Steady growth with continued investment

Grant Hotson
GROUP FINANCE DIRECTOR

Financial performance

Group results	2019 £m (unless stated)	2018 £m (unless stated)
Operating income	**278.1**	266.7
Operating expenses	**(227.2)**	(221.5)
Operating profit	**50.9**	45.2
Adjusted operating profit[1]	**48.4**	46.2
Profit before tax	**51.1**	46.1
Taxation	**(10.8)**	(10.4)
Profit after tax	**40.3**	35.6
Unadjusted basic earnings per share	**75.4p**	67.2p
Adjusted basic earnings per share[1]	**71.4p**	68.7p
Dividend per share	**36.0p**	36.0p
Funds under management and advice	**21.4bn**	20.1bn
Funds under administration	**13.9bn**	11.7bn

1. Key performance indicators are adjusted to exclude exceptional (non-recurring) items (note 10) and amortisation of intangible assets – client relationships (note 14). These non-GAAP measures are relevant and useful in further understanding the group's performance and are explained on pages 22 and 23. The calculation basis is consistent with prior year.

The past financial year has seen steady growth in the group's financial performance, with year-on-year growth in operating income of 4.3% and adjusted operating profit of 4.8%. To support the future development of the group, we have continued to invest in the group's IT infrastructure, with a cash spend of £17.8 million on modernising technical infrastructure, systems and processes.

Group operating results

Operating income for the year has grown to £278.1 million (2018: £266.7 million), led by increased professional services fee income coupled with higher market levels and increased bank income.

Operating expenses increased to £227.2 million (2018: £221.5 million), primarily due to staff costs before exceptional item of £160.5 million (2018: £157.5 million) reflecting salary inflation and a 4.7% increase in headcount. In addition, project costs to modernise IT infrastructure increased to £4.8 million (2018: £3.3 million).

During the year ended 30 April 2019, a final settlement was agreed with HMRC with respect to enquiries concerning PAYE and NIC determinations on the treatment of client relationship payments and the amortisation of intangible fixed assets. As a result, £3.5 million was released to the income statement as an exceptional item (note 10).

Operating profit increased to £50.9 million (2018: £45.2 million), while adjusted operating profit, which excludes the exceptional item (note 10) and amortisation of intangible assets – client relationships (note 14), was £48.4 million (2018: £46.2 million). The adjusted operating margin was 17.4% (2018: 17.3%).

Tax

The overall effective tax rate for the year was 21.1% (2018: 22.6%). This is calculated as the tax charge in the financial statements of £10.8 million (2018: £10.4 million), divided by profit before tax of £51.1 million (2018: £46.1 million). A full reconciliation is set out in note 11.

Basic earnings per share

Unadjusted basic earnings per share increased by 12.2% to 75.4 pence (2018: 67.2 pence). Adjusted basic earnings per share, a key performance indicator for the group, which excludes the exceptional item (note 10) and amortisation of intangible assets – client relationships (note 14), increased by 3.9% to 71.4 pence (2018: 68.7 pence).

Distributions to shareholders

A final dividend for the year ended 30 April 2018 of 26.0 pence per ordinary share was paid to shareholders on 4 October 2018. An interim dividend for the year ended 30 April 2019 of 10.0 pence per ordinary share was paid on 22 February 2019.

The board intends to maintain a progressive dividend policy, as set out in the chairman's statement on page 3. The board is proposing a final dividend to shareholders of 26.0 pence per ordinary share to bring the total for the financial year to 36.0 pence per ordinary share (2018: 36.0 pence). Please refer to the directors' report on page 64 for further details.

Effect of changes in accounting standards

IFRS 9 and IFRS 15 became effective in the current year. However, as indicated in the prior year's annual report and accounts, they have not had a significant impact on the group's financial position or performance.

IFRS 16 will become effective for the year ended 30 April 2020. Initial application of the new standard will have a substantial impact on the group's balance sheet, grossing up assets and liabilities from office property leases by approximately £25.3 million. However, the standard is not expected to materially affect the group income statement with an estimated maximum annual impact of £0.4 million in the year of adoption from a change in the profile of the charge taken to the income statement over the life of the lease.

Further details can be found in notes 1 and 2 to the consolidated financial statements.

Expenditure on IT infrastructure and systems

The multi-year programme to modernise IT infrastructure is well progressed and continues into 2019/20. As set out in the strategy dashboard on pages 20 and 21, major improvements include modernising the technical infrastructure, systems and business processes supporting financial services. Total expected costs for the year ended 30 April 2020, comprising both operating and capital expenditure, will be approximately £7.4 million.

