Business Update Call

Company Participants

- Mark Satchel, Chief Financial Officer
- Paul Feeney, Chief Executive Officer

Other Participants

- Andrew Sinclair
- David McCann
- Gregory Simpson
- Gurjit Kambo
- Paul Allen

Presentation

Operator

(Call Starts Abruptly) This conference call is being recorded. Today I'm pleased to present Paul Feeney. Please begin your meeting.

Paul Feeney {BIO 17570862 <GO>}

Good morning all. Many thanks for joining us at short notice today. At our full-year results we promised that we would get back to you on the strategic review of our International business. And as this morning's announcement makes clear, we've now concluded that process. So, let me give you the high level context; Mark will then walk you through the financial implications and expected timeline to completion; and then I'll talk to what it means for our strategy; we'll then take questions.

Right, let's dive in starting with Slide 3. I'm delighted to announce that we have agreed terms to sell our International business to Utmost for approximately GBP483 million in cash. It was the best bid, which emerged from a competitive process involving a number of bidders. And the terms of the transaction provide very little residual risk to us. And it's a good deal for all stakeholders. Our shareholders get a great price; the customers of our International business get a new owner, who will view this business as core; and it will also provide a range of career opportunities for the employees in our International business today.

Now back at the full-year results, I said that international had been a good business for us and all options were on the table. So, why are we announcing a sale today. Essentially there are two reasons; one strategic and one financial. First, strategic. While international delivered a solid contribution to our profits and cash generation, it is less aligned to our core UK business and the level of integrated flow is fairly modest. So, we concluded that it makes more sense to double down on the area, where our opportunity is most compelling, the UK wealth market.

As you know, this market is large and structurally growing. So, focusing here is more sensible than allocating valuable resources to try and deliver a similar rate of growth from the International business. Without international, Quilter would be a nimbler, simpler, faster growing business. That's why we are also restating our target for NCCF growth to at least 6% today.

The second reason is financial. As you know the revenue line in the International business has been going backwards for the last few years. We've managed to offset that through strong cost reductions to support profitability. But there is only so much you can do to drive profits by reducing costs if revenues are not growing.

So, while the team have done a great job maintaining profitability over the last few years, the impact of the back book run-off cannot be avoided forever. We would have to make considerable investment both in terms of P&L cost and capital to drive the International business forward from here. As a result, we have concluded that a disposal delivers the greatest value for shareholders.

Now moving to Slide 4. As you all know capital discipline is a key focus for us. When we sold our single strategy asset management business, we use the proceeds to repay a GBP300 million bank loan, which we took out to fund a pre-IPO distribution to our shareholder. And we followed it with another GBP220 million special dividend post listing.

When we sold Quilter Life Assurance, we announced we would return the entire net sale proceeds to shareholders through a share buyback and we're making good progress here. And we are saying today that we are minded to return the majority of the proceeds from this sale to shareholders after allowing for costs, a contribution to the 2021 dividend and some investment in the business.

What do I mean by minded? Essentially, if we had the money in our hands today, we would be happy returning that majority of the net sale proceeds to shareholders. But we don't expect this transaction to complete until later this year or early 2022. And as we've learned over the last year, the world can change fast. So, while we plan to make a meaningful distribution, the Board will take stock of the financial and business conditions prevailing at completion, as well as the opportunities to invest and accelerate growth, before deciding the amount and means of a distribution. And it goes without saying that this is something that we'll continue to consult with our shareholders about as well.

Right, let me hand over to Mark to talk through the financials. Mark?

Mark Satchel {BIO 18275874 <GO>}

Thanks, Paul, and good morning all. Right, so I'm starting with Slide 5. As you know, the International Life businesses tend to be valued at a discount to own funds, rather than a multiple of earnings, given their complexity and capital intensity. We think we've achieved a very good valuation at 84% of ends 2020 own funds, particularly given the nature of the Quilter International back book.

