Financial Overview

Close Brothers delivered a resilient performance in an unprecedented, challenging environment while continuing to support customers, clients and colleagues.

Group Income Statement

	2020 £ million	2019 £ million	Change %
Continuing operations			
Adjusted operating income	**866.1**	816.4	6
Adjusted operating expenses	**(538.4)**	(497.4)	8
Impairment losses on financial assets	**(183.7)**	(48.5)	279
Adjusted operating profit	**144.0**	270.5	(47)
Banking	**99.2**	253.7	(61)
Commercial	**4.8**	86.5	(94)
Retail	**34.9**	72.5	(52)
Property	**59.5**	94.7	(37)
Asset Management	**20.4**	21.8	(6)
Winterflood	**47.9**	20.0	140
Group	**(23.5)**	(25.0)	(6)
Amortisation of intangible assets on acquisition	**(3.1)**	(5.8)	(47)
Operating profit before tax	**140.9**	264.7	(47)
Tax	**(31.4)**	(64.4)	(51)
Profit after tax: continuing operations	**109.5**	200.3	(45)
Profit from discontinued operations, net of tax	**–**	1.1	(100)
Loss attributable to non-controlling interests	**–**	(0.2)	(100)
Profit attributable to shareholders: continuing and discontinued operations	**109.5**	201.6	(46)
Adjusted basic earnings per share (continuing operations)	**74.5p**	136.7p	(46)
Basic earnings per share (continuing operations)	**72.8p**	133.5p	(45)
Basic earnings per share (continuing and discontinued operations)	**72.8p**	134.2p	(46)
Dividend per share	**40.0p**	66.0p	(39)
Return on opening equity	**8.0%**	15.7%	
Return on average tangible equity	**9.4%**	17.9%	

Return on opening equity

8.0%

2019: 15.7%

Adjusted operating profit

£144.0m

2019: £270.5m

Adjusted basic EPS

74.5p

2019: 136.7p

The group's performance in 2020 was significantly impacted by the Covid-19 outbreak and the impact of lockdown restrictions on the UK economy. Nevertheless, the group delivered a resilient performance, reflecting the disciplined application of our model while continuing to support customers, clients and colleagues.

Operating Profit and Returns

Adjusted operating profit decreased 47% to £144.0 million (2019: £270.5 million), reflecting higher impairment charges in the Banking division, partly offset by a very strong trading performance in Winterflood, which benefited from significantly higher volumes since the Covid-19 outbreak. Statutory operating profit before tax from continuing operations decreased 47% to £140.9 million (2019: £264.7 million) and the operating margin reduced to 17% (2019: 33%). The group delivered a solid return on opening equity of 8.0% (2019: 15.7%) despite the reduction in adjusted operating profit and continued growth in the equity base. Return on average tangible equity was 9.4% (2019: 17.9%).

Adjusted operating profit in the Banking division decreased 61% to £99.2 million (2019: £253.7 million) primarily due to the forward-looking recognition of impairment charges under IFRS 9 to incorporate the impact of Covid-19. The Asset Management division continued to achieve strong net inflows, although adjusted operating profit of £20.4 million (2019: £21.8 million) was down 6% due to continued investment to support the long-term growth potential of the business, which more than offset the income growth on the prior year. Winterflood delivered a very strong performance, with operating profit of £47.9 million (2019: £20.0 million), up 140%. Group net expenses, which include the central functions such as finance, legal and compliance, risk and human resources, were down 6% at £23.5 million (2019: £25.0 million) primarily due to lower variable staff costs.

Operating Income

Adjusted operating income increased 6% to £866.1 million (2019: £816.4 million), as strong trading income growth in Winterflood and higher income in the Asset Management division were partially offset by reduced income in the Banking division. Income in the Banking division decreased by 3%, reflecting lower customer activity levels and forbearance measures, with a reduced net interest margin of 7.5% (2019: 7.9%). Income in the Asset Management division was up 6%, reflecting higher client assets. Income in Winterflood increased by 63% as a result of significantly higher volumes since the Covid-19 outbreak and very strong trading profitability.

