Schroders PLC
2014 Half-Year Results

Michael Dobson

Chief Executive

Okay. Good morning everyone and welcome to Schroders. We've discussed here before on these occasions the key areas of focus that the firm is concentrating on and that has not changed, and I think that in these key areas we've made good progress in the first half of 2014.

First of all, in continually seeking to diversify our sources of revenue by client type, by asset class and by region. Secondly, focusing on building scale in multi-asset and fixed-income multi-asset is now up to £57b of assets under management; fixed income is at £45b.

In transforming our position in UK wealth management, in terms of market position, where we now have assets under management in the UK segment of our wealth management business across high net worth and charities of £25b. And in terms of its contribution to the firm overall; wealth management now accounts for 14% of Schroders' total revenues and 10% of profit.

In seeking to grow in the US, where we see significant medium-term opportunities, and our acquisition of STW last year and the integration of that business this year has been an important step in that plan, in selectively adding to the talent pool here that we have at Schroders.

By way of example, this year in investment we have a new Head of Equities. We have added importantly to our global and international equity team. In distribution we have a new Head of Distribution in the US. A new Country Head in France. A new Head of UK Client Relationships. And for the first time someone filling the role as Head of Public Policy, as regulatory and political situations become more and more important for this industry.

In finding ways to benefit from the scale we've built in recent years to counteract the continuing pressure on fees and costs, costs partly in relation to regulatory change that we see coming for this industry.

And then finally, in delivering shareholder value, by maintaining our focus on the long term, on building a diversified, profitable, sustainable business that delivers to shareholders, as evidenced by the announcement we made on the dividend this morning.

Turning to the results, I think this is evidence that this focus is delivering. We had profit before tax and exceptional items in the first half of 2014 at a record level, up 15% at £261.5m. That's after a negative foreign exchange impact of £18m. If sterling had been at the same level as it was in the first half of last year our profits would have been £18m higher.

72% of funds are outperforming benchmark or pier group in the three months to the end of -- sorry, in the three years to the end of June. Net inflows £4.8b in the first half of 2014 against £4.5b in the first half of 2013. Assets under management up 15% to a new high of £271.5b. If sterling had been at the same level as it was a year ago, those assets under management would have been £17b higher.

And finally we announced an increase in the interim dividend of 50%, to 24p a share, reflecting these satisfactory results in the first half of 2014, the Board's long-term confidence in the business. A move towards a higher, targeted dividend payout ratio of 45% to 50% over the cycle -- I would emphasize over the cycle -- compared to the probably 35% to 40% we've been operating at in the past. And also a move to rebalance the interim against the final dividend. In recent years we have made perhaps not surprisingly larger increases in the final dividend and we want to get back to that one thirds, two thirds broad balance that we've had in the past.

Looking at net inflows, £4.8b in the first half of 2014 compares to £4.5b in the first half of last year, £3.4b in the second half of 2014 (sic ? se slide 2 "2013").

Turning to the breakdown of this £4.8b, by channel, £3.8b in intermediary, £700m of net inflows in institutional and £300m of net inflows in wealth management. By region, £3.1b in Continental Europe, £1.4b of net inflows in the UK, £900m in Asia Pacific and we had £600m of net outflows in the Americas, in the United States and Latin America.

By asset class, £3.9b in multi-asset, that's net of some outflows in our commodities fund-of-hedge-funds which we decided to close. That is included in the multi-asset segment. That's net of about £400m outflows in commodities fund-of-hedge-funds. £900m net inflows in equities. £500m in fixed income. £300m in wealth management. £300m in our property business. And outflows in our direct commodities business of £1.1b.

Turning to the institutional business, we saw some slowdown in the funding of new mandates in the first half of 2014. Everything is relative. We won £11.4b of gross new business in the first half of 2014, but that compared with £14.2b in the first half of 2013. And it's that that has accounted for a slowdown in net inflows to £700m compared to £2.1b of net inflows in institutional in the first half of last year. So in fact gross outflows are slightly down, gross inflows are down more, and that is why the net number stands at £700m.

In terms of net outflows we had £900m of net outflows in our direct commodities business. We had £1.1b of net outflows in global equities, predominantly quant equities. I don't see anything problematic in this. This has been a very fast-growing area of our business. It's now in excess of £20b. We've won some very significant mandates. This is partly rebalancing. It's partly some clients who gave us multi-billion-pound mandates who wanted to reduce that to diversify, still retaining the significant exposure to Schroders and global equities. But there was an unusual £1.1b outflow in global equities in net terms in the first half of the year.

We had a strong performance in multi-asset, £2.2b of net inflows. And although equities are negative overall, we had some very strong parts of our equity business, not least in emerging market equities with £700m of net inflows.

In bonds, again a negative overall number, but some very strong parts of that, £400m of net inflows in European bonds.

We have a significant pipeline of business we have won that has not yet been funded. It's by far the largest we've ever had. It is of course heavily influenced by Friends Life, £12.2b, which we still expect to fund in the fourth quarter of this year. But we also have quite a significant pipeline of business we've won, which hasn't yet been funded, quite apart from Friends Life.

