Schroders PLC

Interim 2013 Results

Analyst Presentation

Michael Dobson

Chief Executive

So good morning everybody. Thank you for joining us. I'm going to run through the highlights. Richard Keers, our recently appointed Chief Financial Officer, will cover the numbers in a bit more detail and then we will throw it open for questions.

So in what was quite a volatile background for markets and investor demand, these are a strong set of results. Profit before tax and exceptional items up 29% to I think a record for any half year, £228m, up from £177.4m in the first half of 2012.

The Board has decided to increase the interim dividend by 23% to 16p a share, reflecting these results, the very strong financial position of the firm and the confidence in the long-term growth prospects of the Company. Importantly we've had, continued to have competitive performance, with 67% of our funds outperforming benchmark or peer group in the three years to the end of June 2013, 71% outperforming over 12 months to the end of June 2013.

Net inflows were up 67% on the first half of last year at £4.5b. Assets under management were up 21% on the June 30, 2012, number at £235.7b. That's up 11% on the number at the beginning of this year of £212b. And the £235.7b includes £6.6b from our acquisition of STW Fixed Income in the US. That was completed in April. And we completed our acquisition of Cazenove Capital on July 2.

So looking at Cazenove Capital, first of all let me say that none of these numbers are included in the results we announced today, but they will be included in the third-quarter trading statement we make at the beginning of November.

At the end of June, Cazenove Capital had £20.1b of assets under management. £13.2b of that is in wealth management and charities, £6.9b in investment funds. Cazenove had £1.6b of net inflows in the first half of 2013, £400m in wealth management and £1.2b in investment funds. And I think it's worth noting that of that £1.6b, a little more than half in each of those two categories came in the second quarter. So at a time, quite a tough quarter for the industry, and also the quarter immediately following the announcement of the proposed acquisition, the momentum in that business was well maintained and, if anything, slightly accelerated.

As you know, there are two strategic reasons for us making this transaction. First, in Private Banking it adds significant scale to our UK and Channel Islands business, it broadens our client offering and it brings a highly complementary client base. In Asset Management it extends our offering in UK intermediary. It brings strong performance and complementary strategies in UK and European equities, in multi-manager and in fixed income. And it gives us an opportunity, with our very strong distribution capability worldwide, to really leverage some of these interesting, complementary and well-performing strategies. We said at the time of the transaction that we were targeting £12m to £15m of cost synergies, and that number hasn't changed.

Looking at the revenue growth of the Cazenove Capital business, 53% up year on year in investment funds, reflecting the move in terms of assets under management from £3.9b at the end of June 2012 to £6.9b at the end of June 2013, a 10% increase in wealth management. And underlying that it's a 12% increase in high net worth and a 4% increase in revenues from the charities business. So 10% is the blended rate in that business, giving an overall revenue increase of 21% for this business year on year, pretty close to the 19% increase in revenues in our own business first half 2013 against first half 2012.

No performance fees in this revenue picture for the first half of 2013 at Cazenove. Again no performance fees in the first half last year either, so all the performance fees coming in the second half.

Turning back to our own business, £4.5b of net new business in the first six months of the year, reflecting I think above all the very diversified nature of our business by asset class, product range, by geography and by client channel.

Looking at the channels first, we had £2.7b of net new business in our Intermediary retail business. That was £3.5b in the first quarter and net outflows of £800m in the second quarter, all of which came in June. As you know, you've seen it before, with other firms quoting outflows in retail mutual funds in the second quarter and particularly in June of this year, which has reversed in July. We've had net inflows once again in our Intermediary retail business and also in our Institutional business in the month of July.

£2.1b of net inflows in the six months in Institutional, which was £2.3b in the first quarter and a small £200m of net outflows in the second quarter.

And we had £300m of net outflows in Private Banking, of which £200m came in Q1, £100m in Q2.

If you look at it by region, this is just asset management not Private Banking, we had a very strong performance in Asia Pacific in the first half, with £4.1b of net inflows, strong performance in both intermediary and institutional in that region. We had £900m of net inflows in Continental Europe, £400m in the Americas, predominantly the United States, and £500m of net outflows in the UK.

By asset class, continued success in multi-asset with £4.8b of net inflows, £500m of net inflows in equities, £100m of net inflows of fixed income and £500m of net outflows in emerging market debt, commodities and properties, the predominant feature there being our emerging market debt absolute return business, where we've had net outflows because this is an absolute return strategy.

When EMD markets were doing very well last year and the early part of this year, we were lagging. And that led to some outflows. With the turnaround in EMD we're looking pretty strong; we have a positive investment result this year in our emerging market debt absolute return portfolios against an index down, in some cases, 9% on the year. So I think we're beginning to see the stemming of those flows, indeed a reversal. And we'll begin to see net inflows as that strategy once again comes into demand.

Looking at the Institutional business, £139.6b of assets under management in institutional at the end of June. We won £14.2b of new mandates in the first six months, which is the second highest six-month period we've ever had, second only to the record 2010. So very good six-month period in terms of new business generation and new client wins. Equities was the largest asset class within that, with £5.5b of new equity mandates from institutional clients in the first six months of the year.

We saw a pick-up in outflows in the second quarter. One or two, I think, somewhat unusual features. First of all, we lost some client relationships where the client made asset allocation switches. This was not reflecting investment performance; this was a decision to switch out of fixed income or switch out of equities. And so that led to some outflows.

Secondly, we had one big fixed income outflow of $900m, where a US state fund, which we've known for a long time which had all its fixed income assets with Schroders, appointed three other managers. And that led to a $900m outflow in the quarter, which you can see on that graph. We retain -- we're now one of four managers instead of being the sole fixed income manager on that account. As I say, we knew that was going to happen. It was simply a question of timing.

And lastly, we've seen $450m of outflows from STW, the business we acquired, well within our expectations. Three clients left because of the acquisition, accounting for $150m. Three out of 100, so very small attrition rate. And something like 96% of clients have signed up to the change of control. And they had another couple of client losses unrelated to the acquisition. Performance is good, investment performance in that business, and the integration is well on track and we're pleased with the early progress in relation to that transaction.