Segmental performance

As reported in the interim statement, the group reorganised the management and governance structures during the year. As a result, the group revised the composition of operating segments based on the information reported to the group executive committee. For management purposes, the group is now organised into four operating segments: financial services, professional services, fund administration and other.

A review of the performance across the group's operating segments is presented in the next two sections. Results are summarised, by segment, in note 4 to the consolidated financial statements.

Operating income

Operating income for the financial services segment increased by 2.2% over the prior year, mainly as a result of increased fee revenue and banking turn partly offset by lower commission income.

Investment management and advisory fees grew by 3.0% to £128.0 million from £124.3 million. This was primarily as a result of increased funds under management, due to a combination of higher market levels and organic growth.

Trading activity reduced during the year and consequently commission income fell by 13.3% from the prior year. This decrease included the closure of the fixed interest broking operation.

Banking margin (the net margin on monies deposited with the wholesale market and the Bank of England) increased by 58.3% from the prior year, largely due to the increase in Bank of England base rate and higher cash balances.

The core business lines within the professional services segment showed strong operating income growth in the year under review, with business and private client tax, and assurance and business services growing by 9.7% and 12.6% respectively. Assurance and business services and business tax benefited from the acquisition of a competitor business in Dublin, LHM Casey McGrath, in October 2018. This strategic acquisition helped to double the operating income of the Irish office in the second half of the year. Business tax has also benefited from a number of senior hires, which have helped to grow the advisory side of the business.

The non-recurring transactional business lines have seen a varied year of trading, with strong growth in the restructuring and recovery services business of 12.0% being partly offset by shrinkage in forensics operating income, of 11.6%. During the year, the decision was taken to focus corporate finance activities on mergers, acquisitions and strategic advisory and dispose of the capital markets book of business, with a 31.4% reduction in operating income in that business line.

The fund administration business has delivered income growth of 4.3%, largely driven by a 18.8% increase in funds under administration to £13.9 billion (2018: £11.7 billion).

Operating income for the other segment increased to £1.3 million (2018: £0.3 million) due to an increase in net interest income and share of results of associates.

Operating expenses

Operating expenses for the financial services segment increased by 0.8%, to £121.7 million (2018: £120.7 million). Direct costs increased by £3.3 million due to salary inflation and higher share incentive costs. The segment's share of expenditure on indirect and overhead costs increased by 9.9%, largely due to continued growth in the business and the increased cost of regulation. The segment's share of project costs, which mainly include costs of implementing the core wealth programme, was £4.7 million (2018: £4.7 million).

Operating expenses for the professional services segment increased by 8.5% to £96.8 million (2018: £89.2 million). Direct costs increased by £3.7 million due to higher compensation costs from an increase in headcount to 818 (2018: 762) and salary inflation. The segment's share of expenditure on indirect and overhead costs increased by 12.5% primarily due to increased costs allocated from central support teams and marketing activity. The segment's share of project costs, which relate principally to ongoing change projects in the business, including the design of a customer relationship management (CRM) system, increased by £0.5 million. Some setbacks were experienced in the implementation of the practice management system which is now expected to take longer to complete.

Operating expenses for the other segment decreased 11.1% to £2.4 million (2018: £2.7 million), primarily due to lower project costs which are directly attributable to group support operations.

Funds under management and advice

Funds under management and advice of £21.4 billion were 6.5% higher than at the start of the year. The increase, which is analysed below, compares favourably to the MSCI WMA Balanced Index and the FTSE 100 Index, which increased by 2.9% and decreased by 1.2%, respectively, over the same period.

Funds under management and advice	2019 £bn	2018 £bn
As at 1 May	**20.1**	18.8
- inflows[1]	**1.3**	1.5
- outflows[1]	**(0.8)**	(0.9)
Net inflows	**0.5**	0.6
Market adjustments[2]	**0.8**	0.7
As at 30 April	**21.4**	20.1

1. Valued at the date of transfer in/out.
2. Impact of market movements and relative performance.

Private client organic growth, one of the group's key performance indicators (see page 22), has decreased to 1.3% from 2.8% in the prior year.

Financial position

Intangible assets

Intangible assets arise primarily in relation to business combinations, computer software and the acquisition of client relationships. At 30 April 2019, the total carrying value of intangible assets was £131.8 million (2018: £116.8 million). During the year, computer software costs of £14.7 million (2018: £5.1 million), mainly relating to investment in replacement IT systems, and client relationship intangible assets of £2.8 million (2018: £nil), relating to the LHM Casey McGrath Limited acquisition (note 39), were capitalised. No goodwill was acquired during the year.