The STW acquisition has been completed. We are pleased with that. We've had some outflows relating to the acquisition, some outflows relating to clients deciding to move out of long bonds. So probably from when we bought the Business we've seen a 10% to 15% reduction in AUM. More importantly, however, the performance has been outstanding, the investment performance of clients and I think we are very well positioned to grow that business. The integration is complete and we are very pleased with that transaction, and what STW brings to our fixed income business.

Turning to intermediary, we had a high level of gross sales, at £23.3b in the first six months. Net inflows of £3.8b, 90% of which -- 90% was in branded funds so it's been very heavily branded versus sub-advised. Multi-asset again strong, with net inflows of £1.9b. Equities £1.4b and £700m of net inflows in fixed income. Regionally it's a very strong performance in Continental Europe with £2.5b of net inflows. Positive flows in Asia of £900m and in the UK with £600m.

On wealth management revenues up 88% to £105m. Profit before tax more than doubled to £26.3m, obviously reflecting the inclusion of Cazenove. The Cazenove transaction you will recall closed in early July last year so we didn't have it in the first half of 2013. And this is the impact of Cazenove and the underlying growth in our own business coming through in these numbers.

Net inflows in the second quarter of £300m. We had a flat, you may recall, flow figure in the first quarter. The first quarter we had the residual outflow of those two very large clients we lost last year, which we announced. I think about £250m came out in Q1. So I think £300m net year to date, net of that outflow of £250m, we regard as quite a satisfactory result. And I think it's evidence that this integration plan, the client proposition, the buy-in from clients and prospects, is coming through very nicely in that business.

The integration plan is on track and we expect that the cost of synergies will come in at the top end of the range that we gave you when we announced the transaction a year ago. We have a transformed position in the UK market. As I said earlier, £25b of assets under management in this area in the UK. And I think the outlook for the long term is very strong. I think we have a very well-positioned business, bringing together the strengths of Schroders and Cazenove Capital in this area.

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

Richard Keers

CFO

Good morning. As you've already heard from Mike, once again we have delivered record H1 results. We have benefited from the success of the acquisitions we completed last year. 2014 is the first full year of our ownership of STW and Cazenove Capital, and the benefit of those acquisitions can be seen in our half-year results. We have also had good organic growth, but that growth has been partially offset by the strengthening of sterling against most currencies. I will return to currency later.

I'd like to start with the financial highlights. Net revenues are up strongly by £84m. That's 13% up on last year. Our stronger revenue is driven by the additional contribution from Cazenove and STW as well as good organic growth. Net revenue includes performance fees at some £8m.

The increase in AUM and good cost control have led to a significant increase in underlying PBT at £261.5m. That's £33.5m up on last year or some 15%. We have exceptional items of £27.6m, mainly relating to the STW and Cazenove acquisitions. I will return to a detailed breakdown in a minute.

Next turning to underlying diluted EPS, is up 16% to 74.5p. That's broadly in line with our increase in PBT. So with these strong results the Board has declared a 50% increase in the interim dividend of 24p. This is in line with our target of a higher pay-out ratio and a rebalancing towards the interim dividend, following greater increases in final dividend in recent years. As always, we will set the final dividend for 2014 in line with the actual results we produce later this year.

So, as I have said, net revenues are up strongly. I'll now spend a couple of minutes taking you through the detail.

Here's where the £84m increase in net revenue came from. Last year we completed the acquisition of STW in April and Cazenove Capital in July. These businesses would have added £66m to our net revenue for the first half of last year, and we've added that here. Our organic growth strategy and positive net new business has increased this period's net revenue by £25m.

Positive market movements net of FX have led to a small increase of £3m. We estimate that the strengthening of sterling has reduced revenue, in sterling terms, by over £40m. Against that backdrop we consider a £3m increase from markets and FX to be a strong result.

Performance fees are down slightly year on year. It's very difficult for us to predict the full-year performance fees. A normalized annual run rate would be around £50m.

Other revenue movements were a little down, leaving us with total net revenue of £729m in H1 2014. Asset management generated over 85% of our net revenues and I'd like to give you the split between our two sales channels, institutional and intermediary.

Starting with institutional, our revenues of £274m are broadly in line with last year. Despite positive net new business we've seen the impact of lower margins come through in institutional. Margins are now 37 basis points, excluding performance fees, compared to 39 basis points in H1 2013. 1 basis point of that decline is due to the acquisition of STW in Q2 last year, where we picked up some £7b of AUM at 20 basis points. A further 1 basis point decline is due to the growth in their own margin business. The institutional sales channel has been affected by FX, with some 70% invested in overseas stocks.

Now turning to intermediary, here our net revenue is up on last year by £37m. We generated consistent net inflows, increasing our net revenue. Again, positive investment return has been offset by FX in sterling terms. Margins excluding performance fees was 77 basis points. That compares to 79 basis points a year ago. This modest drop mainly reflects the impact of the slightly lower-margin Cazenove book of business and the impact of FX.