Net inflows overall in the first half of £2.1b. Very strong showing in Asia Pacific, also the UK. And in terms of asset classes, led by multi-asset with £1.3b of net inflows, £650m in equities and £250m in fixed income.

Net revenue margins are unchanged at 39 basis points year on year. And although short term I think there's a slightly lower level of client activity we see, nevertheless we still remain quite confident with the range of opportunities in institutional, increasingly in the insurance sector and with official institutions, and I think we're well placed to continue to grow that business over the long term.

Intermediary assets under management at the end of June were £79.2b. Again, we had a very high level of gross sales, £22.6b, one of the highest ever six-month periods in terms of gross sales. Sales slowed in the second quarter and redemptions picked up. And there was a roughly equal contribution from lower sales and a pick-up in redemptions that led to the turnaround of £3.5b of net new business in Q1 to £800m of net outflows in Q2, all of which came in the month of June. Included in that was £1.5b of outflows from UK Alpha products.

Overall we had net inflows of £2.7b in the first half, continued great success in multi-asset, and again a strong result in Asia, in Continental Europe and to somewhat lesser extent but still a good result in United States, with outflows in the UK.

Again, as in Institutional, our net revenue margins year on year are unchanged at 79 basis points.

We brought on a new UK Alpha team, ones from Neptune already here, one, [Paul Felemage], from Jupiter who joins in October, to add to our strong bench in UK equities. And then when you add to that the talent coming in from Cazenove, I think we have the strongest UK equity team that we've ever had in this firm.

So I'm very positive about the outlook there and we intend to have a fairly significant campaign beginning in -- after the summer, presenting the full range of UK equity products we have, which as I say, is strong, both on the existing talents here, the hires we've made and the complementary Cazenove funds coming in, which are not only UK equities, of course, but also European equities, multi-manager, which we're very enthusiastic about, and fixed income. And all those UK, European multi-manager and fixed income managers are already based here with our investment teams in Gresham Street.

Turning to the Private Bank, £16.9b of assets under management at the end of June, a very small increase in revenues and a matching very small increase in costs led to profit before tax of £10.6m against £10.4m in the first half of last year. We had net outflows, as I said before, of £300m in this business, basically entirely accounted for by existing and continuing client relationships slightly reducing the amount of assets they have at Schroders.

If you just look at net new business wins versus lost client relationships, the result was positive in the first six months. I think I mentioned this before, the ultra-high net worth, we've seen large clients reducing their exposure, diversifying into real estate or their business or any number of other opportunities. And that's what accounted for the net outflow positions. As I say, in terms of new clients versus lost clients, it was a positive position in the first six months.

We've been notified of two big outflows, one of which will certainly come in the third quarter, one may be third or fourth quarter. The first one is [they will] take roughly the same, £750m in a custody-only mandate on a very, very low fee, where we were just custodian for a line of stock. So effectively no impact at all on revenues and profits, but a big headline number in terms of assets. And the other, about the same size, £750m, which is a discretionary account, where a change of generation, change of trustees has led to a change of their strategy as to how they're going to have this money managed. Together these two accounts will account for just over £2m of revenues. So quite a big headline number in terms of AUM but quite a small number in terms of revenues and obviously less than that in terms of profit.

We have new leadership in our Private Banking business here in the UK and Channel Islands, principally sourced out of Cazenove, including Andrew Ross, who heads up -- previously Chief Executive of Cazenove Capital Management, who now heads the Private Bank here in the UK and in the Channel Islands. And we have recently appointed a new Chief Executive for our business in Switzerland.

We see the Cazenove transaction as presenting a very significant opportunity for the Private Bank. It significantly increases our scale in the UK and Channel Islands, taking our business from £11b to £24.2b, so well over double. It gives us a financial planning capability which we have wanted for a long time, which I think will play a major role in winning and retaining clients. It broadens the investment offering, both for Schroders and Cazenove high net worth clients.

It enables us to offer banking services for the first time to Cazenove clients. We've had a very encouraging response, I would say, from the Cazenove clients to this transaction. We've seen it as pretty much a natural in terms of putting these two firms together. And finally, in a sense least importantly but not nevertheless unimportant, we think there's some good cost synergies to be achieved here in the operations and administration side of the business, not in the front office, but in time moving to our very effective operations platform in Zurich.

I'm now going to hand over to Richard to take you through the numbers in a bit more detail.

Richard Keers

CFO

Good morning everyone. This is my first presentation as CFO. I've already met a number of you and I look forward to meeting more of you over the coming weeks and months. So to the numbers, as you've already heard from Mike, these are a strong set of results. Today I want to show you the detail that explains why we say this. We'll look at revenues and costs and I'll comment on the drivers behind them. I'll also give you an overview of our capital position. But let's start with the financial highlights, which set the scene.

Net revenues are up strongly by £101m. That's 19% up on last year. It's also 9% up on 2011, which was a record year for the firm. Higher markets and good investment performance for our clients means that we are now seeing the benefit of the significant organic growth delivered in recent years. We're seeing over £59b of net inflows since the start of 2009, and that excludes recent acquisitions. This combination has led to a significant increase in underling PBT at £228m, up 29% or £51m on last year. We have exceptional items of £6.3m, £6m of which is in the Group segment for STW and Cazenove Capital acquisition costs. I'll return to this later.

I know you focus on underlying diluted EPS. This is up 30% at 64.1p. This is slightly better than the increase in PBT as the effective rate of tax has reduced.

Given these strong results and recognizing our financial strength and confidence in our long-term growth prospects, the Board has recommended at 23% increase in the interim dividend of 16p. This follows the 15% increase to the 2012 final dividend. It's in line with our stated policy in the long term to increase the dividend progressively in line with the trend in profitability. We remain comfortable with an approximately third/two-thirds split between the interim and final, but there's no strict formula here. As always, the final dividend will be set in light of the actual results at the end of the year.

Returning to net revenues in more detail which, as I've mentioned, are up strongly in the half, this slide shows the bridge explaining the increase in net revenue from £544m to £645m. Higher market levels, particularly in Q1, and good investment returns contribute some £61m.

