basically, 110% is the number that we live with under Solvency II.

A - Hugh Taylor {BIO 20633614 <GO>}

Thank you, Craig. Nadia, could we go to the next question, please?

Operator

Yes. Our next question comes from Enrico Bolzoni from Credit Suisse. Enrico, please go ahead. Your line is open.

Q - Enrico Bolzoni {BIO 19966397 <GO>}

Hi, thank you for taking the question. Just a couple, very quick for me. The first one is on the competitive landscape. So the industry clearly is attracting a lot of new players that are coming in and offering slightly different things, sometimes partially overlapping with what you offer. Just wanted a comment from you on how do you see the competitive landscape is in the industry, is enough in a way to -- does it have space enough for everyone, or you see indeed competition increasing?

And the second question was on DFM. I mean clearly the industry for DFM is very fragmented. Again just wanted to ask you whether you have a feel for about possibly being (Technical difficulty) space or (Technical difficulty) your capabilities? Thank you.

A - Andrew Croft {BIO 5711239 <GO>}

Yeah. Enrico, you broke up on the second question. I think you might have been asking about acquisitions over here?

Q - Analyst

Yes, that's right. Sorry, about DFM space in the UK. Yes.

A - Andrew Croft {BIO 5711239 <GO>}

Yeah. Okay Fine. Let me pick up the competitive landscape first, and I think you're absolutely right, there's a lot of interest in this space. Quite rightly so, because it's incredibly exciting space to be operating in and you heard us talk before about, there being 10 million individuals in the UK marketplace, in our marketplace.

You've heard us talk about there being the advice gap. You would hear us talking about the complexity of the rules, the need for advice and you would have heard us talk about the very large intergenerational transfer wealth, sort of occurring in the UK. That's why it's a very exciting market and why there's lots of people interested in this space.

You know, we are one of the market leaders, so I think we're in a great space to continue to expand in that marketplace. In terms of the DFM, I'm going to pass you over to Craig again. Yeah, the plan for DFM is organic growth. When we made the acquisition, the plan at that stage was always for organic growth and that's proving to be a very successful strategy.

It's always inadvisable to say never in these situations. And so I would never say never. If we found that there was a small opportunity that was just too good to refuse, I think we would owe it to everyone, to give that due consideration. But I think the other criteria that would have to be met in that situation, if it arose, it would also have to be pretty modest, and the reason for that is that we already have a successful formula for growth that we're applying. So I think what I would assume for planning purposes is that this is not an acquisition strategy, but if something came along, that it was just too good to turn down. We would clearly feel obliged to have a look at least.

Okay, thank you. Nadia, can we go to the next question, please?

Operator

Of course. Our next question comes from Rhea Shah from Deutsche Bank. Rhea, please go ahead. Your line is open.

Q - Rhea Shah {BIO 20971663 <GO>}

Good morning, everyone. I've just got one question left, and if I can circle back to Andrew's questions on expenses, and you've already mentioned that there's going to be saving in the second half, specifically from the development costs. I know that there's going to be intelligent automation and salesforce within that, but how much of this is going to be implemented in the second half, and how much could we expect to see coming through in 2022?

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yes. Thank you, Rhea. But the -- the way to think about this. We've got very ambitious plans for investment improvements in growth. But within our controllable overheads, we've set a very clear financial envelope, and that's the financial envelope that grows by 5% a year. So the simple answer to your question as to what you can expect in 2022, is a 5% increase on the total cost for 2021, which itself will be 5% ahead of the total cost in 2020, because that's the envelope that we're working within. And it's that envelope that we have insight as we commit to the plans that we're in the process of committing to.

But the phasing point is simply and you sort of hope this is more a feature of 2020 and 2021. When you find yourself in lockdown conditions, the good news is it hasn't obviously impacted the topline, but it does speed -- it does impact on the speed of execution, particularly of projects, but we do expect to catch up with that in the second half. So, we expect that envelope to right itself during the course of this year. So put simply, the guidance that we put out at the beginning of the year, which projected into 2022 remains very much in place.

A - Hugh Taylor {BIO 20633614 <GO>}

Okay. Thank you. And Nadia, could we go to the next question, please.

Operator

Of course. Our next question comes from Steven Haywood from HSBC. Steven, please go ahead. Your line is open.