Overall, asset management margins, excluding performance fees, are down to 52 basis points and that's in line with what we said in March. Depending on market conditions, we anticipate that there could be a further. 1 basis point decline by the end of the year.

Now let's turn to wealth management. Net revenue margins were 66 basis points; two basis points up on a year ago. Cazenove Capital had margins very close to our existing book, but we've seen an increase due to the loss of the low-margin business that we told you about in March and which Mike has just referred to.

Net revenues are made up of management and transactional fees plus net interest income. Overall, wealth management generated revenue of £101m, up £47m on H1 2013. That's mainly a result of the Cazenove acquisition, with AUM increasing to nearly £31b. Management fees and transactional income are both up due to the increased scale of the business, at £77m and £17m. Net interest income is broadly unchanged year on year, at some £6m. So, strong growth in wealth management again.

That brings me to the end of our look at revenue. Now let's look at profit before tax. With a record year last year it's a satisfactory picture on profit before tax and exceptional items, with an increase of £34m.

This slide shows the movement year on year. You can see the impact of the higher revenues of £84m there in green. Compensation and other costs have increased by £35m and £17m respectively. This is mainly due to the acquisitions of STW and Cazenove that we completed last year, and I will return to this in just a moment. So, along with interest and other income, that brings us to record profit before tax and exceptional items of £262m. If you look at it by segment, you can see that the improvement really comes through in the operating businesses, asset management up £23m and wealth management up £16m.

Now I'd like to take you through costs in more detail. Here we are talking about the numbers before exceptional items. Starting with compensation costs, this makes up 71% of our cost base. Total comp costs have increased by £35m due to the net revenue increases I mentioned earlier. We are accruing compensation costs at 47% this year, in line with what we said in March. Within those costs just over 50% of our spend is fixed. Headcount has increased by 400 on a year ago. The vast majority relates to employees that joined us through the Cazenove acquisition. We keep compensation under review and will determine final ratio at the end of the year.

Other costs, excluding depreciation, were £130m compared to £114m in H1 a year ago. Excluding the insurance recovery of £5m last year, other costs are up 9%, and all of that increase is due to acquisitions. We also continue to have targeted investment in areas such as IT. For 2014 we still expect other costs, including depreciation, to be approximately £300m for the year as a whole. We have achieved over 60% of the synergy savings we targeted from the Cazenove acquisition and we expect to achieve the rest later this year. Those savings will come through in the future, mainly from 2015 onwards.

In total our spend is equal to a cost/net revenue ratio of 66% in H1 2014. That remains in line with our long-term target in KPI of between 65% and 70%. Looking forward, I have previously made reference to our global efficiency initiative. It is an ongoing program. The aim is to deliver cost efficiencies to offset the likely deterioration in revenue margins.

I'd now like to take you through the exceptional items you can see in our accounts. For the half year we've seen exceptional costs of some £28m. In December last year we took a provision in wealth management for the industry-wide US Department of Justice program that applies to Swiss banks and that level of provision remains our best estimate based on what we know so far. We should have a final position by the end of the year.

We expect to see some £24m of exceptionals in H2, so £52m for the full year. The £52m is split £22m for amortization, £16m for deferred compensation relating to acquisitions, £12m for integrating costs and £2m for the closure of Opus commodities business.

I'd now like to turn to the Group segment. What we are looking at here is investment capital returns offset by governance and other central costs. The total return for the segment is a profit of £0.1m compared to a profit of £5m in H1 last year, which included a £5m insurance recovery.

Investment capital returns are some £12m out of the £15m returns you can see on this slide. That's made up of total net revenue, interest income, share associate plus what has gone through reserves. Central costs or operating expenses, as you can see on the slide, were £13m in H1. We still see a run rate of some £28m to £30m a year. We continue to expect investment capital returns to cover the costs excluding exceptional items.

The final part of the income statement is the tax charge. Our effective rate of tax is 20.5% before exceptional items. I would expect it to remain around that same level for the full year. After deducting the tax charge, our post-tax profit before exceptional items is £208m and £186m after exceptionals. That gives us earnings per share of 77.1p.

So leaving the income statement and turning to capital, overall Schroders' capital has increased by £54m. On the last slide we saw that post-tax profit after exceptional items was £186m. We spent £45m on share purchases, hedging employee share awards. In May we paid the final dividend for 2013. That's a £113m return to shareholders. Next we had the foreign exchange impact of our overseas operations. Together with the other movements that leaves us with an end of June position of over £2.3b.

On the left hand side you can see the breakdown of the £2.3b of capital. Regulatory minimum capital is £617m, with surplus operating capital

£437m and seed capital of £182m. Investment capital is £573m.

Here you can see a breakdown of investment capital on the right of the slide. We have maintained a strong capital position, which we see as a competitive advantage. We are not contemplating a one-off return of capital. We believe that capital is best returned through increasing a normal dividend. This is consistent with the 50% increase in interim dividend we have just announced.