Operating Expenses

Adjusted operating expenses increased 8% to £538.4 million (2019: £497.4 million) with most of the increase in Winterflood (up 41%), reflecting higher variable costs. Costs also increased in the Asset Management division (up 9%), driven by continued hiring of high net worth portfolio managers and investment in technology. In the Banking division, costs increased marginally (up 1%) driven by continued investment in key strategic programmes, partially offset by lower variable compensation. Overall, the group's expense/income ratio was marginally higher at 62% (2019: 61%) and the group's compensation ratio increased slightly to 37% (2019: 36%).

Impairment charges and IFRS 9 provisioning

We recognised £183.7 million of impairment charges (2019: £48.5 million) with a bad debt ratio of 2.3% (2019: 0.6%), primarily reflecting the impact of Covid-19 on the forward-looking recognition of impairment charges under IFRS 9. Our approach to provisioning reflects the application of our models overlaid with expert judgement to determine the appropriate allocation of loan book balances between stages, to macroeconomic scenario weightings, and to provision coverage at the individual portfolio level.

Specifically, the increase in impairment provisions reflected the migration of loans between stages, including to reflect the increase in forborne loan balances; the incorporation of more severe macroeconomic scenarios, with increased weighting to the downside; as well as a review of provision coverage for individual loans and portfolios.

This resulted in an increase in the coverage ratio to 3.0% at 31 July 2020 (31 July 2019: 1.3%). We believe this represents an appropriate level of provision at the balance sheet date and remain confident in the quality of our loan book, which is predominantly secured, prudently underwritten and diverse, and supported by the deep expertise of our people.

Tax Expense

The tax expense in the year was £31.4 million (2019: £64.4 million), which corresponds to an effective tax rate of 22% (2019: 24%). The decrease primarily reflects an increase in deferred tax assets following the reversal of the previously announced reduction in corporation tax rate.

Earnings per Share

Adjusted basic earnings per share ("EPS") from continuing operations decreased 46% to 74.5p (2019: 136.7p) and basic EPS from continuing operations decreased 45% to 72.8p (2019: 133.5p).

Discontinued Operations

There were no discontinued operations in the 2020 financial year. Discontinued operations in the comparative year reflect the unsecured retail point of sale finance business sold on 1 January 2019. The profit from discontinued operations in 2019 was £1.1 million and included a £2.7 million profit on disposal net of tax. Basic EPS from continuing and discontinued operations was 72.8p (2019: 134.2p), down 46% on the prior year.

Dividend

Following a resilient financial and operational performance in the second half, the board is proposing a dividend of 40.0p per share (2019: 66.0p per share) in respect of the full financial year. This reflects the board's confidence in the group's business model and strong financial position, notwithstanding the current uncertain environment. Subject to approval at the Annual General Meeting, the final dividend will be paid on 24 November 2020 to shareholders on the register at 16 October 2020.

Balance Sheet

The group entered this period of economic uncertainty with a strong balance sheet and has focused on maintaining its prudent approach to managing financial resources. The structure of the balance sheet remains unchanged, with most of the assets and liabilities relating to our lending activities. Loans and advances make up the majority of assets.

Other items on the balance sheet include treasury assets held for liquidity purposes, and settlement balances in the Securities division. Intangibles, property, plant and equipment, and prepayments are included as other assets. Liabilities are predominantly made up of customer deposits and both secured and unsecured borrowings to fund the loan book.

While the loan book was broadly flat in the year, total assets increased 5% to £11.1 billion (31 July 2019: £10.6 billion). This primarily reflects an increase in treasury assets as the group increased its liquidity holdings in response to Covid-19. Total liabilities were up 5% to £9.6 billion (31 July 2019: £9.2 billion) driven by an uplift in customer deposits. Other assets and other liabilities both increased as a result of IFRS 16 accounting adjustments. Shareholders' equity of £1.5 billion (31 July 2019: £1.4 billion) continued to build, with profit in the year partially offset by dividend payments of £65.8 million (2019: £95.5 million). The group's return on assets reduced to 1.0%, reflecting lower profitability in the year (2019: 1.9%).

Group Balance Sheet

	31 July 2020 £ million	31 July 2019 £ million
Loans and advances to customers	**7,616.7**	7,649.6
Treasury assets[1]	**1,733.9**	1,395.4
Market-making assets[2]	**719.1**	666.1
Other assets	**1,001.8**	850.2
Total assets	**11,071.5**	10,561.3
Deposits by customers	**5,917.7**	5,638.4
Borrowings	**2,591.2**	2,601.0
Market-making liabilities[2]	**622.8**	582.4
Other liabilities	**490.2**	333.1
Total liabilities	**9,621.9**	9,154.9
Equity	**1,449.6**	1,406.4
Total liabilities and equity	**11,071.5**	10,561.3

1 Treasury assets comprise cash and balances at central banks, and debt securities held to support lending in the Banking division.
2 Market-making assets and liabilities comprise settlement balances, long and short trading positions and loans to or from money brokers.