Q - Steven Haywood {BIO 15743259 <GO>}

Thank you very much. Good morning, everybody. And just following up actually on the previous question. Could you remind me of guidance and your strategic development costs, and they seem obviously low in the first half of this year. Do you see them back them backend loaded in the second half?

And then, secondly, from me, you've had a significant change in your persistency assumption with embedded value. Can you talk about whether this sort of assumption is now in line with your current experience? Or are you still being somewhat conservative on your assumption? And this is taking to account, using regular withdrawals, the surrenders and maturities, and taking into account all of the money leaving your funds. I noticed that obviously, you always provide your retention rate, excluding the regular withdrawals and surrenders. Why is this -- this is part of the ongoing nature of the business. I just wonder why you would exclude these from your retention rate? Thanks.

A - Andrew Croft {BIO 5711239 <GO>}

Okay, I might just pick up those aspects, just from a historical point of view. So, the way the embedded values working, if you look at the withdrawal rates, the withdrawal rates are assumed in the embedded value calculation for the new business profit, et cetera, et cetera. So that's why it's logical to map the attention that we talk about to the calculation of the embedded value.

Your other questions were around expenses and the change. So, I'll hand back to Craig.

A - Craig Gordon Gentle {BIO 20095126 <GO>}

Yeah. So, I go back to the guidance actually, because you're right. Strategic development costs are lower than you might have modeled for the half-year, but the point we're making here is that that will catch up in the second half. And I think for simple modeling purposes, the best way to think about this is the way we've structured the guidance, which is to lump them all together and think of them on a combined basis as controllable overheads.

And if you assume that year-on-year, those controllable overheads will go up by 5%. You will have the right overall number in your model, for the year. When we pull together the guidance, we said that there would be a 25% increase in operational developments, and we also combined with that strategic developments, and that's the basis on which we are going to be reporting at the end of the year. So that 25% increase on GBP 42 million in 2020, would take you up to about GBP 53 million, and I think that's what we're saying, you should expect to see on a combined basis at the end of the year.

Turning to the assumption change and embedded value, you've used the word conservative. I would use the word prudence, because prudence is a requirement when you produce an embedded value. What you don't want to be doing, is changing these things year in, year out.

So what you would have observed in our embedded value over the years is a stream of positive -- positive variances. And that's usually indicative of being on the right side of prudence within the embedded value. So, I would say what it does, is it takes account of everything we've seen over the past few years. You don't pick on any particular year So, for example, 2020, we would have had very strong experience, but that may not be sustainable.

What we've done is we've looked at it over a very long period of time and concluded that now is the right time to change the assumptions that go into the embedded value. And all of this is geared towards what an actuary would call a best estimate, but within that best estimate, there is always a degree of prudence, because that is essentially a requirement.

A - Andrew Croft {BIO 5711239 <GO>}

Okay, thank you. Nadia, could we go on to the next question, please?

Operator

Of course. Our next question is our final question, follow-up from Andrew Crean from Autonomous. Andrew, please go ahead. Your line is open.

Q - Andrew Crean {BIO 16513202 <GO>}

Good morning. Thanks for taking the second question. It's a point of clarification, actually. On page 20 of your results, you say that the funds in gestation will contribute about GBP 22.2 million to the 2021 result, as they come out of gestations, earning a fee. And then in the slide, you said that there was about GBP 20 million benefit to net income in the third half due to maturing gestation plan. I might conclude, therefore, the benefits in the second half will be GBP 2.2 million.

A - Unidentified Speaker

I'll take that. No, no, that's not the case, Andrew. Because if you think about the disclosure here, what we're saying is for the remainder of 2021, there will be an additional GBP 22.2 million contribution and that's on top of GBP 20 million that we've already seen coming through.

Q - Andrew Crean {BIO 16513202 <GO>}

Okay. So, it's H2 '21. Okay. Got you.

A - Andrew Croft {BIO 5711239 <GO>}

Yeah, Andrew. So what we're saying is the little table you see there for 2021, because we're at the half-year point, is six months. It sort of also explains the step-up to next year and the year after that situation.

I think that probably comes to an end of the questions unless anyone's got any final questions. If not, just to say thank you very much, for taking the time to both watch the presentation and participate in the questions and answers. No doubt as you go through the body of the accounts, you might have some other queries and Hugh is the first person to contact there I think.

Now Craig and I are now both smiling at you, as we leave you there. So thank you very much everyone, and have a good day.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for joining. You may now disconnect your lines.