

## Schroders Q1 interim management statement 2014 conference call

**Michael Dobson**  
**Thursday 1 May 2014**  
**9.00am GMT**

Operator: Thank you for standing by and welcome to the Q1 interim management statement 2014 conference call. At this time, all participants are in a listen only mode. There will be a presentation followed by a question and answer session at which time if you wish to ask a question, you'll need to press star one on your telephone keypad. I must advise you that this conference is being recorded today, Thursday May 1, 2014. I would now like to hand over the conference over to your first speaker today, Mr. Michael Dobson, Chief Executive. Thank you, sir. Please go ahead.

Michael Dobson: Thank you. Good morning, everyone, and thank you for joining us. We announced our first-quarter results this morning. I'm sure you've seen the press release. We had, I think, a good start to 2014.

Net revenue at the Group level was up 11 percent to GBP358.8m. Profit before tax and exceptional items up 14 percent to GBP137 -- GBP130.7m.

As you know, we have 60 percent-plus of our revenues coming from clients outside the UK and therefore sterling or the level of sterling has quite an impact. Sterling having been strong over the past year, particularly against the Australian dollar, the Japanese yen and the US dollar has had a negative impact on profits of about GBP15m compared to where they would have been had sterling not moved over the past 12 months. So I think profit before tax and exceptional items up 14 per cent despite that headwind is a solid result.

68 percent of the funds are outperforming over three years. A higher number, 74 percent, outperforming over the past 12 months to the end of March 2014. It gave us a good platform for new business wins and we generated net new business of GBP3.8b in the first three months of the year.

Assets under management ended the quarter at their highest ever level of GBP268b.

Turning to the individual segments, in asset management, net revenue was up 6 percent at GBP306.2m, including GBP6.3m of performance fees compared to GBP2.8m of performance fees in the first quarter of last year.

Net revenue margins, excluding performance fees, were 52 basis points in asset management, which is 1 basis point lower than 2013, in line with the guidance we gave you in March when we announced our 2013 results. Profit before tax and exceptional items was up 11 percent at GBP117m.

In intermediary, in our intermediary retail business, we had very strong net inflows of GBP2.8b in the first quarter, of which GBP2.3b was in branded funds.

A particularly strong demand coming out from Continental Europe, which generated GBP1.7b of net inflows and a strong result also from the UK, with GBP700m of net inflows. But we also had positive net flows in Asia and in the US.

By asset class, equities dominated with GBP1.6b, and in particular a very strong performance in European equities. But we also had good flows in multi-asset with GBP1b net and in fixed income with just over GBP400m there.

In institutional, we had GBP1b of net inflows in the quarter, again a strong performance in Europe and the UK and also positive flows in Asia and in the US.

By asset class, another strong result in multi-assets, a small positive in fixed income and property, and small outflows in equities due basically to the rebalancing of some quite large quantitative equity mandates we'd taken on. I think nothing particularly to read into that. Some very big mandates, partly from sovereign wealth funds where we expected some rebalancing away, and to some extent that happened in the first quarter of 2014.

Turning to wealth management, a big rebound in revenues, up 90 percent to GBP50.3m, and in profits up 170 percent to GBP13.3m, reflecting a stronger performance from our own Schroders business in this area, but also the inclusion of Cazenove Capital Management.

Flows in wealth management were flat in the quarter. But this masks some quite good levels of net new business that we've been winning, which have offset the final outflows from the two very large mandates we highlighted as going in the middle of

last year. So the funds have been flowing out through the fourth quarter of 2013 and into the first quarter of this year and those outflows have been offset by net new business. These two big mandates are now completely withdrawn so that impact is now behind us.

In the Group segment, there was a small profit before tax and exceptional items of GBP400,000 and shareholders' equity ended the quarter at GBP2.3b.

With regard to the outlook, we said in the statement that we may well see some slowdown in retail investor demand given the number of uncertainties facing financial markets. In April we've had quite good levels of net inflows in intermediary, not quite at the level of the first quarter, but nevertheless quite satisfactory. But as I said, we wouldn't be surprised if we saw a slowdown to some extent in that business, depending very much on where markets head in the next few months.

Institutional has been quieter. GBP1b net in the first quarter is not a bad result. It's not -- it's by no means one of our biggest quarters. It's been quieter, I think, basically for timing reasons. I don't think anything specific to read into that.

Short term we're seeing some outflows in commodity funds in the second quarter. With difficult conditions in commodity markets, it's been tough, I think, for most players in that asset class. And we've had a manager change which will also lead to some loss of mandates.

Longer term we have a significant pipeline of new business we have won but which has not yet been funded in institutional. And that of course includes the very significant mandate from Friends Life of GBP12.2b, which we'll fund in the fourth quarter of this year.

So that's it by way of introduction. And I'll now hand it over to questions.

Arnaud Giblat: Thank you. Good morning. I've got -- Arnaud Giblat from UBS. I've got two questions, please. First is on the annuities. How big an opportunity do you think the cancellation of the obligation to buy individual annuities in the UK is for Schroders? Do you see an opportunity to leverage perhaps your experience as a provider of bulk annuities in the US and now in the UK?