Intangible assets relating to computer software are amortised on a straight-line basis over three to ten years from the date the software is operating as management intended. The assessment of the expected useful life of computer software is based on the contractual terms or, where appropriate, past experience of the life of similar assets. The total amortisation charge for the year was £0.7 million (2018: £0.6 million).

Client relationship intangible assets are amortised over their minimum estimated useful life of ten years. If and when a client relationship is lost, any related intangible assets are derecognised in the year. The total amortisation charge for client relationships, including the impact of any lost relationships, was £1.0 million (2018: £1.0 million).

Goodwill that has arisen on business combinations is not amortised, but is subject to a test for impairment on an annual basis. No goodwill was found to be impaired in the year under review or the preceding year.

Lockup

Total lockup as at 30 April 2019, being the amount of capital tied up in accrued income and debtors, has increased to 4.1 months (2018: 3.8 months) representing a £3.1 million year-on-year increase in working capital. This increase is a reflection of growth in the business during the year and a change in the income mix of the group particularly where significant transactional growth has come from the restructuring and recovery business line which has a much longer working capital cycle than corporate finance and forensic services.

Defined benefit pension schemes

The group operates two funded defined benefit plans for qualifying employees, namely the S&W and NCL schemes. Both schemes are closed to new members.

At 30 April 2019, the NCL scheme reported a net surplus position of £1.6 million (2018: £1.2 million surplus), while the S&W scheme remained in a net flat position. Surpluses are not recognised in the balance sheet as the group does not expect to benefit from contribution holidays in respect of the plans and has no contractual right to a refund of contributions in the event of a wind-up of the scheme.

The NCL scheme liabilities decreased by 6.0% to £23.7 million (2018: £25.2 million). The decrease was largely driven by transfers out of the scheme and cash commutations in the current year. Scheme assets decreased by 3.8% to £25.3 million (2018: £26.3 million) due to capital withdrawals from the scheme.

The S&W scheme assets and liabilities have increased to £1.8 million (2018: £0.7 million) and £1.8 million (2018: £0.7 million) respectively. This increase is due to the inclusion of an insured annuity contract (liability) which is matched by an insurance policy (asset).

Capital, treasury and liquidity

The group's regulatory capital, risk weighted exposures and capital ratios at 30 April are shown below.

Capital requirements

For regulatory reporting purposes, the group is subject to proportional consolidation through which entities not subject to prudential supervision are excluded from the calculation of regulatory capital.

In the year to 30 April 2019, group risk weighted exposures increased by 13.4% to £599.1 million (2018: £528.2 million) reflecting balance sheet growth driven by an increase in deposits which are predominantly held with the central banks and highly rated institutions, consistent with the group's prudent approach to capital management. The increase in risk weighted exposures was offset primarily by an increase in profits retained by entities subject to prudential consolidation.

The group's continuing profitability has resulted in organic capital generation which allows for the payment of a progressive dividend and an increase in deductions for intangible assets associated with the investment in IT systems. As a result, the CET1 capital ratio has remained relatively stable at 25.1% (2018: 25.0%).

The group's CET1 and total capital ratios continue to be comfortably ahead of minimum regulatory requirements based on the standardised approach to credit and operational risk. All entities subject to prudential capital requirements exceed minimum requirements on a standalone basis.

The group is required to allocate capital to cover the capital requirements to which it is subject under the Capital Requirements Regulations and Capital Requirements Directive (collectively known as CRD IV). CRD IV is supplemented by Regulatory Technical Standards and the Prudential Regulatory Authority's (PRA) rulebook which are subject to change as certain aspects of CRD IV are dependent on clarifications to be issued by the European Banking Authority and adopted by the European Commission and the PRA.

Common equity tier 1 capital (CET1)	2019 £m	2018 £m
Share capital and premium	**31.1**	30.7
Reserves	**234.3**	191.3
	265.4	222.0
Deductions	**(115.3)**	(90.2)
CET1 after deductions	**150.1**	131.8
Additional tier 1	-	-
Tier 2	-	-
Own funds	**150.1**	131.8
Risk weighted exposures	**599.1**	528.2
CET1/Tier 1/Total capital ratio	**25.1%**	25.0%

The group holds capital in respect of:

Pillar 1 – minimum capital requirement

The group holds capital to cover the risk of losses arising from credit, counterparty, operational and market risks.

