United Kingdom
Credit Update

Collins Stewart Tullett plc

Ratings

Collins Stewart Tullett plc
Foreign Currency

Long-Term	BBB
Outlook	Stable

Sovereign Risk

Foreign Long-Term	AAA
Local Long-Term	AAA
Outlook	Stable

Financial Data

Collins Stewart Tullett plc

	31 Dec 2003	31 Dec 2002
Total Assets (GBPm)	1,026.5	276.7
Equity (GBPm)	394.5	150.2
Net Income (GBPm)	40.7	16.0
ROE (%)	14.7	10.9
Equity/Assets (%)	38.4	54,3

NB: Tullett acquisition in 2003 distorts comparison.

Analysts

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Rating Rationale

Assessment

- The Long-term rating of Collins Stewart Tullett plc (CST) reflects the low credit and market risk profile of its operating subsidiaries, their decent cashflow and low funding requirements. It also takes into account the group’s small size, the cyclicality and lumpiness of some of its revenue streams and a high cost/income ratio, although its cost base is very flexible.
- CST is the holding company of two businesses: Collins Stewart (CS), an independent UK stockbroker, corporate finance boutique and private client asset manager and Tullett Liberty (Tullett) , the world’s second largest inter-dealer broker (IDB), which merged in 2003.
- Correlation between the revenues of CS and those of Tullett appears low. CS’ revenues are correlated to the state of the UK equities market and thus are cyclical; corporate finance fees are also lumpy. However, a high bonus element to the group’s remuneration structure means costs can be flexed and the business performed well even in the depths of the recent bear market. Tullett’s revenues are earned across a wide range of products and geographies and are more dependent on market volatility than direction. Although seasonal, they are less cyclical than those of CS. Its margins are quite thin but, as with CS, its cost base is flexible, with staff costs being very bonus/commission-driven. The anticipated acquisition of Prebon, the fourth largest IDB, in 4Q04 is a good strategic fit and should help improve margins.
- Credit/settlement risk is low. All trades are settled dvp and credit losses have been negligible.
- Market risk is also low: Tullett and Prebon operate on a name give-up or matched principal basis, while Collins Stewart is a “jobbing” business in which maintaining inventory is necessary, but has historically been kept within conservative limits. It is the policy of the corporate finance business to sub-underwrite with high quality counterparties.
- Reputation and litigation risks are relevant: CST is one of the 21 firms involved in the FSA’s investigation into the split capital investment trust industry and some sort of financial settlement appears inevitable. CST’s legal advisers have not found evidence of any material wrongdoing.
- Double leverage at the holding company level is at an acceptable level (and is expected to change little post the Prebon acquisition) and the group and its regulated subsidiaries typically meet the Financial Resources Requirements (FRR) of their regulators very comfortably. Holding company creditors are dependent on dividend flows from operating subsidiaries for debt service as surplus capital is largely kept at the operating subsidiaries level. In addition, the holding company is looking to arrange a GBP15m 3-year committed facility. Operating subsidiaries have numerous bank settlement lines.
- Leverage ratios and the consolidated FRR position are expected to weaken post the Prebon acquisition, but should return to end-2003/early 2004 levels relatively quickly through earnings retentions and as goodwill is amortised. At end-2003, CST’s consolidated gross debt/tangible equity ratio was c.63% and its Financial Resources exceeded the FRR fairly substantially.

Support

- Should CST get into financial difficulty, it is possible that the group’s shareholders might provide financial support, but it cannot be relied upon.

Background

- CST employs 2,100 staff in 21 jurisdictions. It is listed on the UK stock market.

2 July 2004