Positive net new business also continues to deliver revenue growth and accounts for £25m of the increase.

Performance fees of £11.8m in the half were £2m higher than 2012. These were all earned in asset management, £11.6m of which was Institutional. Equity mandates dominated, particularly

Australian, Asian and emerging market equities. We expect performance fees to be around £35m for the full year, which, as you know, come mainly in the last quarter.

Finally, STW contributed £4m of revenue in the half. We also saw a £6m increase in net revenue in the Group segment. This was due to higher returns on investment capital, excluding interest earned.

Asset management is 90% of our net revenues. So let me give you the split between our two sales channels.

Starting with Institutional, revenues of £275m are up £42m on last year. Excluding performance fees, net revenue is up £41m, that's 19% up on a year ago. Some £11m of this increase is due to positive net new business over the last two years. A further £25m is due to higher market levels and good investment performance. As you know, many institutional mandates are based on month or quarter-end valuations and despite some volatility in Q2, the MSCI World Index still ended the quarter up a further 1%. STW has contributed £4m of revenue in the half, as I've already mentioned. Performance fees increased by just under £2m to £12m. So the Institutional channel has experienced good core business growth. This has been a key objective in recent years.

Now turning to Intermediary, net revenue is up £53m on last year. Performance fees haven't really featured. Here we've also seen consistent net inflows until June this year, increasing net revenue in the first half by some £15m. Market movements have increased revenue by some £35m. With most retail funds being daily priced, the channel has benefited from sustained higher market levels, particularly in Q1.

Overall, asset management margins, excluding performance fees, are unchanged at 54 basis points. This is compared to both the first half of last year or full year 2012. The benefits of higher markets on higher-margin business has offset downward pressure from product mix changes. This mix change has happened in both channels, with a higher proportion of fixed income and multi-asset business. Behind this, underlying Institutional margins are 39 basis points, unchanged from the same period last year, but 1 basis point down on 2012. The acquisition of STW in Q2, some £7b of AUM at some 20 basis points has had an impact here. In Intermediary, underlying margins were 79 basis points. This is in line with a year ago, but 1 basis point higher than 2012 as a whole.

Whilst it is difficult to forecast, at current market levels we expect margins to remain at these levels for the rest of the year.

Turning now to Private Banking, net revenue margins were 63 basis points in the half, 2 basis points down on a year ago. Net revenues are made up of management and transactional fees and net interest income. Around 1 basis point of the decrease is on management fees. The other is on interest and fee-based income. Overall, revenues, at £53.5m, is up 2% compared to the first half of 2012. This is driven by higher assets under management, up 4%, and this helped to offset the impact of lower margins. Transactional income, in orange, is broadly unchanged at £11m. Net interest income has continued to fall in line with others in the sector and is now £6.2m.

So that brings me to the end of our look at revenue. Let's turn to PBT. This slide shows the movement year on year. You can see the impact of higher revenues of £101m. Compensation costs have increased by £50m, although we have reduced the compensation-to-operating-revenue ratio to 48%. This is down from 49% in 2012. It's too early to predict a final ratio here. It's dependent on market conditions and future recruitment. But for forecasting purposes the first-half ratio is a good estimate for you to use. This will be for the Group as a whole, including Cazenove Capital. Other costs and the contribution from JVs and associates were broadly unchanged. This brings us to profit before tax and exceptional items for the half of £228m.

By segment, you can see the improvement comes through in asset management, up £37m, then the Group segment up £13m, with Private Banking flat year on year.

Turning now to cost in more detail, starting with compensation costs. This is 72% of our cost base. Within comp costs, 52% of our spend is fixed. The fixed spend is up 8% as we've continued to invest in our people. Headcount has increased by 183 since the end of June last year, of which 129 new employees joined us in the first half of this year. Approximately half of this increase is in operations and IT. We continue to recruit for our three-year investment platform program as well as the integration of STW and Cazenove. About a third of the increase is in fixed income, with the addition of STW in Q2. As I've mentioned earlier, we have reduced the comp-to-revenue ratio to 48% from 49% last year as a whole.

Other costs, excluding depreciation, were £114m in the half. They are slightly up on last year. This is partly masked by the insurance recovery in Group of some £5m that we highlighted in Q1. Excluding this, other costs are up 6% on last year as we face inflationary pressure in areas such as accommodation.

We are maintaining our guidance of £275m for the full year. This includes Cazenove but is before exceptional items. Depreciation is within this guidance. It is unchanged in the half, but we expect this to increase in the future given our IT investment program. In total, our spend is equal to a cost-to-net-revenue ratio of 66% in the half. This is better than our long-term target and KPI of 70%.

I'll now take you through exceptional items you can see in our accounts, and I'll also give you some guidance on what you can expect from H2. We've incurred acquisition costs of £4m in the half, mainly on Cazenove. The majority of STW costs were taken last year. Integration cost of £1.5m cover both acquisitions, including some STW redundancies. The intangible asset for STW is £11.7m. We'll amortize this over 10 years and this gives a charge of £0.3m in the half. This is for one quarter so you can expect to see a further £0.6m in H2.

As you know, we completed the STW acquisition on April 2. The interim accounts disclose the consideration paid of £34.7m. The full acquisition cost, including deferred compensation, was £43.5m though. This deferred comp will be expensed over the next four years. We'll treat it as an exceptional item and, as such, it won't be included in our compensation-to-operating-revenue ratio. For H1, we'll have a charge of £0.5m. This is shown as deferred compensation arising from acquisitions.

Looking ahead to the second half, we've completed the acquisition of Cazenove on July 2. The final acquisition cost was £413m. This compares to the £424m when we announced the deal. In March we had to make some estimates, such as the fully diluted share count. We now have a more accurate view.

In total I'd expect some £30m of exceptional items over the next six months. These include a further £1m for STW deferred compensation. For Cazenove, we will treat the £29m of post-acquisition remuneration in the same way as STW. This means we'll see a further £8m exceptional item in H2 for deferred comp.