So, to wrap up my part of the presentation, after generating record H1 results in 2013, both before and after exceptional items, we have delivered further growth in our profitability against the real challenges of strengthening sterling. Cost control continues to be good. We are on track for delivering synergies in the integration of Cazenove and we are maintaining our key cost ratios. Operational efficiency clearly remains a key focus for all of us in the business.

I'd now like to hand back to, you, Mike. Thank you.

Michael Dobson

Chief Executive

Thank you Richard. So just summarizing the outlook as we see it, good levels of flows in July in the first three weeks in both intermediary and in institutional.

Some uncertainty in our view around markets. No clear trend in markets, going to the summer to be a quiet period and therefore retail and investor demand in the short term to us is uncertain. So, as I say, we had a very strong start to the quarter, but I wouldn't necessarily extrapolate that from here.

On the contrary, we have a very visible pipeline in institutional, which is much larger than we've ever seen before. So that gives I think for that side of the business quite a lot of visibility going through the balance of this year.

We are seeking efficiencies, as Richard said, to offset pressures on fees and the cost of regulatory change. But this is not a cost-cutting program. This is how do we leverage the scale we have built to benefit the future and to maintain the ratios that we are targeting on.

And finally we don't, as you know, focus on the short term here. We can't control the short term. We are not focused on this quarter. We are focused on three to five years. We have, apart from institutional, we have very little visibility on the short-term trends, but we think we can influence heavily the trends over the next three to five years, and that's precisely where we are focusing our efforts.

And we see on that basis very interesting growth opportunities right across the business, in institutional, in retail, in wealth management and pretty much across the globe, here in the UK and Continental Europe, in our very strong position throughout Asia, and in the United States where our market share is really quite low and we think we can increase that significantly over the next three to five years.

So let's now throw it open to questions. Okay. Over here in the front. Could you please introduce yourself and your company before your question?

Q&A Session

Chris Turner - Goldman Sachs

Great. Thank you Michael. It's Chris Turner from Goldman's. Three questions if I may, two on flows, one on capital. Starting on the flows, I guess one of the main themes of these results was the commodity outflows and the closure of the Opus funds. Can you talk a little bit about whether we should expect that to continue into this quarter and for the rest of the year, or whether that weakness in commodities was a Q2 issue in particular?

Secondly, on flows at the private bank, I think you've been very clear in the past in saying that there have been some very large private banking mandates that have been running down and that's been a bit of a drag on the net flow figure. That seems to have ended in Q1. Should we consider this the new run rate for that business and this is a more positive outlook for the flows there?

And then finally maybe a question for Richard. With respect to the capital, I think I'm quoting you correctly, you said you're not contemplating a one-off return of capital and that you think it's better to address the surplus capital issues by raising the dividend payout ratio to 40% to 50%. But that doesn't really address the surplus capital issues. It just means that you're accruing surplus capital less quickly. So I guess the question is why aren't you considering a one-off return of capital or some more radical action in terms of the surplus capital? Thank you.

Michael Dobson

Okay. So let me deal with those. Opus Commodity is substantially done, not entirely, but substantially done and that was about, as I said earlier, about £400m of outflows in the first half.

Our direct commodity business, harder to judge. It's still quite a big business. I would hope that most of those flows are behind us. And in fact ironically as people pull out not just from Schroders but it's a worldwide phenomenon -- every day you see a bank getting out the commodities business -- these markets are beginning to perform. And so we've generated good returns for our clients, those that have stuck with us in the first six months. So we also had a manager, change which we highlighted, so that is well-communicated, well-known and I would hope and expect that that is substantially behind us.

On wealth management I don't think you should extrapolate £300m per quarter as the growth rate in the future. On the other hand I do think that this business for us is well-positioned, with a great client offering, good performance and with two very complementary businesses that have been put together which resonates with clients and prospects. So I wouldn't multiply £300m by four, but that big outflow, actually two outflows from two very big clients, is behind us, finished and I think we are back on a, I would hope, a growth track going forward here in the UK particularly, but also potentially longer term in Switzerland and elsewhere.

Finally on capital, I think I'll answer that if you don't mind. We haven't changed our position on this. You saw the breakdown of surplus operating capital, of investment capital, of £200m in seed capital. We run £272b. We have tangible equity of under £2b, just under £2b. We do not think that is an excessively capitalized position.

And, as I've said here many times before, it's our firm belief that Schroders' organic growth in the last five or six years, which has been very strong, part of that is based on our confidence in investing throughout the cycle for the future, in never really cutting costs when times get tough, in seeing that as more of an opportunity to invest, and the confidence I think our clients, our counterparties, our distributor relationships get from seeing a very strongly capitalized balance sheet.

So we don't think -- we are not thinking of a one-off return of capital. We don't think long-run that is the best way to build shareholder value. We do think a progressive dividend policy and a higher payout ratio targeting, as I said, 45% to 50% over the cycle, and the first decisive move in that direction was with the final dividend last year and even more so with the interim dividend this year, that I think, we, the Board, thinks is the best way to build shareholder value in the long term.

Chris Turner

That's very clear. Thank you.

Michael Dobson

There's one here.