The total consideration is made up of a base consideration of GBP460 million and a ticker, which is interest income on net figure from the 1st of January this year until completion. So, if we complete on 31 December, 2021, that is worth GBP23 million, hence the GBP483 million.

Costs are expected to absorb around GBP33 million, leaving net proceeds of GBP450 million. Given the size of the transaction, it will require shareholder approval at a general meeting and we will be issuing a Class 1 circular to support the approval process. It also requires regulatory approval in each of the five main jurisdictions in which our International business operates and there is an EU antitrust approval requirement too. So, we need three main things to complete on the transaction: our shareholders' approval, regulatory approvals, and the antitrust approval.

In terms of use of the GBP450 million proceeds, first we expect to allocate a portion to cover Quilter International share of the overall Quilter 2021 dividend on a pro rata basis to this year's earnings. Next, as Paul has said, we are currently minded to return the majority of the proceeds to shareholders following the disposal and we will update you on that at completion. Finally, we also intend to reinvest a portion of the proceeds into our core business to fund selected revenue growth plans and to help optimize the cost base. We will update you on our detailed plans at a Capital Markets Day that we are planning in Q4 this year.

Let me now turn to the impact of the sale on our financials and what we expect from here on Slide 6. Our International business made an IFRS profit of GBP57 million in 2020. You'll recall that at the full-year results announcements, I referenced the group benefiting from a total of some GBP42 million of tactical cost savings.

Quilter International contributed some GBP8 million of that through lower variable compensation, reduced travel and lower change in marketing spend. Without that benefit, the profit contribution from international in 2020 would have been around the same level as that of the prior year and our expectation is that, if we retain the business its profit trajectory would trend downward from here, without meaningful restructuring actions and investments in the business.

Turning now to the operating margin, as you know Quilter achieved an operating margin of 25% for 2020. Quilter International has a high margin legacy run-off book, which gives it a higher operating margin than the group average. Excluding international, the ongoing Quilter business delivered an operating margin of around 20% last year.

Now you've heard us say on a number of occasions, that we believe our business should have an operating margin that starts with the 3, and we believe that is what our UK business should be achieving.

Based on our current plans for the continuing business, excluding Quilter International and assuming broadly stable market conditions with some normalized equity market growth, we expect to get an operating margin of at least 25% by 2023 and at least 30% by 2025.

Flipping to Slide 7, let me now say a few words on capital. I know one of the first questions I'm going to get is whether there is scope for a change in our capital regime. This is something we intend to discuss with our regulators. It's important to caution that we do expect to remain group Solvency II regulated for the time being because all the pension assets on our UK platform are held through a life company.

So, on technical grounds, we remain a group Solvency II regulated group, regardless of where the Quilter International is part of the group or not. By swapping the value in force VIF, in the International business for cash, we expect the capital and cash positions of the group to be materially enhanced immediately after the transaction, before considering the return and redeployment of the sale proceeds.

As I said earlier, the International business will contribute its share to the Quilter full year dividend on a pro rata basis to earnings. In effect this means that partial distribution of the net sale proceeds in the form of the full-year dividend. That is also what we did in 2019, when we sold Quilter Life Assurance using a similar locked in box mechanism. So, you can regard the 2021 Quilter full-year dividend as effectively based on the same corporate perimeter, as the 2020 dividend. And our dividend payout policy remains unchanged. We've also announced today that we'll restart the share buyback shortly to continue returning the Quilter Life Assurance sale proceeds, and we're aiming to accelerate the program by removing the 50/50 LSE-JSE split that was in place last year.

Turning now to the timetable on Slide 8. The main points to note here are that, as I said earlier, the transaction will require shareholder and regulatory approval. We expect the Class 1 circular to be published in around six weeks and for the General Shareholder Meeting to follow some five to six weeks after that. And that's a slightly extended timetable than you might typically expect, due to [ph] I need to mail our documents in South Africa. If all goes to plan on the shareholder and regulatory front, we expect that the transaction should complete by late this year or early in 2022.