We are still working on our detailed integration plans, but you can continue to assume that exceptional costs will be some 1.5 times the synergies. This is consistent with what we said in March. That's some £23m of cost split equally over the second half of this year and 2014. So £11.5m this year to achieve the Cazenove synergies. You can also add a further £2m to £3m charge for STW integration-related spend. Our current estimate for Cazenove amortization remains around £14m for the full year, so £7m in H2, but we'll update you on this as part of the Q3 results in November.

So let me now turn to the Group segment. This is investment capital returns offset by governance and other central costs. We have a profit of £5.3m in the half compared to an £8.2m loss last year. This excludes items that go through reserves, such as on private equity. This has reduced returns by £2.1m this year. The total return for the segment is a profit of £3.2m compared to a loss of £0.9m last year.

Investment capital returns are some £12m. This is the total of net revenue and interest income, plus what has gone through reserves. Central costs or operating expenses, as you can see on the slide, are £7.5m. These are flattered by the insurance credit of £5m that we booked in Q1. Excluding this, we are still seeing a run rate of some £28m a year. For forecasting purposes, we continue to expect investment capital returns to cover costs, so a nil result for the second half. This excludes exceptional items.

The final part of the income statement is the tax charge. The effective rate of tax is 21% for the half. This is in line with guidance and I would expect it to remain around this level for the full year. After deducting the tax charge, our post-tax profit before exceptional items is £180m. This is equal to earnings per share of 66.3p.

So leaving the income statement and turning to capital, overall capital has increased by £115m. On the last slide we saw that the post-tax profit after exceptional items was £174m. During H1 we spent £36m on net share purchases to hedge our employee share awards. In May we paid the final dividend for 2012. This was a further £80m returned to shareholders. Next we have foreign exchange differences on our overseas operations after hedging. These increased capital by £27m in the half. Together with other movements, such as share-based payments, this leaves us with an end June position of nearly £2.2b.

This is a busy slide, but one that I know you are familiar with. On the left-hand side you can see the breakdown of the £2.2b of capital. £879m is operational capital, mainly cash and other working capital balances. Regulatory capital of £554m is within this. Investment capital before the completion of Cazenove has increased to nearly £1.1b. Dividends from subsidiaries have been offset by the share buybacks and dividend payments during the half, as I've already mentioned. Investment capital is analysed in the pie chart on the right of the slide.

We increased our cash holdings at the end of June in advance of completing the Cazenove deal. On a pro forma basis, deducting the £413m spent on Cazenove, investment capital is £664m. Of the £413m, £217m is loan notes, which for this purpose I've taken off investment capital. Cazenove shareholders have the option to roll these loan notes over into funds. We expect there to be a high level of conversion. However, as the election period is open until August 12, I can't give you the final picture yet.

So that concludes my part of the presentation and I'd like to hand you back to Mike. Thank you.

Michael Dobson

Chief Executive

So looking at the outlook and priorities. Those of you who've been following us for some time will be quite familiar with our outlook because we always say that we can't predict the short term and therefore we don't particularly focus on the short term. We are not fixated on monthly flows, quarterly flows. It absolutely is without our control and therefore we don't spend time focusing on it.

We are passionately interested about building this business, taking a three- to five-year view of how we want this firm to look three to five years out. And every single thing we do, whether it's an organic investment decision or an inorganic investment decision is based on that time horizon. And so please remember that when people write that our outlook is less positive that someone else's, or whatever, it is entirely consistent with the philosophy we have in building shareholder value over the long term.

So we're saying that we do think we're going to remain in a volatile market for investment demand. And we've seen an incredible rollercoaster of significant investment demand in the first four and a half months of the year, the brakes being slammed on completely and going into reverse full out in the latter part of May and June, and we've seen it come back in July and we've got good flows in institutional and good flows in retail. But we can't predict that, so we do think that that uncertain, difficult-to-predict environment will continue.

We're focusing on the competitive advantage we think we have and leveraging that to the full. And it starts with the extraordinary base of talent we have in this Company. And as I look at it today, I think it's the greatest pool of talent this firm has ever had.

Secondly, on, and most importantly, on what we do for our clients in terms of delivering performance, it's absolutely critical. And again, we try to focus on three- to five-year returns, not 12-month returns. But as you saw, just over two-thirds of our funds are outperforming benchmark or peer group, which we think is a good number. We want to see it higher, but we think it is a good and a competitive number.

We have an extraordinarily broad product range. And this is key to what we do here. If you look at some of the flows we've generated in Asia in, for example, intermediary in Asian multi-asset income fund, we've generated billions of flows. We've closed that fund for capacity reasons. We're always looking to close funds if we think they're pushing their capacity, which could damage returns for investors. So we closed that. It's led to £500m of outflows net in the second quarter.

But on the other hand we brought forward a global multi-asset income fund just to, in a way, replace that. And we've generated £1.1b of net inflows in the second quarter in global multi-asset income.

So the breadth of the product range is key to our strategy and how we want to position this firm long term.

We have an extraordinary distribution capability in this Company. You've seen it in terms of the gross inflows we've generated in the first six months in Institutional and in our Intermediary retail business. So it's a competitive strength for the firm, one we're very proud of, and we will leverage that to the full.

We have, I believe, a unique global footprint. 70% of our business outside the UK. A phenomenally strong position in Asia, in Continental Europe. A growing position in the Middle East. Big growth opportunities I think in the United States. We have new leadership of our US business. We've just completed the STW acquisition. And I think I said here before that our plan is to grow the United States as a proportion of the whole, from about 10% where it is today, to double that as a proportion of the totality over the next five years.

And finally, we are now I think, certainly in the European context, a scale player, with Cazenove, close to £260b under management. And I think there's an increasing advantage of scale in terms of costs, in terms of dealing with the regulatory agenda, in terms of maximizing distribution relationships.

We're very focused on the acquisition of these two -- the integration of these two acquisitions. So STW, which will be completed this year in terms of the integration program, and of Cazenove, which we expect to complete by this time next year in terms of integration. So far, as I think you will have seen and you've heard me say, we're very pleased with the early results from these two important transactions.