Anil Sharma - Morgan Stanley

Morning. It's Anil Sharma from Morgan Stanley. Just a couple of questions please. The first one is, there's obviously lots of regulation coming up from Europe and the UK at the moment, I just wondered if you could give us your thoughts specifically on the potential ban on dealer commissions for research. What impact do you think it may or may not have on your cost base I guess pre any mitigating steps you might take and post mitigation?

And then also the FCA has obviously got a wholesale sector review going on and I think one of the things they raised for asset managers was the pricing differential between institutional and retail, and whether that was justified. I just wondered if you could give some comments there.

And then thirdly just on the cost base, just trying to understand. Massimo, in the past you've given us some very helpful color on revenue margin dynamics. I'm just trying to think should I be phasing the cost efficiencies lock-step with the change in the revenue margins or is there some other way I should think about it?

Michael Dobson

I'll deal with the dealing point and then, Massimo, will you pick up the institutional retail point on fees and costs, or perhaps with Richard?

I think on commissions, so we've seen this -- these ideas coming from ESMA in Europe. We've seen the FCA looking hard in this area. We have a number of questions in relation to this in terms of, if paying for research out of commissions is no longer allowed, the impact on the efficiency of markets, particularly in the small- to mid-cap sector, we think there will be quite a negative impact on the availability of research and therefore market transparency and efficiency.

We have great concerns about a level playing field. We don't see if this is introduced in Europe it is likely to be rolled out globally. We don't see this as in the foreseeable future being rolled out in the United States and so we think that has very significant implications for European asset management and indeed clients of European firms. And we don't see it being rolled out in Asia either. So that's a second concern to us.

Schroders -- so we'll see where we end up. We are obviously communicating our views to regulators, policymakers, industry bodies and we are very much engaged in that process right now. We'll see where it ends up, but we have quite a number of serious questions to be asked which we think need to be focused on before this is rolled out.

As far as Schroders is concerned we have been reducing our commissions systematically. Even at a time when volumes are up, both in terms of trading volume and assets under management are up, our commissions are going down, so we've been very rigorous in managing that process for the benefit of clients while I think retaining the quality of research input we get from the sellside. We have obviously here a very significant commitment to in-house research across equities, fixed income, multi-asset and therefore we are relatively well-placed if this happens I think, because we have such a deep commitment here to our own internal research capabilities already.

But clearly that would be -- there would certainly be an impact. I've seen some numbers from some of you. I think that they are on the high side. But I'm not saying there would be no impact. But it remains to be seen whether and how and when this is implemented.

Max, can I hand over to you on the institutional/retail one?

Massimo Tosato - Executive Vice Chairman and Global Head of Distribution

Yes. Well, in fact analysis will go ahead and the focus will be on the different pricing model between the two channels in which asset managers distribute. I think it would be another example of the UK [front-fanning] and gold-plating European regulation that are not yet in force yet.

Traditionally the difference in pricing has been explained and is explained by scale and by administration and operation cost. You also have a significant difference in marketing cost because most of the marketing is built around the intermediary and then consequently retail distribution. These are the key three factors, three key factors that differentiate the true pricing model. So I think the difference is driven by cost and the question should be more, are the European markets as efficient as possible in the pricing model for the retail?

And three years ago a firm sponsored research that compared the investment cost, excluding external distribution cost and platform cost, between the United States, the most efficient market in the world, and Europe. And actually the difference came short of 7 basis points, mainly different by scale in market size and local regulation and in language and other fragmentation cost of Europe versus the United States. So to me the key question is about the comparative efficiency of retail investment cost rather than between institutional and retail.

Anil Sharma

Thanks. Just on the cost efficiencies, should I be -- on the cost efficiencies that Richard talked about, should I be assuming they are delivered at the same time as the revenue margin compression?

Massimo Tosato

Last time that we met we mentioned our expectation for the margin compression. Nothing has changed. We still have the same vision over the next three years. And we are coping with that with the three-year plan of cost efficiency that are probably less about cost cutting but more about being more efficient and managing the larger business volume with the same cost structure.

Anil Sharma

Thanks.

Daniel Garrod - Barclays

Good morning. Daniel Garrod from Barclays here. Couple of questions from me. Firstly, you mention the £12.2b Friends Life mandate funding expectations in Q4. I wondered if you could give any color around other elements of that partnership with Friends. When you announced that transfer it was very much framed as part of a broader cooperation between the two of you. Any annuity-replacement-type products you can give us any detail on that you're working on together or any other areas.

Second question. In the Q2 it looks like the flows have been dominated by the Continental European side. You mentioned encouragement for July. Has there been any improvement on the UK side in July particularly I guess around things like raised ISA limits. Thank you.

Michael Dobson

Massimo, do you want to answer those two points, Friends Life and July flows?

Massimo Tosato

Let me answer first on Friends Life. The evolution of regulation in the UK opened up an opportunity for asset managers that we estimate to be between £8b and £12b overall at an industry level for the possibility to produce substitute option to the annuitization. In our relationship with Friends Life we could have a major partnership in capturing a market share in that segment. That is something we are working on mainly for 2015 and onwards because, as you know, the rules will come only into effect from next year.