Financial Overview continued

Group Capital

	31 July 2020 £ million	31 July 2019 £ million
Common equity tier 1 capital	**1,254.0**	1,169.2
Total capital	**1,441.0**	1,364.6
Risk weighted assets	**8,863.2**	8,967.4
Common equity tier 1 capital ratio	**14.1%**	13.0%
Total capital ratio	**16.3%**	15.2%
Leverage ratio	**11.2%**	11.0%

Capital

The prudent management of our capital is a core part of our business model and has been a key focus since the Covid-19 outbreak to ensure the group can continue to support customers, clients and colleagues during these unprecedented times.

Our common equity tier 1 capital ("CET1") ratio increased to 14.1% (31 July 2019: 13.0%), primarily due to retained profit with the impact of higher impairment charges largely offset by the capital add-back under transitional IFRS 9 arrangements. The total capital ratio increased to 16.3% (31 July 2019: 15.2%).

The group applies IFRS 9 regulatory transitional arrangements which allows banks to add back to their capital base a proportion of the IFRS 9 impairment charges during the transitional period. Our capital ratios are presented on a transitional basis after the application of these arrangements and the Capital Requirements Regulations qualifying own funds arrangements. Without their application, the CET1 and total capital ratios would be 13.1% and 15.1%, respectively.

CET1 capital increased 7% to £1,254.0 million (31 July 2019: £1,169.2 million) reflecting resilient capital generation through £109.5 million of profit in the year and the transitional IFRS 9 capital add-back of £55.7 million, partially offset by the regulatory deduction of dividends paid and foreseen of £59.9 million and an increase in intangibles of £20.8 million.

Risk weighted assets ("RWAs") remained broadly flat at £8.9 billion (31 July 2019: £9.0 billion) driven by lower credit risk RWAs partly offset by an increase in operational risk RWAs. The decrease in loan book RWAs includes the implementation of the revised SME supporting factor which was accelerated as part of regulatory measures announced in light of Covid-19.
The group and its individual regulated entities complied with all of the externally imposed capital requirements to which they are subject for the financial years ended 31 July 2020 and 2019. Our capital ratios remain significantly ahead of minimum regulatory requirements, leaving us well placed to continue to help our customers and clients beyond the crisis and in a position of strength to respond to opportunities ahead once restrictions begin to ease.

Our minimum CET1 capital ratio requirement is 8.0%, including the applicable buffers and a 1.0% pillar 2 add-on, with a total capital requirement of 12.3%. Accordingly, we continue to have significant headroom of over 600bps in our CET1 capital ratio, and 400bps in the total capital ratio.

The leverage ratio, which is a transparent measure of capital strength, not affected by risk weightings, increased in the year and remains strong at 11.2% (31 July 2019: 11.0%).

We have continued to make good progress on our preparations for a transition to the Internal Ratings Based ("IRB") approach, despite the operational challenges posed by Covid-19. Our initial IRB model suite is now complete, and we are currently on track to submit our formal application to the Prudential Regulation Authority by the end of the current calendar year.

Funding

The primary purpose of our treasury function is to manage funding and liquidity to support the lending businesses and manage interest rate risk. Our conservative approach to funding is based on the principle of "borrow long, lend short", with a spread of maturities over the medium and longer term, comfortably ahead of a shorter average loan book maturity. It is also diverse, drawing on a wide range of wholesale and deposit markets including several public debt securities at both group and operating company level as well as a number of securitisation facilities.

We entered this challenging period in a strong position and further increased our total funding in the second half of the year to £10.2 billion (31 July 2019: £9.9 billion) which accounted for 135% (31 July 2019: 129%) of the loan book at the balance sheet date. Our average cost of funding of 1.7% was broadly stable on the prior year (2019: 1.7%).