We have an on-going program here to strengthen our business organically. We say in the management statement that we see these two transactions as being unusual opportunities to strengthen our business in areas which are strategically important to us. But I would stress the word unusual. This firm remains committed to an organic growth strategy. We believe that is the best way to build value over the long term for clients and for shareholders, and that's where our focus returns.

And we will continue to invest heavily in the long-term organic growth of the Company. We're doing it in a major IT project, you've heard us talk about that before, in support of our investors, which is a heavy weight on the cost base this year, next year and to some extent into 2015. We do it in terms of selectively adding to the great talent pool we already have here, in investment, in distribution, in private banking and in our support areas.

Irrespective of short-term volatility, we think we remain committed to the long-term growth prospects of the firm. It's one of the factors that underlies this decision on the dividend. And we think the long-term opportunities, given the business model and the very diversified business model we have, remain very exciting.

So thank you very much and we're happy to take your questions. There's one. Can we have a microphone over here, please?

Q&A Session

Catherine Heath - Cantor Fitzgerald

Thank you. Catherine Heath, Cantor Fitzgerald. Can you talk a little bit more about the integration of Cazenove, please, and what the milestones are that we need to think about over the next 12 months?

And also how you're going to manage the two separate brands, which I think is your intention? Thank you.

Michael Dobson

On brand, we are migrating the Cazenove brand in the investment funds business to Schroders. On the other hand, we are keeping the Cazenove brand in the wealth management business. And we are using both brands, Schroders and Cazenove, in the wealth management private banking business. We believe they're both very strong brands. We believe passionately in our own and we think we've acquired with Cazenove a great brand in the wealth management space, particularly in the UK, and so we're going to keep both. But on the investment fund side, we're going to migrate over time to Schroders.

In terms of milestones, I think that we have, as I said before, we've integrated the investment business now here and all the investors, the Cazenove investors you will find here in Gresham Street, either in equities or in fixed income. We are getting behind some of these strategies along with our own existing strategies in the third and fourth quarter of this year, with a marketing program taking some of these strategies to the market, to some of our existing distribution relationships. And I think I'm very excited about that given the complementarity of those strategies and the performance that Cazenove have generated.

On the Private Banking side, we are going to center our private bank in London in the Cazenove building in Moorgate and that will happen in November of this year. So moving the other way, our Private Bank moving here from Wood Street into Moorgate in November, once we've made a few changes to that building, whereas the investment funds side has already moved here.

In terms of the back office, there's a lot of work to be done. Over time we're going to center that on our Zurich centre, which is highly efficient for private clients. It gets reports out very quickly after the quarter end in a very efficient and I think informative way. And we think that's a big opportunity for Cazenove clients. But we're going to do that in a thoughtful way. And we don't expect to complete that until July of next year. So this is a process where we're more intent on quality than speed, and particularly quality of client experience.

In terms of exceptionals, as you've heard it from Richard, there will be two or three years of exceptionals going through the P&L and then that'll be done with.

In terms of client losses, I was asked when we announced the transaction, I think on March 25, what have you factored in for losses. And we said, well, we're not factoring in anything. And so far indeed it's been the opposite because we've seen good gains and, as I said before, interestingly even stronger gains in the second quarter than in the first quarter of this year in both those businesses of investment funds and wealth management.

But obviously it's early days and we watch that very closely, and we factored in a good margin for that. But I think that our early experience is great and the feedback we've had from Cazenove clients is great. They see it as a natural fit, a similar culture and I think from their point of view something which is quite exciting and offers some very significant opportunities for them too. So I think it's so far very good.

So there are a lot of internal milestones we have. But over time you will see the business integrated. I think a much stronger Private Banking business, much bigger presence in the marketplace, and I think some very interesting and complementary additions to our investment range within asset management, and particularly within the UK intermediary sector.

Catherine Heath

Thank you.

Michael Dobson

One here. Thank you.

Chris Turner - Goldman Sachs

Yes. It's Chris Turner from Goldman Sachs. Two questions, if I may. Firstly to you, Michael. Compared to Schroders' very strong footprint in other geographies, I think as you've touched on in your closing remarks, Schroders is slightly more modestly sized in the US. STW helps with that a little bit, but can you just expand on your comments about the potential for Schroders to grow much larger in the US region?

And then the second question actually for Richard, slightly technical, which is I noticed the operational capital has declined by, I think, about £80m half on half, about a decline of about 8%. Can you just explain this and what is going on there, please?

Michael Dobson

So as far as the US is concerned, we have essentially two businesses in the United States. One is selling international products into the US, so products managed in London particularly, but also in Asia to some extent, and it ranges from equity products, ex-US international equities, global equities, emerging market equities, quantitative equities, a range of fixed income products, multi-asset, and some of our products within, for example, emerging market debt and commodities. So that's one business which is significant and we think we can grow it.

And we are -- we have a strong distribution capability in the US. We will be selectively strengthening that. And we are in that market in both institutional and intermediary, and we can grow that and we plan to do so.

The second business is domestically manufactured asset classes or managed asset classes in US equities, large cap, small cap, mid cap, and US fixed income, and there of course STW has helped and it's pretty much doubled our US fixed income business and I think we are grow that too. What we're saying is that irrespective of whether the overall market is growing that much, and for example, defined benefit pension plans, our market share is so small and I think some of the strengths we have are so significant that we can really build market share.

We've had great success in the United States in the last 10 years. 10 years ago, I may have said this to you before, 10 years ago we were losing assets under management. We had net outflows, significant net outflows year on year and we were losing £10m a year in that business. Today we're growing in terms of net flows in intermediary and institutional. And we have a good, profitable business in that marketplace and, very importantly, a strong reputation.

So I think, with those building blocks, what we're saying to ourselves is this can be a much bigger region for us and we want it to be. I don't think it's going to lead to further acquisitions. I think we can do this organically. STW is a useful bolt-on transaction with strong performance, 100 institutional client relationships which are new to us, with very little overlap. I think there's some cross-selling opportunity, but that's not the priority for us. The priority for us is to solidify those client relationships, bed them down in the new Schroders environment before we offer up new products to them. But I think ultimately there's a cross-selling opportunity.

And so far we're pleased. So the business is moving from California to New York. The fund managers are moving to be integrated with our business. And the client response, as I say, has been good.