Michael Dobson

The other question was July and we had, I think I said, £600m of net inflows in the UK in the first half. But July flows and I think in particular Daniel's question was in relation to the UK, if you can give some --

Massimo Tosato

The UK institutional business is progressing well and has been progressing in July. The intermediary has been a little weak. That is driven by two factors, some specific product issue in the Schroder case and an uncertainty in the market with reduced gross volume that we have seen in the last few weeks. That's not the case in the rest of the world, where both institutional and intermediary have performed extremely well.

Daniel Garrod

Thank you.

Michael Dobson

Okay. In the second row, Philip.

From the floor

Thank you. On institutional you said you were expecting some margin slippage in the second half. I wondered how much of this is Friends, which presumably will cause margin slippage regardless?

And secondly, you talk about a very strong forward pipeline. Again, could you just give us some idea of what sort of products those are? Is it still larger than multi-asset type mandates?

Michael Dobson

Friends won't have an impact this year because there'll be funds in Q4. I think it's going to be towards the end of Q4 so it will have a negligible impact.

Multi-asset is still growing. We have good margins in multi-asset but slightly below the institutional average so there is a slightly depressing effect, not a bit one on margins. But I think the pipeline apart from Friends Life is pretty well spread across the board, in equities and multi-asset and in fixed income.

From the floor

Okay. Thank you.

Arun Melmane - Canaccord Genuity

Morning. Arun Melmane from Canaccord. I had two. So if I back out the numbers of Cazenove acquisition between H1 last year and H1 this year, I was wondering what the organic growth in the business was and what we should think about -- and from which product set does it come from? Are we largely looking at multi-asset growing organically, and what does that do to margins was question one?

The second one was on surplus capital. Having said that you are not going to do specials, what else can you think about doing with special -- with the surplus capital? Would that be in terms of higher seed capital funding or would you look at further in-fill acquisitions to right-size the surplus capital issue? Thank you.

Michael Dobson

So when you talk organic growth, you're talking about the Schroders business or the Cazenove? The Schroders business. So we did £4.8b in the first half this year. We did I think £3.4b in the second half of last year. So call it just a little over £8b in the 12-month period.

Some of that came from Cazenoves, particularly on the fund side in the second half of last year, not in the first half of this, but in the second half of last year. The rest came from Schroders. It's in multi-asset. It's been in equities as you saw. It's been in part of our fixed income business. We've had a very strong -- I think we had about £1.4b of net inflows in European bonds in the first half. Even if fixed income as a whole was slightly negative, very strong growth in European bonds. We've seen very strong growth in emerging market equities through the period.

So there've been a whole range of growth areas for us, by no means just multi-asset. And we remain very positive on the outlook for the equity business and very positive on the outlook for the fixed income business. I think that our client consultant ratings, our performance, our products, our people and our process is actually ahead of market perception. We've majored on this in the last several years. We've brought in a lot of new people. We've developed a lot of new products. The performance is coming through extremely strongly in fixed income.

And I think there's a catch-up frankly between the market and what we've done, and we are very positive about the medium-term outlook for our fixed income business and the growth opportunities.

On surplus capital we are not going to make an acquisition just, as you said, in your words, to right-size capital. That's the last thing we are going to do. We think that, as I said, and we've said here consistently and there may be differences of views on this, but we do not see that the surplus capital of this firm today is materially out of line with the scale of the business and the growth opportunities going forward organically. We just don't see that.

And we also see a much better way of building shareholder value over the long-term is a progressive dividend policy and a higher payout ratio, rather than a one-off return that has a one-off impact and no long-term impact. And we are very firmly of that belief.

Our focus today, as it always has been, is 99.9% on organic growth, which we think is material in the medium to long-term. If we can find acquisitions that complement that then we have the financial resources to execute. We've actually made a number of acquisitions in recent years. Cazenove was the largest. STW in the United States. As you know we bought a shareholding in an Indian fund management business, in an insurance-linked securities business in Switzerland.

So we've made a number of, apart from Cazenove and perhaps STW, we've made a number of bolt-on acquisitions. And we'll continue to do that where we think there's a fit and an interesting opportunity going forward, and potentially something larger. But that is not on our agenda right now. We're very happy with the way the firm is positioned. We're very happy with these two significant -- important acquisitions we've made in the last 12 months or so. And we are not there, sitting there thinking this capital position is completely out of line with the scale of our business today and the opportunity going forward.

Arun Melmane

And on the ?- sorry, if I ask that question differently, on the product suite that we have to date is there anything that you see that you still need to build maybe in the pension industry given the changes in regulation or anything else that you think the 600-odd teams that you have, is there anything that you're deficient in or you want to build up in terms of either acquisition or even organic team build. Thank you.