Pillar 2 – supplementary capital following supervisory review

The Pillar 2a capital requirement is set by the board and is subject to review by the PRA, to cover risks not sufficiently covered under Pillar 1. These risks include operational risk, interest rate risk, credit concentration risk and pension risk. At 30 April 2019, Pillar 2a represented 2.2% of risk-weighted exposures and the Total Capital Requirement (Pillar 1 and Pillar 2a) was 10.2% (2018: 10.2%). The board assesses Pillar 2a on an annual basis.

Combined capital buffers

The group is subject to the capital conservation buffer (CCB) under CRD IV, which is intended to result in a build-up of capital by banks outside of periods of stress. The buffer has been increased in incremental steps since 2016 and, as of 1 January 2019, the CCB was increased from 1.875% to 2.5% of risk weighted exposures representing full implementation.

The countercyclical capital buffer (CCyB) is based on the buffer rate applicable for each jurisdiction in which the group has exposures. On 28 November 2018, the Financial Policy Committee increased the CCyB rate for UK exposures from 0.5% to 1%. The buffer rates set by other national authorities for our non-UK exposures are not currently material. Overall, this results in a 0.96% CCyB for the group as of 30 April 2019.

The group prepares a Pillar 3 disclosure on an annual basis, which provides further detail about the group's regulatory capital position. The Pillar 3 disclosure can be found on the group's website.

Treasury and liquidity operations

Total assets at 30 April 2019 stood at £1,837.5 million (2018: £1,645.2 million) of which £1,267.3 million (2018: £1,149.7 million) comprised client deposits with Smith & Williamson Investment Services Limited representing the uninvested cash component of client portfolios.

A prudent approach is taken with respect to capital and liquidity management. The security of client assets is of paramount importance with the majority of the bank's liquidity (comprising cash deposits accepted from customers) being held in the form of high quality liquid assets. This explains the proportion of current assets represented by cash and balances with central banks. The group regularly assesses and stress tests liquidity requirements and continues comfortably to meet the liquidity coverage ratio.

The group undertakes stress testing as part of the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and the Recovery and Resolution Plan (RRP).

Group borrowings (note 27) of £21.9 million (2018: £19.4 million) are comprised primarily of funding for the Smith & Williamson Holdings Limited Employee Benefit Trust (EBT) which is guaranteed by the company.

Cash flow and capital expenditure

Included in cash and cash equivalents was £195.2 million (2018: £184.0 million) of the group's own net cash. This increase was mainly due to growth in operating profit partially offset by additional capital expenditure during the year.

Net cash generated from operating activities was £92.1 million (2018: £847.0 million) primarily due to operating cash flows and an increase in customer deposits. The larger balance in the prior year was due to the effect of bringing client money accounts on balance sheet.

Net cash used in investing activities included capital expenditure of £17.0 million (2018: £6.0 million). Total project costs of £19.2 million (2018: £10.6 million) were primarily spent on investment in new IT systems during the year, of which £13.2 million (2018: £5.1 million) was capitalised and £6.0 million (2018: £5.5 million) was expensed.

Net cash used in financing activities included returns to ordinary shareholders amounting to £20.3 million (2018: £17.7 million).

Extracts from the consolidated statement of cash flows	2019 £m	2018 £m
Net cash generated from operating activities	**92.1**	847.0
Net cash used in investing activities	**(16.2)**	(5.5)
Net cash used in financing activities	**(19.5)**	(22.4)
Net increase in cash and cash equivalents	**56.4**	819.1
Net cash and cash equivalents at the beginning of the year	**1,108.9**	289.8
Cash and cash equivalents at the end of the year	**1,165.3**	1,108.9
Group's own net cash at the end of the year	**195.2**	184.0

Viability statement

The directors have assessed the prospects and viability of the group over a three-year period in line with the requirements of the UK Corporate Governance Code, with which it has chosen to comply in this respect.

The directors have taken into account the group's current position and the potential impact of the principal risks and uncertainties, based on the annual business plan and the risk assessment performed as part of the annual ICAAP.

The directors consider that three years continues to constitute an appropriate period over which to provide its viability statement given the uncertainties in predicting the future impact of investment markets on the business over longer periods.

As part of the viability statement, the directors confirm that a robust assessment of the key risks facing the group has been undertaken together with stress and scenario testing of those risks to determine the sustainability of the group business model based on expected business performance in a stressed economic environment.

Based on this assessment, the directors have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due to 2022.

Grant Hotson
GROUP FINANCE DIRECTOR

27 JUNE 2019