Richard?

Richard Keers

In terms of the operational capital, we flagged in the annual report that we were increasing dividends up from subsidiaries of -- to £300m. So that accounts for the increase.

Chris Turner

And just to follow up, you still have, I think, about £300m or so in surplus over the regulatory capital. Is there capacity to bring up more over the next six months or so?

Richard Keers

I think it'd be wrong to infer -- there's a minimum regulatory requirement, but you always need a margin above that. And this is obviously in a number of overseas territories. You've got to deal with overseas regulators and their expectations are to have a margin above the minimum.

Chris Turner

Thank you.

Jonathan Richards - Bank of America - Merrill Lynch

Jonathan Richards from Bank of America - Merrill Lynch. Couple of questions, if I can. Firstly on the strategy that you talked about for your new launch of your UK retail business. Could you just give us a little bit more of an idea of what you're thinking about there and how that dovetails with the new operating environment post the implementation of the RDR?

And then secondly on your global multi-asset launch of funds, can you give us an idea of the regional split of that? I think you said about £1b of inflows that you saw in Q2. Is that predominantly Asia again or are you seeing the multi-asset demand, if you will, broaden out to different geographies? Thank you.

Michael Dobson

Multi-asset is much broader than just Asia. Asia's been particularly strong for us, but the UK has been good and the United States has also been very strong for quite some time. But Massimo, would you like to pick up on that and particularly the UK point?

Massimo Tosato - Executive Vice-Chairman and Global Head of Distribution

Yes. The specific fund, the global multi-asset income has seen strong growth both in Asia and in Continental Europe. In Asia we have used it to complement our relationship where we were closing down the Asian asset income for capacity reasons. And that's to say that even in the, mentioning the capacity issues of the Asian asset income, we have started to experiment quite innovative strategy, where we had closed in some countries, but for other countries that had a later regulatory approval we had kept special share classes open. So for example, we have been open in Korea and we are now opening in Taiwan while we are closing Hong Kong and Singapore.

So we have been able and we are recapturing some of the outflows from wealth managers that cannot handle portfolio models with closed funds and are exiting the product in other countries to reduce the outflows. Global asset income has been part of this strategy where it has been offered as a complementary and broader diversification than the previous product.

The first question was about the effect of the RDR in our UK business or else?

Michael Dobson

Also about some of the equity strategies we have in the UK and Cazenove and existing strategies and so on.

Massimo Tosato

If you take the Cazenove roster, they had excellent results in Julie Dean's UK Opportunities and in Marriage UK smaller companies. However, those two products are now near to capacity.

Where we see a major opportunity is in the multi-manager line, the one run by McDonald and Brookes. That's very important to us because this is a segment where we were not competitive. And if you divide by UK retail in advisory and discretionary, in advisory the gross flows in multi-manager is being constantly around 20%, 25% in the last few years. That gave us a major capability to compete in the sector with a much stronger and broader distribution force.

We are also very keen on the UK equity income by Mr. Hudson, because that income space is the more core income space, where income space is more in the recovery. So the two can sit next one to the other and satisfy different customer needs. Finally, there is also a strength in the European income product run by Mr. Sym, that is complementary to our own European where we already had a quite broad range.

In respect to the specific effect of RDR, we have seen a little bit of a weaker and uncertain market in the recent couple of months. But actually, if you analyse our UK flows, net of the losses of the UK Alpha team, and you even take into consideration -- you don't even take into consideration the fact that we were missing, not only we lost assets but we were missing a segment in demand, we still had £900m to £1b of net positive inflows in that business. So it would have been one of the best years, actually cracking first half, if not for the Alpha team. And it's running very well.

Daniel Garrod - Barclays

Good morning. Daniel Garrod from Barclays. Can I follow on from that on what's going on in the UK revenue margin discussions with distributors? We got a flavour from Standard Life of the kind of discounts that they've managed to achieve. Are you seeing that kind of pressure on your revenue margins or is that a one-off, the comments out of them? That would be the first question.

Second, you obviously highlighted £1.5b out of the UK Alpha. Can you just remind us where we are on the remaining overhang from there, what your anticipation about what further assets might come out of there in the second half?

And then thirdly, have you had some recent staff turnover in your equities division? Any colour on what's been going on there? Is that just right-sizing ahead of Cazenove integration? Thank you.

Michael Dobson

If I deal with the last point, I'm not sure --

Massimo Tosato

I can deal with the numbers, if you don't mind.

Michael Dobson

Yes. This staff turnover, I'm not quite sure what you're referring to.

Daniel Garrod

I believe you've had some turnover in the equity research area recently.

Michael Dobson

Yes. I think maybe two or three people. We've got 150 analysts.

Massimo, do you want to pick up the first two?

Massimo Tosato

Yes. I can update you on July 31 data, if you like. The overall Alpha range that was managed by the team that left, so it's not just the UK Alpha Plus fund, but a number of other funds and some advised mandates. As of July 31, since the day of the announcement March 15, has lost £1.96b of assets, in addition to which we have notified but not yet gone sub-advisory mandate for £377m. So the total that is gone or will go is £2.3b.

From there the daily flows have now reduced to a drizzle. And we estimate that only £100m to £200m over the next six months will go out. So you could conclude that we have retained about half of the assets. And now that we have the Cazenove teams and the new team members that have joined us or will join us in October, from here we will start to recover.

Michael Dobson

And do you want to talk about UK revenue?

Massimo Tosato

Yes. Unquestionably there is some margin pressure from the large operator. That is also the reverse in our case. You might have noticed that the margins of Cazenove are lower than our own margin. Part of that is product mix, the strong presence of multi-manager versus equity, where we are already heavier in equity and lower in multi-manager. And multi-manager comes with 47, 48-basis-point margin.

The second point, however, that you can measure in 4 or 5 basis points is the fact that Cazenove has a small distribution strength and size and breadth of product offering than we have. So they have to pay 4 or 5 basis points more to distributors than we do. So that gives you an idea that the strength is on both sides, the big buyers but also the big providers.