My second question is with regards to your outlook on intermediary. Could you maybe highlight in which geographies or asset class we could expect to see some slowdown?

Michael Dobson: Yes. Okay, Arnaud. So first of all on annuities, I think it is an important development. I think that it's obviously long-term in nature and I think that it should be positive for us. We've done a lot of work over recent years in developing outcome-orientated solutions for the retirement market for decumulation. And to some extent I think we've been slightly ahead of the game and actually haven't seen as much demand as we might have expected. I think that could and probably will change in the long term.

And clearly our relationship with Friends Life is not unimportant here and I think we can work well together in developing solutions for this new environment. So it's a long-term influence, but I think it's net positive.

On intermediary, there's no specific regional or indeed asset class issue we were highlighting. We were simply saying that a good year in 2013, a strong first quarter this year, markets -- still the underlying trend is quite good. But facing a number of uncertainties, it wouldn't surprise us if we see a slowdown.

In the month, in April, we saw broadly the continuing trend that we saw in the first quarter but at a slightly lower level. And beyond that I really don't think we can say much more. But if we have a quieter few months, it wouldn't surprise me.

Arnaud Giblat: Okay. Thank you.

Operator: Bruce Hamilton, Morgan Stanley.

Bruce Hamilton: Hello. Can you hear me?

Michael Dobson: Yes, I can.

Bruce Hamilton: Cool. So two questions. So firstly, just on the point you made on commodities, I think from memory you've got about GBP5b. But I just wanted to get the size of the commodity book and how much of those assets were managed by the manager where you've seen a change.

And then secondly, just looking at the costs, obviously cost looked to be pretty well managed in Q1. Is there any seasonality? So say the other costs, should we assume

there's a bit of a build in those numbers, i.e. we're not yet at the full quarterly run rate for cost in some areas? Or is there anything to say on the cost for Q1?

Michael Dobson: Okay. On commodities, GBP4.7b. The person who's left was the head of the commodity business but reporting to Geoff Blanning, who ran emerging market -- who has, for the last 10 or 15 years, run emerging market debt and commodities. So he's taken over the leadership of these commodity funds personally and will continue to do that. So we're not looking for a replacement at that level.

But I think we will -- and indeed we're already seeing actually prior to this change, we were already seeing some outflows because commodity managers have struggled. Commodity markets have struggled. It's been a tough asset class and I don't think we're any different there.

On costs, I think they have been well controlled, so up 9 percent in the first quarter. We moved -- salaries are adjusted in March so the salary impact does not play much in the first quarter of any year but comes through in the second quarter onwards. But, as you know, we are accruing a 47 percent comp-to-revenue ratio this year. So that won't change and the salary impact will be accommodated within that.

Non-comp we are -- we gave you the guidance, I think, of about GBP300m and I think we're not changing that.

Bruce Hamilton: Great. And sorry, just to follow up, on the 47 percent comp to revenue, that was the number for the first quarter, was it?

Michael Dobson: That was the number for the first quarter, yes.

Bruce Hamilton: Okay. Thanks.

Operator: Chris Turner, Goldman Sachs.

Chris Turner: Yes. Thank you and good morning. Just two questions from me. Firstly on performance fees. Were they -- that GBP6m, was that in particular products or has there been a broader spread of funds driving that? And is there any kind of seasonality that we should anticipate there, I guess given some of the asset moves we've seen in April?

And then secondly, on your GAIA platform, the alternative funds platform, it looks to me like there were some particularly strong funds there in your Sirios US equity fund. How quickly can you add new managers to that platform? And are there any particular types of strategies or types of funds that you would like to add? Thank you.

Michael Dobson: So on performance fees, roughly two-thirds from equities, some performance fees in various other classes. But two-thirds equities and two-thirds institutional and one-third intermediary.

Some of them are rising on Cazenove funds, where we have integrated the funds or on occasion restructured the funds to Schroders funds. So there was probably a little bit more first-quarter bias as a result of some corporate changes, if you like, than we would normally see. As you know, certainly Schroders has taken the lion's share of its performance fees in the fourth quarter of each year. For obvious reasons Cazenove's came a bit earlier.

So I think that we're probably seeing a trend where there will be -- performance fees will be less. They'll still be dominated by the fourth quarter but perhaps to a lesser extent than we saw in the past, but still heavily weighted to the fourth quarter. I would say GBP6m is probably slightly high for that one-off reason. On -- and slightly higher than we would expect to see.

On GAIA, very -- it's been very successful, our platform. We've got some very successful managers on there, Egerton Capital being the first one which has been a hugely successful experience. More recently, the long/short US equity fund you referred to, Sirios. I think we've demonstrated that with really high-quality managers and well-thought-through products, we have the ability to raise assets in this area. And I think Schroder's GAIA UCITS platform is now recognized as being a very attractive place for very high-quality managers.