Michael Dobson

There always are new areas where we want to develop product and I think one of our successes in recent years has been product innovation, bringing on new products, being early into opportunities like multi-asset income, which has been a very big win for us, and other areas. And Massimo's group has a big product development part to it, which is central to the growth of the Company, the path then I think going forward. So there have always been new products. And, as you know, we have close to £200m invested in seeding these new strategies before we bring them to the market.

So there's no shortage of new ideas, but if I look at our capabilities today then I think the high level answer to that is no, there are no significant gaps. We said in the past when asked about where might we be interested in terms of acquisitions, we mentioned three things, wealth management, fixed income and the US. Well, obviously Cazenove ticks the wealth management box, and STW ticks both the US and the fixed income box. So to some extent we would -- I might have said to you in answer to that question two years ago I might have given you those three segments, but I think that's substantially done.

So I'm not saying that we absolutely wouldn't consider something if it came along and we felt it fitted culturally, financially and strategically, but we don't see any significant gaps in our business today, albeit it we always see opportunities for new product development.

Yes, in the second row here please.

Arnaud Giblat - UBS

Good morning. Arnaud Giblat from UBS. A couple of questions. Sorry to come back to the dividend policy, but could I just clarify the 45% to 50% penetration over this cycle, how long is this cycle or when do you expect to reach a 45% payout ratio?

Secondly, on operating margin, clearly the Cazenove -- on operating margin wealth management, sorry, the Cazenove acquisition has clearly brought a lot of scale to that business. I'm wondering, if you are adding more assets as you go along, where can the operating margins go to in wealth management?

Michael Dobson

How long is a cycle? Well, five years, if you want a number. And how quickly are we going to get there? Well, we've given you a range and it depends where we are on that range as to how quickly we'll get to it. This was a decisive move. It was actually quite a decisive move with the final last year, I wouldn't overlook that, but it's another decisive move today.

And I think that it's perhaps larger than the market was expecting, but nevertheless it's consistent with what we've said in the past, namely moving towards a higher payout ratio. We've wanted to invest organically in the business. We've wanted to make some acquisitions. We've done both of that. We're seeing the results come through and we're now saying, given the success of that, the long-term outlook, the financial position, now is the time to move up towards that 45% to 50% payout ratio.

On operating margins in wealth, 74% today, our target is certainly 70% so we are getting there and potentially better than that, but that's our medium- to short-term target to get that business to 70% profit margin.

Right at the back.

David McCann - Numis

Morning. It's David McCann from Numis. Just a couple of more technical questions just on the guidance. Firstly, looks like the effective tax rate has gone up to 20.5% and you've also guided 20.5% for the full year, which compares to the 20% I think you outlined at the annual, so I just wondered why there had been that very slight tick-up there.

And secondly, the item which you didn't, I don't think you gave guidance on this time was on the comp ratio for the rest of this year. I think you said you'd see how that turned out at the full year. I just wondered why that was the case and is 47% not a sensible run rate to continue using for this year. Thanks.

Michael Dobson

I think 47% is a sensible run rate to use. We make the judgment call at the end of the year as always, but that's the rate we have accrued at in the first half and it's the rate that we will be thinking of in terms of the second half. The fine judgment will depend on all sorts of things, performance fees, markets, where things turn out at the end of the year. But that's I think for all intents and purposes the working assumption as of today.

Richard, will you pick up the tax point?

Richard Keers

The UK tax rate is clearly coming down but our mix of local business just edges that up. UK is now a relatively low tax jurisdiction. The more business we do in the US and the higher tax countries just forces that up. So there's nothing untoward there.

Michael Dobson

Was there one more at the back? Yes.

Neil Welch - Macquarie

Welch at Macquarie. Two questions, the first is on Cazenove. There appears to be some pressure appearing particularly through platform market on DFM margins and I wondered whether you'd be able to comment on what you think the trend in the industry is and where you're placed in Cazenove under those circumstances.

And the second is there has been an enormous focus on research commissions from the MiFID reforms, but actually there are some fairly fundamental reforms about the independence of asset managers' inducements, disclosure and suitability. And it strikes me that as an independent manager with your intermediary brand in Europe that's something that's going to be a significant opportunity for you. Am I wrong?

Michael Dobson

In what sense?

Neil Welch

Well, in the sense that you now have the recognition of independence within the European market both for advice and independent fund managers. There's the banning of inducements for independent fund managers. There is full disclosure of all charges, which kind of makes where those costs are passed onto individuals fairly irrelevant. And also you've got the possibility of improved levels of suitability being put through client portfolios, which gives you a great opportunity in multi-asset.

Michael Dobson

Philip, do you want to pick up the DFM point?

Philip Mallinckrodt - Group Head of Schroders Private Banking

Yes, the DFM book of business is about 4% of our total wealth assets. We haven't seen pricing pressure up until now. You may be right. We always anticipate that things will come, but right now we haven't seen any pressure.

Michael Dobson

Massimo, Peter, do you want to pick up the other point?

Massimo Tosato

Yes. Well, on the European side I think it's an open question on how the market will evolve because, as a difference to the UK and the United States, distribution is currently really controlled by the banking industry and by the insurance industry.