Having said that, unquestionably we would expect for the very large player a reduction in margin. But actually we estimate worldwide, as Mike has mentioned at the beginning, to be between 10% and 15% over the next three to five years in the intermediary. That would put the business more or less in line with the US average. That is currently 7 basis points lower than the rest of the world as a weighted average once you unbundle the pricing with -- from distribution cost, administration, transfer agency, etc.

Daniel Garrod

Thank you.

Michael Dobson

Anything else? Yes?

Arnaud Giblat - UBS

Good morning. It's Arnaud Giblat from UBS. Two questions, please. In Europe, Germany, a few Nordic countries, Netherlands are under way of implementing a retail distribution review. Is this -- do you see this as a big opportunity for you to have better access to distribution? And how are you positioning yourself for that?

And the second question is on surplus capital. Previously you had indicated that in the medium term you were targeting to return, to look at returns to shareholders. How has that thought process evolved, especially in light of today's comments on really targeting on growing the business organically.

Michael Dobson

I'll deal with capital and then Massimo, perhaps you can pick up the comment in Europe and particularly Germany.

So, as you heard, our surplus capital as a result of Cazenove was reduced from £1.1b to about £660m. We think that we will replenish that reasonably quickly given the cash generative powers of this business. We haven't in any way changed our view on surplus capital. So our view is that it is a core belief of Schroders that we are going to retain a strong capital position. We're going to run with Cazenove's close to £260b. We have about £1.9b of tangible equity. Running £260b, some people will say that's vastly over-capitalized. Some people would have a different view.

There's no question that the regulators are moving in our direction and I expect to see much more strongly capitalized asset management companies, which I personally believe is essential and it's going to happen, and there is going to be demand for it. And, as we've said repeatedly, one of the reasons, one among many of the reasons for the success of Schroders, you've heard about £59m of net inflows over the last few years, is unquestionably the financial strength of this Company and how that plays into our ability to take long term views as we build this business and take those decisions. So we haven't changed our views at all on that.

We have had a program of buying back non-voting shares. We never issues shares, so if we issue shares as part of employee stock programs or as part of an acquisition of Cazenove we always buy them in to cancel them in the marketplace. So you will never see this firm being a net issuer of stock if anything it will be slightly reduced through the non-voting share buyback programs.

You've seen a 23% increase in the dividend. We want to see a progressive dividend policy, increasing dividends broadly in line with increases in profits. And I think that's what we've done and we will continue to do that. So I think if this firm does well, as I believe it will, then I think you can look forward to further dividend increases in the future.

Finally, I would say of course ultimately there may come a time where we believe excess capital has got to such a stage we want to look at something more substantive, but we've never -- we haven't done that in the past because frankly we haven't felt we came to that time. Maybe we were getting towards it, but then we found, I think, two very good acquisition opportunities which we've executed on. Now the time may come in the future. We're not blind to that. But we don't think we are there yet and we think this strategy on the balance sheet has been entirely appropriate for this Company. I don't comment on others, but for Schroders we adhere completely to that philosophy.

Mass, do you want to pick up the other point?

Massimo Tosato

The two countries where the possible implementation of similar rulings are the Netherlands and Switzerland. The Netherlands has been already implemented and will start on January 1. In Switzerland that is the consequence of a court ruling that affect the discretionary private banking business and one big player, UBS, has already announced that they will move their discretionary business into a net pricing model for underlying funds.

That is a managerial source of concern for the industry because while we favour transparency across the market the delay in the implementation of a European ruling is creating a vulcanisation of different structure that is something that add cost and complexity for us to manage. So we would embrace positively the development, but we would not embrace positively a set of individual rules, laws or interpretation of courts' ruling in different one country from the other.

Having said that, we have already net share classes. We have used them for a long time. A large part of our business is already in net pricing share classes. We are launching in those countries specifically another additional range of share classes that reflect exactly our current net pricing after distribution fee. So we are coping with it in a relatively simple way and it's not a disruption to the business.

Actually as you hinted there are some opportunities out of it because these complexities are not easy for a small player to handle. Some of the large players, and only the large can afford that, are building their own fund range that they will then outsource recycling margins through profitability rather than through commission. In that case they prefer to select a limited number of providers then they can serve them across the board. And we are one of those providers that have a breadth, a full range, and the breadth of distribution coverage that can be selected.

Arnaud Giblat

Thank you.

Peter Lenardos – RBC Capital Markets

Good morning. It's Peter Lenardos from RBC. Just a question on STW. The first one is you indicated £6.6b STW AUM at the end of the quarter against £7.1b for the prior. I was curious if the £0.5b difference was the result of outflows since the acquisition.

And the second question would be is how much surplus capital is required in both acquisitions? Thanks.

Michael Dobson

Richard, maybe you can deal with the second question. The first question £7.1b, as you correctly say at acquisition, £6.6b at the end of June, the difference being accounted for roughly equally between outflows and market movements in long duration bonds.

Richard, do you want to deal with the other two points?

Richard Keers

I don't have the STW surplus capital [marker].

Michael Dobson

STW is small. Caz?

Richard Keers

The answer is we don't know. We're still working through the balance sheet at the moment. I will come back in quarter three and brief you fully in terms of intangibles, goodwill split and take you through how we see the regulatory capital position of Cazenove.

Michael Dobson

But I think we can give a broad number for capital in the business.

Richard Keers

£30m.

Gurjit Kambo - Credit Suisse

Hi. It's Gurjit from Credit Suisse. Just a question for you, Massimo, just on you mentioned a couple of UK funds being close to capacity. Are there any other funds which are close to capacity?

And in terms of the multi-asset, is it right to think given the nature of those funds, that capacity is not really an issue there?

Massimo Tosato

You're absolutely right; in most of our multi-assets fund there are no capacity issue. In some, like the Asian asset income, which is more regionally specific, you sometimes, you have a capacity issue in the underlying component, and so one slice might constrain the capacity of the overall product. But because most of the multi-assets is in tailor-made, custom-made strategies, I don't see an issue going forward in that. And actually part of it, that one is designed for the institutional market, the strategic beta, has immense capacity availability.