We're very selective in terms of the funds we launch. So we've raised -- others have raised assets with a much longer list of funds. We've raised quite significant assets with quite a short list of funds and that's how we want to operate. So we want to remain very selective. We have one launch which has been just waiting for regulatory approval, which I think should come up pretty soon, which I believe will be, both in terms of the asset class and the manager, very positively received.

And yes, we're looking to broaden it out but in a measured way, and also using some of the talent in house. So this is not just for third party managers, it's also for Schroders' managers. And we already have two or three funds on that platform, a [catastrophe] bond fund being one of them and others which we are either actively selling now or incubating for the future. So I think it's going to be a combination of third party providers and Schroders' providers in the future, but very selective.

Chris Turner: That's very clear. Thank you.

Operator: Peter Lenardos, RBC.

Peter Lenardos: Good morning, Mike. It's Peter Lenardos from RBC. I just had a question on the revenue yield. I know that it moderated to 52 basis points in Q1. My question was -- and I know that's for your guidance, but do you expect a further downward trend with the SCW business, the F&C Friends Life business and then also the bias towards fixed income as well as of late? Thanks.

Michael Dobson: Yes, Peter. So I think what's happened so far is entirely expected and I think we gave you all a pretty clear heads up on that. I think it will come down further. F&C will have an impact of at least a basis point.

And I think fees are, for the industry, I don't think this is Schroder specific, I think fees are coming under some pressure, certainly in retail and in some cases in institutional. So I expect that there will be a reduction, not dramatic, but probably sustained over some period of time.

And in that sense I don't think we've changed our view at all. We've been talking about this for a long time. It's partly a good result because it means we are growing our multi-asset business, we're growing our fixed income business, which have been two important strategic objectives. And as you know, we've seen enormous growth in multi-asset.

So a lot of what's happening is, in a sense, is actually positive because we're growing in areas we wanted to which have good longevity, good strategic rationale albeit lower fees. And that is most of what's happening now rather than having to cut fees to compete. But I do think in intermediary that is -- we've already seen fee compression for competitive reasons and I think we'll continue to see that.

And a basis point or two a year, but not every year, I think will continue until we see stabilization. It's hard to say, but in the -- my guess would be in the high 40s, something like that. I think that Schroders can handle that.

12 years ago our fees were sub 40 basis points. As you know, a part of our strategy while we were contracting in institutional and seeing net outflows every year was to focus on higher-margin business and we drove the average fee up from 39 basis points to 60, focusing on this higher-margin business, but at a time when we weren't growing at all in fixed income, contracting in multi-asset and contracting in institutional. That is now a completely changed picture.

And I think the blend of business we have, some high-margin retail, albeit not quite as high-margin as it used to be for competitive reasons, for market reasons, some lower margin but greater longevity. That is the mix we want. And where we are today with fees in asset management, 52 basis points is pretty much where we expected to be and as a matter of fact hasn't moved at all in the last four quarters.

Peter Lenardos: Great. Thank you very much for that, Mike.

Operator: Daniel Garrod, Barclays.

Daniel Garrod: Good morning, Michael. A couple of questions from me. First I just wanted to clarify the detail on the Group-wide net flows, the GBP3.8b. It looks like about half of that comes from the multi-asset side. I wonder if you could clarify that exact figure. And then how much is from the equities? I think you detailed GBP1.6b was intermediary and then a small outflow out of institutional, but could you tell me the total figure?

And second, I just was interested in a more general question around the FCA's investigation into paying for research out of brokerage commissions. How far advanced do you think those kind of discussions are, what you're working on and how you feel you might be positioned relatively if it's a question of increased disclosure or restrictions on what you can pay for research out of brokerage commissions? Your thoughts there would be helpful. Thank you.

Michael Dobson: Yes, Daniel. Thank you. First of all, on Group flows, so the GBP3.8b, GBP2.2b in multi-asset, GBP1.3b in equities and GBP500m in bonds, small outflows in emerging market debt and commodities.

As far as the FCA is concerned, you probably -- you may be -- you're probably as up to date as I am, coming from a slightly different angle. But obviously this is an ongoing program. We are engaged with them, as are other large fund managers.

I think that we are pretty well positioned. I think we have a rigorous process for allocating commissions which we take very seriously indeed. We do not pay for corporate access and never have done. We're in the privileged position of being able to, I think, get access to companies whenever we want, just given our size apart from anything else. So we've never paid for access.

I think if this moves further and research-based commissions just disappear, I think that relative to competitors we are well placed because we have an enormous commitment to research here, with 200-plus analysts so that we are self-sufficient to a large extent. Where this is going to end up, your guess, however, is probably as good as mine.

Daniel Garrod: Thank you.

Operator: Once again, that is star one to ask a question.

Michael Dobson: Okay. Well, look, thank you very much for joining us. If you have any follow-up questions, please call Emma, who will be happy to help. Thanks a lot.

Operator: Thank you. That does conclude the conference for today. Thank you for participating. You may now disconnect.

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