Just before, I hand back to Paul, let me show you Slide 9, which you will recognize as a summary of our financial guidance. The key changes that I would highlight are; a revised expectation of growth in NCCF from 5% to 6%, which is just the mathematical adjustment from excluding the slower growing Quilter International from the ongoing business; a new target for our operating margin; a higher overall group tax charge once release the benefit of low tax earnings from the Isle of Man based business.

Finally, you'll note that the revenue margin for the International business in 2020 was broadly in line with the group average. So, the disposal will not have much of an impact on the short-term margin, but we think a future drag is removed, which should lead to increasing stability over time.

And with that, let me hand back to Paul.

Paul Feeney {BIO 17570862 <GO>}

Thanks, Mark. I'm now on Slide 10. Since we listed back in 2018, we've had two main objectives to simplify our structure and to deliver on the growth potential of our business. 2021 as seen has made two key strides here, selling Quilter International delivers a major simplification and it leaves us with a faster growing core business, and completing the migration onto our new UK platform sets us up to deliver a meaningful acceleration in growth.

This slide shows the new Quilter on a page. We cover all three parts of the wealth value chain; financial advice, platform and wrappers and a full range of investment solutions. That covers the full spectrum from bespoke offerings for high net worth clients to unitized and managed portfolios for the affluent and mass affluent market. What also sets us apart from our peers is our two strong distribution channels, our own advisers and the third-party open market IFAs that we serve.

And as I alluded to earlier, we think the revised perimeter of the business should be capable of delivering NCCF in excess of 6% of AuMA through the cycle, with the UK platform running ahead of that level. So, we will now be targeting that as a minimum over the medium term from 2022 onwards.

So in summary, on Slide 11, we are delighted to be announcing this transaction today with the sale of Quilter International and the completion of PTP earlier this year, the heavy lifting to transform Quilter is now behind us. The foundations are in place to deliver on our next phase of our journey. Our focus is now on driving growth and efficiency. And under new ownership, our International business will be free to invest in its core franchise and to deliver for its customers, employees and new shareholders. And I wish them well for the future.

Now, let me open up for questions.

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions) Our first question comes from the line of Andy Sinclair from Bank of America. Please go ahead.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Thanks, and good morning, everyone. Well done on this disposal. Three for me as usual sounds, okay. Firstly, you've talked about material capital return, but also said about funding selected growth initiatives. You also just said that the heavy-lifting to transform Quilter is now behind us. So, should we think about those growth initiatives, just adding some more financial advisors, maybe capabilities for Quilter investors rather than anything transformational in terms of M&A? That's question one.

Secondly, just from looking at the new operating margin targets, how much of that should we think just the original partner effectively adjusted for the QI disposal? How much is newly expense opportunities? And how much is deployment and so those new growth initiatives?

And thirdly, perhaps a slightly tricky question. Look we know at 1st of April, just wondered if you could give us any color on Q1 trading? And how you feel just now about the 5% target for 2021? Thanks.

A - Paul Feeney {BIO 17570862 <GO>}

Thank you Andy, it's Paul. So, I will have a go at number one and number three, and hand over to Mark for number two on operating margin targets.

In terms of material capital return, as we said, if we had the money in our hands today, we'd be making that very meaningful -- meaningful capital return to shareholders now. Of course, it is we are -- we have positioned Quilter front and center in one of the UK's, if not the UK's fastest secular growth market in financial services, the UK wealth market, particularly the retirement-driven UK wealth market and that's where Quilter is now positioned.

So, clearly there are opportunities there. We are not saying -- we're certainly not saying that we want to, can afford for major transformational move, but clearly there are opportunities to accelerate our growth still further. So, we will consider those and obviously we'll update and we will update back at the Capital Markets Day in the fourth quarter.

