Final Transcript

InterCall

Contents

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Corporate Participants

Michael Dobson

Richard Keers

Schroders - CFO

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Q3 Interim Management Statement 2013 Conference Call. At this time all participants are in a listen only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question you need to press star followed by one on your telephone. I must advise you that this conference is being recorded today on Thursday, 7th November 2013. I would now like to hand the conference over to one of your speakers today, Mr Michael Dobson. Please go ahead, Sir.

Michael Dobson

Thank you and good morning everybody. I will highlight the figures for the nine months in the third quarter. Richard Keers will give a little more detail in relation to exceptional items and then we will throw it open to questions.

These are record results for Schroders in terms of revenues, profit before tax, and assets under management, and I think reflect the strength of what is a very highly diversified business model. For the nine months net revenues are up 23% to just over £1 billion. Profit before tax and exceptional items is up 31% at £349.6 million. Net inflows were for 5.5 billion.

Importantly, 68% of funds under management are out performing benchmark or peer group in the three years to the end of September, and assets under management at the end of September were 256.7 billion including, for the first time, the 20.1 billion we took on with Cazenove's when that transaction closed on 2nd July.

Just looking at the third quarter alone the increase in profits was ahead of that, as I say including Cazenove for the first time, profits were up 37% on the third quarter last year to 121.6 million. And we generated net inflows in the third quarter of £1 billion.

Turning to asset management for the nine months net revenue was up 22% at just over £900 million, and profit before tax and exceptionals was up 23% at £321.7 million. Net inflows for the nine months were 6.5 billion of which 3.7 billion was in institutional and 2.8 billion in intermediary.

In the third quarter net revenue was up 28% to £315 million, including £17.5 million of performance fees in the quarter, predominantly on Cazenove Capital Funds, and profit before tax and exceptional items was also up 28% at £109.6 million. We generated in asset management £1.7 billion of net new business in the quarter, including £600 million of net inflows into Cazenove Capital Funds - £1.6 billion of that, of those £1.7 billion, were in institutional with continued strong flows in Asia and in the UK in particular. And we had £100 million of net sales in intermediary retail in the third quarter.

Good levels of net sales in the UK, just over £250 million in the quarter. And also in the US, offset by sub-advisory outflows in Japan where we've seen some profit taking particularly on our Maximiser range of funds from sub-advisory retail clients. And also some outflows in our Asian Asset Income Fund, which we closed as you know in the first quarter of this year for capacity reasons.

Turning to wealth management and we've renamed this segment from private banking to wealth management to better reflect the breadth of the services we now offer in the wealth sector. Net revenue in the third quarter, reflecting the inclusion for Cazenove capital for the first time, was nearly doubled at £47 million. And profit before tax and exceptionals was more than doubled at £10.4 million. For the nine months net revenue was up 30% at £100.5 million and profit before tax and exceptionals was up 46% at £21 million.

We had £700 million of net outflows in the quarter reflecting the loss of one very large custody account on very low fees, which we highlighted to you in August. And as you know we have a mandate of a similar size, which is going to go in the fourth quarter of this year. For the nine months reflecting this large outflow, net outflows overall of £1 billion, but assets under management at £29.9 billion, are up 86% on the level of a year ago.

The integration of Cazenove Capital is on track, it's going well. The response from clients, both in the wealth management and the asset management segments, has been very encouraging, and as you've seen the business continued to generate net inflows in both segments in the first quarter of our ownership, which I think is a very strong result.

I'm now going to hand over to Richard Keers, Chief Financial Officer, to update you on the exceptional items, particularly relating to the Cazenove capital transaction.

Richard Keers - *Schroders - CFO*

Thank you Mike. Today I'm going to take you through the exceptional charges that we taking in the quarter and update you on the amortisation of intangible assets on the Cazenove capital acquisition. As you can see we have reported exceptional items of £15.4 million in Q3. This is in line with the guidance I gave in August although the make-up of this is slightly different.
We continue to expect a (unclear) to £15 million in exceptional items in Q4. We've seen the last of the acquisition related costs come through in the quarter at some £0.2 million. In August I mentioned a charge with deferred comp. of 8 million to £9 million in H2 and you can see roughly half of this at £5.0 million in the Q3 result - £4.5 million for Cazenove and £0.5 million for STW.