So while on one side you could say that separation of margins between manufacturing and distribution, that transparency could reinforce the opportunity set for independent asset manager, there could be also a different outcome, and that is that many of the large institutions that tend to be largely open architecture could go more into closed architecture, or at least a branded closed architecture with their own sub-advisory business, so they build their own fund range that is then sub-advised to us at an institutional level.

Which way the market is going to go is difficult to predict because it's a step-by-step evolution that will actually start in one or two years and will continue over the next four or five years.

Nitin Arora - HSBC

Nitin Arora, HSBC. I have three questions. Firstly, looking back six months H1, you mentioned a bit around institutional that the gross flows slowed down compared to last year. Could you comment a bit around whether it was an industry phenomena where the industry flows or was it Schroders-specific performance or lack of products which were in demand at that time?

Secondly, on margins again, if I think of it in terms of the stock of business and the new money, for example intermediaries 77 basis points as the stock's sitting today, could you highlight, the newer products which you are selling today, are there any products or geographies where you are selling higher than the stock or we are into an environment where the redemptions are from the higher margin and the newer money is always at slightly lower?

And then lastly on the ISA changes in the UK which came into effect from July 1, how you are feeling about it, neutral, good or very good for you?

Michael Dobson

Okay, so I'll pick up the first point. Massimo, will you pick up the second two?

Gross flows I think we said £11.4b. For us that's slightly down from I think £14b in the first half of last year. I think if you look at others that would be a very big number. So I think it's strange to say that £11.4b of new business in a quarter in institutional is a weaker number because I think for many people that would be seen as a very strong result.

So I don't think there is anything to read into that. I don't think it's industry-specific particularly and I don't it's Schroders-specific either. I think it's timing. And certainly the net is a timing issue and if we'd added the first two weeks in July into the second quarter we would have had a positive number in institutional in the second quarter. So I wouldn't read anything into that.

Massimo, will you pick up the retail point?

Massimo Tosato

Well, the product mix in the short term is the key driver of our weighted average margin in intermediary and actually, because equity has globally a margin that is higher than the current average, that they have increased since beginning of last year as a flow because the cyclical interest into equities. We also have higher margins in Asia and Latin America. As a result I don't see any structural difference to the guidance we gave you when we said that we would expect margins to decline about 15% over a cycle of three years, as we mentioned last time.

What was your second question again please?

Nitin Arora

It was on the ISA changes in the UK. Any comments there? Are you feeling neutral, positive, very positive on those?

Massimo Tosato

Certainly positive. It's not dramatically different in size as a market opportunity, but it continues to be a significant driver of long-term flows and interest from long-term investment products. I think that has been one of the major -- one of the best structure of a UK market for long-term saving and you have seen that, how that has now been copied in Japan with the launch of NISA in January and the initial success in the take-up.

Richard Perrott - Autonomous Research

Morning. It's Richard Perrott from Autonomous. Could I ask two questions please? The first on the intermediary margin, and sorry if you actually just referenced this, but you've been very clear on the, what you expect the impact of reform, the negative 15%, but could you give us a sense of what you've felt to date as a result of reg reform there?

And the second question is on the investment performance. Obviously it's been very strong and stable, but I was wondering are there any particular asset classes where your performance is particularly strong. Conversely, any asset classes where you're looking to improve investment performance?

Michael Dobson

Okay. So Massimo, will you answer the question on intermediary compression so far and then, Peter, perhaps you'd pick up the performance question?

Massimo Tosato

There are competitive forces in the market that have been driving a decline in intermediary margins since 1999, 2000. If you give a global picture actually intermediary margins have gone down by about 1 basis point in each of the last 15 years. So this realignment and, if you like, assimilation and getting closer to institutional pricing, that was one of the original questions at the beginning of the session, has been already happening over time.

What we've said is that expect a continuation and even reinforcement of this pressure, not because direct influence of regulatory changes on us, but because the regulatory change force pressure on the margin of distributors and distributors are trying then to use their competitive power to regain margin on ourselves. That is where we expect the 15% to come from. That has already started to be implemented last year and it's in the market this year, and will continue to be for another year or two, in as much as rules are being rolled out in the different countries.

So it's an evolutionary process. You have not seen it that much in our margin for the reason I mentioned before, the increasing volume of equities that have compensated this factor over the last 18 months.

Peter Harrison

And on performance I think you'd split it into two areas. In terms of areas where performance isn't quite up to where we'd want it, global equities is one where we see it as a very important segment, fundamental global equities, and we've taken steps there to strengthen that team very recently. And the only other in the very short-term is some of the Cazenove products where they've performed very well over the longer term but that short term the rotation has hit those performance numbers, but this is a short-term issue.

The areas where performance is still strong, a lot of our fixed income range, as Mike mentioned earlier, is very strong across the piece. Multi-asset performance has been very good. EM and commodities performance is very good and quite a lot of the equity areas. So there aren't -- with the exception of the global equities numbers where we've taken action, actually the picture is pretty good.

Michael Dobson

Okay. Well, if there's nothing else, thank you very much for joining us.

[End]