In terms of Q1 trading, I think our update is on the 21st of April -- 21st of April. I have said already that I'm pleased with what I'm seeing in the first couple of months of the year, given our new platform is in. That's being driven by our new platform. So, that's nice to see. Obviously, it's early days, but so far so good. Put it this way, I take what I'm seeing at the moment. But we'll update you on the 21st of April.

And in terms of margin targets, how much when you expense opportunity --

A - Mark Satchel {BIO 18275874 <GO>}

So, Andy, look, when we set out optimization phase 1 couple of years ago, I spoke then about what was imprimatur and what was outside of the sort of the Board promote [ph] that we were looking at is a phase 1. And I spoke about a phase 2 to come.

So, clearly this builds upon phase 2 because there's now, it's quite a different business construct with the opportunity there. So, there is a -- within what we do and it's a combination of what we previously planned to do, but then more because we've also got a substantially change to the business perimeter to actually work through on that.

So, a large chunk of it is coming through on the expense side. But there are also additional revenue enhancing initiatives that we are considering. And we'll update you on that later on this year, as Paul mentioned. It's a combination of the two.

Q - Andrew Sinclair {BIO 17749036 <GO>}

Understood. Thanks. Thanks guys.

Operator

And the next question comes from the line of Gurjit Kambo from JP Morgan. Please go ahead.

Q - Gurjit Kambo {BIO 6300383 <GO>}

Hi, good morning guys. Yes, congrats [ph] on getting the deal done quickly. So, just two questions from my side. Firstly, just in terms of the -- I think Paul you said, if you have the cash today, you would give majority of that back. I guess, just thinking about the M&A environment, the reason you give it all back is it, because you don't see many gaps in the course we're offering? Or if there was any M&A out there, maybe valuations are too high? Just you know, the landscape currently, if you were -- if you had that GBP450 million in your pocket today, why you'd give it back rather than maybe doing something else with it? That's first question.

And then secondly, just in terms of sort of stranded costs, if we think about adjusting our models to excel Quilter International. If we take the revenues out, how should we think about taking the costs out, do they all come out or will there be some, which stick around for a couple of years?

A - Paul Feeney {BIO 17570862 <GO>}

Thanks Gurjit. Well, I'll take the first question, and then hand over to Mark for the second one.

It's actually nothing to do with that. We see the opportunities in this market, which we see as significant, as a completely separate decision to the fact that we're going to have a chunk of money. So, the fact that we have announced today, the sale of International GBP483 million. Just because we'll have that money, doesn't mean to say we shouldn't make -- we should make it.

If we felt that was good opportunity for significant investment, we talked to our shareholders anyway. So, I think the two are separate. Yes, we always take a decision first, what is the right strategic thing to do; this has been the right strategic thing to do.

Commercially, we got a great deal, which makes it even better. Now separately, we look at the market, we do see growth opportunities; we see opportunities to accelerate growth. But at the same time, we're very well aware, this is our shareholders' money. We've always been very capital conscious. And so we intend to make a meaningful return of that capital. But it's basically we see the two separately. So, if you're asking me do I see opportunity to accelerate growth? The answer is yes.

But at the same time, it's our shareholders' money, and we're very well aware of that. So, it's nothing to do with the share price. It's nothing to do with the fact that we've got cash; we've got cash in hand. It's to do with two separate decisions. And we're going to update that to say at the Capital Markets Day on that. Mark?

A - Mark Satchel {BIO 18275874 <GO>}

Gurjit, on the stranded costs, we've got about GBP8 million of stranded costs immediately after completion, is obviously work that we'll be doing between now and then in order to minimize the impact of that. Probably around about half of that is kind of the more you remember on the side of (inaudible) we spoke about sort of stubborn stranded costs. And half of that is at the most of the stubborn end of the spectrum. But that's all fully incorporated in the 23 and 25 guidance that we provided to you. And that will obviously also form part of the overall next phase of the optimization initiatives that are being considered.