On integration costs we spent £4.8 million in the quarter. As we mentioned in the IMS, integration plans are progressing well, and our synergy target on Cazenove remains at £12 million to £15 million with costs of about 1.5 times this level. We also now had a final position on goodwill and intangible assets for Cazenove. As I mentioned in August the full cost full cost was £413 million, of which we have now confirmed that £101 million, related to intangible assets, and £222 million to goodwill.

We amortized the intangible assets, which I've split £67 million in wealth management and £34 million in asset management. The amortisation periods are eight years in wealth management and four years in asset management and are based on client longevity.

Finally, a quick update on costs. We continue to accrue comp costs at 48% of operating revenues and on non-comp costs our expectations remain in the region of 275 million for 2013. I now hand you back to Mike.

Michael Dobson

So just to sum up I think strong results, pretty much in line with market expectations. Some of you might have had a slightly higher estimate on AUM and I think the reason for that is the impact of FX. Remember our business is very international and there was a FX impact on, in the third quarter, in terms of assets under management, and a small impact, negative impact, in terms of revenues, just in terms of the FX translation effect.

We're pleased with the progress with Cazenove capital. The integration of STW fixed income in the United States is also progressing well. We continue to invest I would say significantly in the business, in talent, in technology, in seeding new investment strategies, and we believe that Schroders is well positioned for long-term growth on the back of the very diversified business model that you’re familiar with. So I'll leave it there and we would welcome your questions.

Questions and Answers

Operator

Thank you ladies and gentlemen. As a reminder, if you'd like to ask a question or make a comment during today's conference, please press star followed by one on your telephone. If you need to withdraw your request that would be the hash-key. So that's star followed by one if you'd like to ask a question. And our first question comes from the line of Arnaud Giblat from UBS. Please go ahead and ask your question.

Arnaud Giblat - *UBS*

Good morning. Quick three questions if I may. The first one is on performance (unclear)[fees], Q3 saw very high level of performance fees. Can you please explain what drove this and should we be looking for a higher contribution of performance fees going forwards?

My second question is on the wealth management business, you indicated that there was a loss of 0.7 million low margin mandate. This hasn't impacted the management fee margins yet, so… I mean the conclusion should be that we should be looking for higher management fee margins going forwards. Is that a fair conclusion? And maybe if you could give us an indication of the run rate coming out of Q3.

And, finally, just on costs, sometimes we see some seasonality and cost pickup slightly in Q4, is that something we should be looking for? Thanks.

Michael Dobson

Okay, so the last question was some guidance on cost in Q4. Is that right?

Arnaud Gidlat - *UBS*

Yes.

Michael Dobson

Okay, so let me take the first two and Richard Keers will deal with the last point. On performance fees you're right, we had some significant performance fees in the third quarter, 17.5 million, which is quite a bit higher than we normally have. Generally we, as you would expect, generate most of our performance fees in the fourth quarter. As I said predominately this relates to performance fees on some Cazenove Capital Funds. We expect further performance fees in the fourth quarter. I can't give you guidance on that, but we would expect some further performance fees in the fourth quarter.

I think overall it would be reasonable perhaps to expect slightly higher performance fees than we've seen in the past, because there are a number of performance fee related funds in the Cazenove Capital Portfolio, which we obviously didn't have in the past. Probably you could factor in a slightly higher level than we've seen in recent years, although I would say the third quarter was somewhat exceptional in that regard.

Turning to the outflow in private banking we highlighted this with the interim results in August. It's about £750 million, it's probably on three or four basis points, so it's a very low fee, and therefore the impact on revenues and profits is very small. I suppose it will have a marginal effect on the blended margin in wealth management, which is currently 63 basis points and has been stable now for a few years. Now, Richard, if… you pick up the cost point.

Richard Keers - *Schroders - CFO*

Yes, as I said, at the half-year, the interim, our expectations are for non-comp costs of 275 million and continue to feed our guidance. I think that's how we anticipate total non-comp costs to sit for the year. And in terms of the missing ingredient, which is comp costs at 48%. Again, which is consistent with the half-year message.