Our customer deposit platform, launched in 2019, has allowed us to offer a wider range of deposit products to further diversify our funding and improve customer experience. In the first half we introduced a new online portal, with a number of new savings products to come during the 2021 financial year, including cash Individual Savings Accounts ("ISA") products, which will continue to grow and diversify our retail deposit base and further optimise our cost of funding and maturity profile. Deposits increased 5% overall to £5.9 billion (31 July 2019: £5.6 billion) with non-retail deposits decreasing slightly to £3.3 billion (31 July 2019: £3.5 billion) and retail deposits increasing by 22% to £2.6 billion (31 July 2019: £2.1 billion).

Our range of secured funding facilities include securitisations of our Premium and Motor Finance loan books, and during the year we raised £200 million via a third public Motor Finance securitisation. Following admission to the Bank of England's Term Funding Scheme with additional incentives for SMEs ("TFSME"), we transitioned £228 million of drawings previously under the Term Funding Scheme to TFSME at the end of July 2020.

Unsecured funding, which includes senior unsecured bonds and undrawn facilities, remained broadly unchanged at £1.5 billion (31 July 2019: £1.5 billion).

We have maintained a prudent maturity profile. The average maturity of funding allocated to the loan book remained ahead of the loan book at 18 months (31 July 2019: 20 months), while the average loan book maturity stood at 15 months (31 July 2019: 14 months).

LIBOR, which had been the principal sterling reference rate used by the group, is due to be withdrawn by the end of 2021. The group is actively participating in initiatives to determine the appropriate treatment of all instruments on the withdrawal of LIBOR, including the use of SONIA, the Sterling Overnight Index Average.

Our strong credit ratings have been considered by both Moody's Investors Services ("Moody's") and Fitch Ratings ("Fitch") during the year. Moody's rates Close Brothers Group "A3/P2" and Close Brothers Limited "Aa3/P1" with a "negative" outlook.

Group Funding[1]

	31 July 2020 £ million	31 July 2019 £ million
Customer deposits	**5,917.7**	5,638.4
Secured funding	**1,418.2**	1,404.8
Unsecured funding[2]	**1,460.1**	1,462.2
Equity	**1,449.6**	1,406.4
Total available funding	**10,245.6**	9,911.8
Of which term funding (>1 year)	**4,671.6**	5,493.4
Total funding as % of loan book	**135%**	129%
Average maturity of funding allocated to loan book[3]	**18 months**	20 months

1 Numbers relate to core funding and exclude working capital facilities at the business level.
2 Unsecured funding excludes £7.9 million (2019: £29.0 million) of non-facility overdrafts included in borrowings and includes £295.0 million (2019: £295.0 million) of undrawn facilities.
3 Average maturity of total funding excluding equity and funding held for liquidity purposes.

Group Liquidity

	31 July 2020 £ million	31 July 2019 £ million
Cash and balances at central banks	**1,375.8**	1,106.4
Sovereign and central bank debt	**72.2**	48.3
Certificates of deposit	**285.9**	240.7
Treasury assets	**1,733.9**	1,395.4

Fitch applied a one notch downgrade to our ratings alongside several mid-sized UK banks following their downgrade of UK sovereign debt to AA-, reflecting their view of the negative impact of Covid-19 on the UK economy. The result was a rating of "A-/F2"(from "A/F1"), with a "negative" outlook (previously "stable") for both Close Brothers Group and Close Brothers Limited.

Liquidity

The group continues to adopt a conservative stance on liquidity, ensuring it is comfortably ahead of both internal risk appetite and regulatory requirements. Against a backdrop of a generally weak economic UK outlook driven by the continued uncertainty over the final Brexit settlement and the Covid-19 crisis, treasury assets increased 24% to £1.7 billion (31 July 2019: £1.4 billion) and were predominantly held on deposit with the Bank of England, giving us continued good headroom to both internal and external liquidity requirements.

We regularly assess and stress test our liquidity requirements and continue to comfortably meet the LCR requirements under the Capital Requirements Directive IV ("CRD IV"), with a 12-month average LCR unchanged at 823% (2019: 823%).

Basis of Presentation

Results are presented both on a statutory and an adjusted basis to aid comparability between periods. Adjusted measures are presented on a basis consistent with prior periods and exclude amortisation of intangible assets on acquisition, to present the performance of the group's acquired businesses consistent with its other businesses; any exceptional items, which are non-recurring and do not reflect trading performance; and discontinued operations. Discontinued operations relate to the unsecured retail point of sale finance business, which was sold on 1 January 2019.