Q - Gurjit Kambo {BIO 6300383 <GO>}

Okay, great. Thank you.

Operator

And the next question comes from the line of David McCann from Numis. Please go ahead.

Q - David McCann {BIO 15885639 <GO>}

Good morning all. And two questions from me. The first one's partly been addressed already, but maybe asking slightly in different way. Just related to the new operating margin target for the group. I mean clearly to get 25% medium term and 30% longer term from the kind of base of 20%, where you are, I guess today that is quite an uplift in where you can talk about further.

I appreciate that you're going to give some details on the Capital Market Day. But I guess could you give us just a little bit more color on the main drivers of this short, so I mean if there's more cost reduction in a more significant sense, is it combination of high growth, the top-line kicking it. Is it something else, just a bit more color just so we can get a bit more comfortable with that at least a big uplift you're now talking about over that time. That's I guess question one.

Second question is on the balance sheet, appreciate there is a little bit detail on the slide in terms of the solvency capital ratios themselves. Maybe could you just walk us through some of them, the matters to what this actually does to your own funds and the regulatory capital requirements component of that rather than just because of overall percentages you have, just like to understand those moving parts, what the deal (inaudible).

A - Paul Feeney {BIO 17570862 <GO>}

Okay. Thank you, David. It's Paul. I'm going to hand to Mark for both of these, but just very quickly on the first one. It's a two goals that I've said, we've now got growth and efficiency. So, once -- one of course, speaks to growth in assets, growth in revenues, growth in flows. And the other speaks to efficiency and costs. So, Mark do you want to add some on the operating margin stuff.

A - Mark Satchel {BIO 18275874 <GO>}

Paul, that's entirely right. I mean David, this is a meaningful contribution from costs and that's -- some of that's been planned anyway. That's provided in previous guidance, when I've spoken about optimization phase 2. That as I have referenced already this sort of changes the perimeter of that the in scope items on that relatively significantly. And then there is also revenue growth opportunities too. So, it's both. It's not either or. And it's probably sort of relatively similar measures across the Op margin.

On the solvency capital, so you've got the own funds number in there. The capital requirements for the International business of GBP300 million odd. It reduces that part of the SER that effectively moves the SER from approaching 900 just under 600, is the -- in rounded numbers the impact that has on capital requirements. And on a Solvency II basis, it still keeps us at a very healthy Solvency II margins, if you consider it after a post distribution event two.

As I've said numerous times before, the Solvency II ratio itself is not a constraining factor for the group from a private capital perspective. It's liquidity, and liquidity stress tests and ensuring that we got sufficient liquidity in the stress event. That is a constraining factor, when it comes to, I guess, further capital returns, which you haven't said it. But I'm assuming that, that's the sort of underpin part of the question that you have around it.

So, even in a post capital return environment, I'd still expect a Solvency II ratio that's going to be in the high 100. So, it'll be -- I think we expect to be over 200%. But it will be round about 180%-odd. Obviously that's going to change at time, but that's more or less, where it expected to be.

A - Paul Feeney {BIO 17570862 <GO>}

Next question operator.

Operator

And the next question comes from the line of Greg Simpson from Exane BNP Paribas. Please go ahead.

Q - Gregory Simpson {BIO 18850594 <GO>}

Hi, good morning. Congrats on the transaction. Just a few -- a couple on my side. The first is, could you remind us of the overlaps with the International business and the rest of Quilter. And in particular, I'm wondering if any of the GBP23 billion of Quilter investors, AuMA is sourced from Quilter International clients. And if so, will you expect to retain it with the new owner?

And then the second question. I think you mentioned earlier that you pulled the right margin for the UK business should begin with 3, I think, you said. So, just to confirm you're seeing the 30% target is as kind of like a minimum you want to be at in an ideal world assuming all goes well with markets and then flow, you'd hoped to be above 30% by 2025? Thanks.