Operator

Thank you very much. Our next question comes from the line of Chris Turner from Goldman Sachs, please go ahead.

Chris Turner – *Goldman Sachs*

Yeah, good morning, thank you for taking my question. UK Equity Funds have obviously been quite eventful both for yourselves, I guess, earlier in the year and more recently for some of your competitors. Two things on this, firstly, have we seen the end of the outflows related to Richard Buxton, or should we expect some further small outflows in Q4?

And then also given the comparatively strong performance of Schroders brand and also Cazenove branded funds in that space, have you seen any pick up in flow since the announcement of fund management departures elsewhere in the industry in September and October?

And then, secondly, a question on the UK Institutional space, the last few weeks we've seen some noises from the UK regulator about potentially clamping down on the fees charged by pension funds going forward. Obviously that won't impact you directly, but do you see the risk of an indirect impact perhaps on a further round of margin pressure in that UK Institutional Space. Thank you.

Michael Dobson

Okay, on your first question, the question on UK equity funds, very little outflows, I mean recently, from our UK Alpha product. We've seen strong inflows, probably the nearest… I mean we still have a UK Alpha product; we have a new manager there with a strong track-record. So we'll be certainly taking that back to the market, but we also have a, I won't say similar fund, but broadly in the same space, the UK Opportunities Fund. Cazenove Fund brought in £900 million of net flows in the third quarter. So I think, you know, there are a range of funds here doing very well in that space and I think UK Alpha will be part of that in the future, in addition.

On fund manager exits elsewhere that you talked about, I would say no, we haven't seen so far much impact of that, but I think we may in the future, and we have some very strong income products in the UK, which are very competitive in that space and I think should or may benefit in that sense.

And then on fees, well, we've been saying for a while that we think fees in this industry are going to come under pressure. Regulators, politicians, the press, competition, everything to me points to that fact. We've said that we expected that particularly in intermediary and we've seen that to some extent. Fees in intermediary actually at 79 basis points in the third quarter of this year are fractionally ahead. It was 78 basis points this time last year, but I wouldn't read too much into that. But I think over time we've seen some erosion there, we'll probably see a bit more.

In institutional our fees are running at 38 basis points, 39 basis points a year ago, so, basically, negligible change, so you can't see much of a trend here. Broadly I would say fees and asset management at 54 basis points overall, pretty much in line with where they were last year.

But I think looking forward I would expect to see some fee pressure, I think we're seeing that from large institutional clients in, say, the official institution space for example. And I think that scale therefore, efficiency, and a diverse range of products and clients are important in that sense. Schroders I would say is well placed to deal with that impact which I think is to some extent inevitable.

Operator

Thank you very much. Our next question comes from the line of Peter Lenardos from RBC. Please go ahead.

Peter Lenardos – *RBC*

Hi, good morning, it’s Peter Lenardos from RBC, just two quick questions. First of all on the compensation ratio, is 48% an acceptable amount for you that we should model going forward, or do you still hope to put downward pressure on that? And the second one would be on foreign currency, if you could quantify the negative impact that FX movements had on AUM during Q3.

Michael Dobson

On the comp. ratio I'd probably leave it there, I mean where it is at 48. In the past we’ve been down at 45, I mean that is still our target, but as you know if we think there are investment opportunities in the business we want to take advantage of that. So I think for now probably leave it there, it might edge down, but we'll have to see where markets are and where the investment opportunities are.

As regards the impact of FX it's about £4.2 million in terms of the revenue impact in the third quarter on management fees, negative. We don't have the precise number for AUM but it will have had an impact on the AUM figure as well.

Operator

Thank you very much. Our next question comes from the line of Anil Sharma from Morgan Stanley. Please go ahead.