There are not other products that are currently close to capacity. There are some strategies that are high in our consideration with respect to capacity, for example the emerging market equity one.

Gurjit Kambo

Thank you.

David McCann - Numis Securities

Good morning. David McCann from Numis. Just wanted to pick up a question you've had a couple of times on the surplus capital and more related to the dividend. Gave guidance back in February/March that we should expect the dividend to grow in line with operating profit. It looks like it has actually grown more in line with statutory profit. Is that revised guidance we should look for going forward or does the operating profit growth guidance still stand for the full year?

Michael Dobson

We never meant to give the impression that there's a lock-step move in the dividend in line with profits. We said we wanted to increase – well, not precisely so it's not going to be a sort of pound-for-pound increase, point one. We want to have a progressive dividend policy and I think a 23% increase in the dividend in the context of a 29% increase in pre-tax, pre-exceptional profits is broadly in line. But we never meant to give the impression it's going to be, as it were, precisely in line in that sense.

Secondly, the dividend, the final dividend in the context of the overall year is always in our view a more important decision and a better decision in a sense. You've heard Richard say before that we want to over time broadly get to a one-third/two-third split. But there is no -- you shouldn't read in that therefore that's a precise commitment for the final dividend. We'll take that decision at the time of the final results in March next year.

David McCann

But broadly speaking because of the level of exceptionals you've guided to today coming in, there will be a reasonable difference in the growth this year and next between statutory profit and underlying profit, so which of those two measures would you say is the more reasonable to look for?

Michael Dobson

I think underlying profit is what we're going to --

David McCann

The underlying profit. Okay. Thank you.

Michael Dobson

Just I think, Richard, do you want to come back for a point of clarity on the Cazenove capital position?

Richard Keers

Peter, can I just check your question? Was it surplus regulatory capital or the tangible assets acquired?

Peter Lenardos

Surplus regulatory capital.

Richard Keers

Because the tangible assets are at about £89m. The surplus capital is broadly £30m.

Uri Mulmani - Canaccord Genuity

Hello. I had -- [Uri Mulmani] from Canaccord Genuity -- two questions, one on Private Bank and the other on asset management. On the Private Bank, given there you're running both brands, could you talk a bit more on what you're doing with the Schroders brand of private equity -- sorry, Private Bank, because that's been underperforming for the last couple of halves or two years?

And the other one's on asset management. Given how you've seen the flow reverse between Q1 and Q2 largely because of fixed income, some fund managers moving that across or in mutual funds, could you just talk about how much of the AUM might be at risk and how do you mitigate that in case there is a theme flow between fixed income to equity or multi-asset?

Michael Dobson

I'll deal with the last point and maybe, Philip, you could pick up the first point on the Private Bank. There was obviously a manager-related flow in UK Alpha. There's been no manager-related flow elsewhere. Fixed income, we had a couple of unusual events in the second quarter with STW and with this one big US fund diversifying, but I don't see any other influences of that kind. And we've seen a good pick up in flows in July and we have, as I say, a very diversified product range and so we tend to pick up flows, demand in many different assets classes in many different regions from many different client types in any one given point of time. So I don't think, absent UK Alpha, that's an issue.

Philip, do you want to pick up on the Private Bank?

Philip Mallinckrodt - Group Head of Private Banking

Yes. Number one, I don't think we're looking at a link between the performance issues and the brand issues, so we are really looking at the brand in a forward looking way. And, as we said, nothing has changed in that since the statement in March. We are looking at how we incorporate the Cazenove Capital brand in our Private Banking business mainly in the UK and that will be confirmed probably in the fourth quarter later on this year.

Uri Mulmani

Could I just come back to that? You see the Cazenove growing just by its underlying revenues, but you don't see the Private Bank at Schroders doing much since the last two years. Could you talk a bit about growth strategy or what else do you -- do you just -- the strategy would just be to put the Cazenove brand into the Schroders existing client, and that's how you grow or do you create new products?

Philip Mallinckrodt

I think if you look at the growth patterns that we've actually had, you have to take on board two things. Number one, our business mix was more exposed to the international markets than to the UK market, including changes in what's been happening in Switzerland, but also in the offshore markets that affects both the Channel Islands and Singapore, if you will. So the Cazenove acquisition has re-tilted us more towards a domestic wealth management franchise and that was deliberate, and part and parcel of how we saw changes both in onshore and offshore wealth management markets.

Secondly, we were more weighted to the ultra-high-net-worth segment and, as Mike has referred to, there have been different dynamics there. And the Cazenove business is more weighted towards the high-net-worth segment, also some material ultra-high-net-worth segment. But, again, from a strategic point of view when we were looking at this in the run up to the acquisition, it was part geography and part breadth business if you will.

And I think as we put these businesses together we are looking through the brand question, because the brands have, both brands have very strong resonance with different client bases, if you will.

And we, as I said, we'll probably unveil in the fourth quarter precisely how we are going to bring that closer together. But behind that there is the substance in terms of where we are going to growth in terms of both geography and breadth.

And I would say that as I look at the combined business in the UK, I look at it in four ways, the UK high-net-worth business, the UK ultra-high-net-worth business, the charities business and the international business. And I think that the two firms combined have a strong presence in both the UK ultra-high-net-worth and in the charities sector. And I think we have a tonne of growth opportunity both in the UK high-net-worth sector and in terms of the international community, which is partially London but partially the linkage with our overseas subsidiaries in Channel Islands, Switzerland and Singapore.

So we're really looking at the business segments, if you will, in terms of our relative weight in those different parts of the market in terms of where we emphasize marketing and growth opportunities.

Uri Mulmani

Can I just ask whether the kinds of UBS or a Credit Suisse in their strategy, would that affect you much in the clients that you are targeting in Private Banking?

Philip Mallinckrodt

No, I think UBS and Credit Suisse and indeed the JP Morgans and HSBCs are the mega-banks. And in reality a lot of the business that we compete for, we see them in certain areas but I wouldn't extrapolate their positioning on to us. I think we approach it in a slightly different way.

Uri Mulmani

Thank you.

Michael Dobson

Okay, if there are no more questions, thank you very much.

[End]