A - Paul Feeney {BIO 17570862 <GO>}

Okay. I'll bring Mark in as well. But there's relatively little overlap between Quilter International and the rest of Quilter. I mean there is about 600 managed within portfolio bond wrappers by Quilter achieve it. And about 970 managed within those wrappers with Quilter investors. And yes, we do expect to retain all of that, certainly the vast majority of that, as a result of the deal we've done.

So, we don't see any real attrition or leakage from that. But of our total overall AuMA, it's relatively modest. And we've said, at least 30%, we've said at least or 30% plus. So, we haven't given you an actual number in the 30s, but we've said at least. So, I think that's fairly clear.

Q - Gregory Simpson {BIO 18850594 <GO>}

Okay.

A - Paul Feeney {BIO 17570862 <GO>}

Yes, and again, we'll update, Greg as well at the Capital Markets Day in Q4.

Q - Gregory Simpson {BIO 18850594 <GO>}

Great. Thank you.

A - Paul Feeney {BIO 17570862 <GO>}

Thanks.

Operator

(Operator Instructions) We have one more question from the line of Paul Allen from BMO. Please go ahead.

Q - Paul Allen {BIO 1402424 <GO>}

Hi. Yes. Thank you. So, just a question on Solvency II, you mentioned earlier that you'll still have to report under Solvency II. But that you will have some discussions with the regulator around that. You said, it would be for time being potentially. So, just interested what your options are? You mentioned, obviously the UK Life business at the moment, means you have to report under Solvency II. But what your options going forwards for potentially transitioning out of that regime?

A - Paul Feeney {BIO 17570862 <GO>}

So Paul, it's really a discussion when we're having with the regulators around, as I've said on technical fundamentals, the remain group Solvency II regulated. But we're unit-linked business that we're not a traditional life business. So, and sort of on a more practical basis, when you stand back and look at it, we don't have the same sort of -- I call the same sort of the balance sheet risk, that's a lot of other groups Solvency II regulated businesses would be carrying. That operates in the life industry.

But I mean, if we weren't in group Solvency II regulated, we'd be CRD4 group regulated. We already have a component of that group regulation, but it doesn't apply to the whole group, as things currently stand. But that's really sort of a discussion to have with the PRA, I mean, ultimately, it's for the regulators to future [ph] upon on that.

Q - Paul Allen {BIO 1402424 <GO>}

But potentially that is an option that you could get away, I don't know not using the UK Life business or somehow. So, just in general -- why (Multiple Speakers) the Solvency II?

A - Paul Feeney {BIO 17570862 <GO>}

No. So, I'm not saying that we won't be constrained by Solvency II. I fully expect Life and -- the Life and Pensions business on the platform we'll absolutely Solvency II regulated on the solo basis. And we have no plans to change any of that. This is more purely at a group supervision level in terms of where the ultimate group supervision from a capital perspective such.

Q - Paul Allen {BIO 1402424 <GO>}

Okay. Thank you.

Operator

And as there are no further questions, I'll hand it back for closing remarks.

A - Paul Feeney {BIO 17570862 <GO>}

Well, I just want to say thank you to everybody. Thank you for your support. I am delighted, as I said, Mark and I are both delighted with the outcome of our strategic review. We do think it is absolutely the right decision for our shareholders, for our employees, and for our customers. And it does give us now complete focus on the fast-growing secular growth UK wealth market. And we have got all three parts of the value chain, they're increasingly fully integrated.

We've got two hugely strong distribution channels in the open market, IFA market. And our own control distribution with Quilter Financial Planning. And as a result of our new platform now in safely, securely and quite frankly working really well. We're hugely optimistic and we are where we envisaged we would be. You know, where we have now completed the transformation of Quilter and it's now up to us to focus on our two core objectives of growth and efficiency. Thank you very much everybody.

Operator

This concludes our conference call. Thank you all for attending. You may now disconnect your lines.