Anil Sharma – Morgan Stanley

Morning everyone. Just a couple of questions please. So, the first one was, in the retail flows you were saying in the quarter you had some outflows from Asian asset income, and I just wanted to check, and please correct me if I'm wrong, but my understanding was that fund has now been reopened. So should we be expecting a kind of reversal of those outflows in Q4? And then my second question was just more around sort of demand dynamics and geographic. You gave some colour but I was wondering if you could perhaps expand a bit more, and if I think of Schroders overall, how much of the inflow that we've seen in Q3 has been some sort of multi-asset? If you could just help us that'll be useful.

Michael Dobson

So your first question was on… was it Asian asset income, your first question?

Anil Sharma – Morgan Stanley

Yes.

Michael Dobson

Okay, well, it was a very successful launch as you know and I think we were probably the first to launch a product in that space, very successful. So we closed it for capacity reasons and inevitably when you do that you get outflows, which is what we've seen.

We have reopened it but not everywhere. We've reopened it in Hong Kong and one or two other places. We've also launched a global asset income fund which has been successful and brought in, you know, done well, and offset those flows to some extent. So we haven't been able to do it everywhere. So I would say I think the flows would tail-off. They may reverse. But as I say it's not a broad reopening, it's quite a specialised reopening of that fund.

In terms of multi-asset flows - very strong in intermediary, continuing in the third 3rd quarter also strong in institutional. But also we've had good institutional flows net in equities and in bonds.

Geographically, I think you asked a question as well, so in the institutional business - very strong in the UK, about £800 million of net new business in the UK, flat in Europe, strong performance again in Asia, just over £600 million, and probably£ 200 million, or so in the US. And, in intermediary, a good performance - over £250 million in net sales in the UK, a similar result in Asia. And then the outflows that I think I referred to, particularly in Japanese, Maximiser products, people taking profits, and in Asian asset income, producing a negative, £300 million, or so, net redemptions in Asia.

Operator

Thank you very much. Once again, ladies and gentlemen, if you'd like to ask a question or make a comment please press star, one on your telephone, and our next question comes from the line of Arun Melmane from Canaccord, please go ahead.

Arun Melmane – Canaccord

Good morning gentlemen. I had a couple of questions on wealth management. If you look at the legacy business, I was just wondering how do we look at inflows going forward, do we just assume the legacy business stays as is and most of the inflow comes through the Cazenove acquisition and so we should bake in something on that? And the other one was on performance, how do we look at performance seasonality in Cazenove? Is it throughout the year or is it based on the second half, Q3 and Q4, and (unclear) costs, which probably answer after the strategy one?

Michael Dobson

On wealth management, the legacy business as you call it, I mean we will grow the legacy business. What you have in this big custody outflow in Q3 and the other outflow we've highlighted that's coming in Q4, which is a discretionary mandate, which is going as a result of the sort of generational change, basically, in the client, means they are, I would say, one-off in terms of size and I wouldn't expect a repeat of those kind of size-flows. So, no, I think they're rather exceptional and we would expect to be growing the Schroders book and the Cazenove book in the future in wealth management beginning 2014.

On performance fees relating to Cazenove there's a September year-end for some of these funds and there's an October yearend for some other funds with performance fees. So there are potentially some Cazenove related performance fees in the fourth quarter, as well, in addition to Schroder funds with performance fees, which historically have arisen in the fourth quarter.

So as I said earlier we expect some fourth quarter performance fees. I can't put a number on it. You've seen the sort of numbers we've generated in the past in the fourth quarter and that's maybe, you know, not a bad place to focus on in terms of results. It's too early to say.

Arun Melmane – Canaccord

On costs, a quick one for Richard, on sort of the deferred compensation cost arising that sits (unclear), you've said half is in Q3, what about the other half? Do we bake that in, in 2014, or…?

Richard Keers - *Schroders - CFO*

I was actually referring to my guidance of 8 to 9 million, half was in Q3, and half was in Q4, so that deferred comp will continue to come through into 2014, yes.

Arun Melmane – Canaccord

And roughly, the 5 million rate, is it per quarter or…?

Richard Keers - *Schroders - CFO*

Quarter, yes, four and a half.

Operator

Thank you very much and our next question comes from the line of Nitin Arora from HSBC, please go ahead.

Nitin Arora – HSBC

Good morning gents. I had three questions. Firstly, on the retail side, if you look at the macro data there has been like a lot of money, or the largest inflows going into Europe the last quarter. So if you can give some clarity on why you have not participated in that flow?

Michael Dobson

Sorry, can you repeat that last question?

Nitin Arora – HSBC

Sorry, so starting again, from the intermediary side in Europe, if you look at the macro data, industry data, it talks about record flows going into Europe from the retail clients in the last quarter. So I just wanted to understand why you guys have not participated in the flows there? You mentioned you had seen flat Europe in Q3. Secondly, on the UK retail side and the UK Opportunities Fund, can talk about the capacity there. And, thirdly, on, again, given the volatility in the bond markets, people keep talking about the great rotation, so is that something that you have seen in retail or the institutional side at all?

Michael Dobson

We haven't seen… I don't think we've seen this great rotation. I think, you know, we've tended to see people coming out of cash to move into equities rather than switching out of bonds so much. In terms of the UK Opportunities Fund there's a bit more capacity. I mean it's certainly not unlimited and we will manage that very tightly, and clearly with the success it's had it's getting towards that.

As far as Europe is concerned we've had some outflows in emerging markets equities which I don't think is Schroders specific. I think it's, you know, concerns over the performance of EM equities widely. We've had some outflows in Asian equities in Europe. We've had good inflows in European equity, in convertible bonds. So it's a mix and I don't think there's a clear trend.

But, you know, positive inflows in some assets and then some profit taking, or people changing asset allocation reasons, pulling money out from other strategies, and I don't read much of that. Our European businesses is very strong, we've got a very strong distribution capability, a very strong network of distributor relationships, so one quarter's results I don't think is an issue.

Operator

Once again ladies and gentlemen that's star, one if you would like to ask a question, and our next question comes from the line of Gurjit Kambo from Credit Suisse, please go ahead.

Gurjit Kambo – *Credit Suisse*

Hi, good morning guys, it's Gurjit here from credit Suisse. Just on the fees, you know, as some of the platforms start to gear up for implementing RDR2 from early next year, are you seeing much discussions with the platforms and much fee pressure coming from that in the next, you know, few quarters?

Michael Dobson

Well, we've seen a little bit and I think, you know, large platforms and distributors are using their scale to do two things - one is concentrate the list of firms with which they work, which is good news for people like us, with the scale, and breath of product that we have, and the other, which is the flipside of that, to drive down fees, which is less good.

So, you know, there are positives in terms of getting preferred positions with distributors leading to the prospect of greater flows and then negatives in terms of fee pressures. So we've seen a bit of that, I think we'll see more. I don't think that, someone referred earlier to this government initiative on pension charges, and so on, there's nothing that we've seen recently which has exacerbated a trend that we've seen, and highlighted and discussed with you in the past.

So we've been saying for a while that we think fees are going to come under pressure. We've seen a little bit of that; I think we'll see more in the future. I don't see it as very significant, but I think it's a trend and we have to make sure we're an efficient producer. We have scale, we have breadth of product, and we have breadth of distribution relationships, so I think we are, as I said before, well placed for that.

Gurjit Kambo – *Credit Suisse*

And would you look at it on a case-by-case basis, depending on the funds, you know, capacity, etc., in terms of what sort of fee concessions you give to the platforms? Is that the way you would choose to look at it?

Michael Dobson

Yes, we do and also on the institutional size. You know some business is driven by fees particularly, say, in the Sovereign Wealth, Official Institution area where, you know, if you won the mandate there's a fee level, which you either accede to, or you don't. And we look at it on a case-by-case basis in the context of the relationship, the client relationship, the asset class, and our capacity in that asset class, our costs, and all sorts of factors go into making the decision - do we want to compete at that level or not? Sometimes we do and sometimes we say we can't do that and we loose the business opportunity as a result.

Operator

Thank you very much. There are no further questions at this time. Please continue.

Michael Dobson

Thank you for joining us. If you've got any follow-up questions please call Emma Holden and she'll be happy to help you. Thanks a lot.

Operator

Thank you very much ladies and gentlemen. This concludes our conference for today. Thank you all for participating. You may now disconnect.
