Quilter plc announces the proposed sale of Quilter International to Utmost Group

Thursday 1 April 2021

Operator: Hello, and welcome to the Quilter plc conference call. Throughout the call, all participants will be in a listen-only mode, and afterwards there will be a question and answer session. And just to remind you, this conference call is being recorded.
Today I'm pleased to present Paul Feeney. Please begin your meeting.

Paul Feeney: Good morning, all. Many thanks for joining us at short notice today.

At our full year results, we promised that we would get back to you on the strategic review of our international business. And as this morning's announcement makes clear, we've now concluded that process. So, let me give you the high-level context. Mark will then walk you through the financial implications and expected timeline to completion. And then, I'll talk to what it means for our strategy. We'll then take questions. Right, let's dive in, starting with slide three.

I'm delighted to announce that we have agreed terms to sell our International business to Utmost for approximately £483 million in cash. It was the best bid which emerged from a competitive process involving a number of bidders, and the terms of the transaction provide very little residual risk to us. And it's a good deal for all stakeholders. Our shareholders get a great price. The customers of our International business get a new owner, who will view this business as core. And it will also provide a range of career opportunities for the employees in our International business today.

Now, back at the full year results, I said that International had been a good business for us, and all options were on the table. So, why are we announcing a sale today? Essentially, there are two reasons: one strategic, and one financial.

First, strategic. While International delivered a solid contribution to our profits and cash generation, it is less aligned to our core UK business. And the level of integrated flow is fairly modest. So, we concluded that it makes more sense to double down on the area where our opportunity is most compelling: the UK wealth market. As you know, this market is large and structurally growing. So, focusing here is more sensible than allocating valuable resources to try and deliver a similar rate of growth from the International business. Without International, Quilter will be a nimbler, simpler, faster-growing business. That's why we are also restating our target for NCCF growth to at least 6% today.

The second reason is financial. As you know, the revenue line in the International business has been going backwards for the last few years. We managed to offset that through strong cost reductions to support profitability. But there is only so much you can do to drive profits by reducing costs if

revenues are not growing. So, while the team have done a great job maintaining profitability over the last few years, the impact of the back book run-off cannot be avoided forever. We would have to make considerable investment both in terms of P&L cost and capital to drive the International business forward from here. As a result, we have concluded that a disposal delivers the greatest value for shareholders.
Now moving to slide four. As you all know, capital discipline is a key focus for us. When we sold our single-strategy asset management business, we used the proceeds to repay a £300 million bank loan, which we took out to fund a pre-IPO distribution to our shareholder. And we followed it with another £220 million special dividend post-listing.

When we sold Quilter Life Assurance, we announced we would return the entire net sale proceeds to shareholders through a share buyback, and we're making good progress here. And we are saying today that we are minded to return the majority of the proceeds from this sale to shareholders after allowing for costs, a contribution to the 2021 dividend, and some investment in the business.

What do I mean by minded? Essentially, if we had the money in our hands today, we would be happy returning that majority of the net sale proceeds to shareholders. But we don't expect this transaction to complete until later this year or early 2022. And as we've learned over the last year, the world can change fast. So, while we plan to make a meaningful distribution, the Board will take stock of the financial and business conditions prevailing at completion, as well as the opportunities to invest and accelerate growth before deciding the amount and means of a distribution. And it goes without saying that this is something that we'll continue to consult with our shareholders about, as well.

Right, let me hand over to Mark to talk through the financials. Mark.

Mark Satchel: Thanks, Paul, and good morning, all. Right, so, I'm starting with slide five.

As you know, the International life businesses tend to be valued at a discount to own funds rather than a multiple of earnings, given their complexity and capital intensity. We think we've achieved a very good valuation at 84% of end 2020 own funds, particularly given the nature of the quarter International back book. The total consideration is made up of a base consideration of £460 million and a ticker, which is interest income on that figure from the 1st of January this year until completion. So, if we complete on 31 December 2021, that is worth £23 million. Hence, the £483 million.

Costs are expected to absorb around £33 million, leaving net proceeds of £450 million. Given the size of the transaction, it will require shareholder approval at a general meeting, and we will be issuing a Class 1 circular to support the approval process. It also requires regulatory approval in each of the five main jurisdictions in which our International business operates, and there is an EU antitrust approval requirement too, so we need three main things to complete on the transaction: our shareholders’ approval, regulatory approvals, and the antitrust approval.

In terms of use of the £450 million proceeds, first, we expect to allocate a portion to cover Quilter International's share of the overall Quilter 2021 dividend on a pro-rated basis to this year's earnings. Next, as Paul has said, we are currently minded to return the majority of the proceeds to shareholders, following the disposal, and we will update you on that at completion. Finally, we also intend to re-invest a portion of the proceeds into our core business to fund selected revenue growth plans and to help optimise the cost base. We will update you on our detailed plans at a Capital Markets Day that we are planning in Q4 this year.
Let me now turn to the impact of the sale on our financials, and what we expect from here on slide six.

Our International business made an IFRS profit of £57 million in 2020. You will recall that at the full-year results announcements, I referenced the Group benefiting from a total of some £42 million of tactical cost savings. Quilter International contributed some £8 million of that through lower variable compensation, reduced travel, and lower change in marketing spend. Without that benefit, the profit contribution from International in 2020 would have been around the same level as that of the prior year, and our expectation is that if we retain the business, its profit trajectory would trend downward from here without meaningful restructuring actions and investments in the business.

Turning now to the operating margin.

As you know, Quilter achieved an operating margin of 25% for 2020. Quilter International has a high-margin legacy run-off book which gives it a higher operating margin than the Group average. Excluding International, the ongoing Quilter business delivered an operating margin of around 20% last year.

Now, you have heard us say on a number of occasions that we believe our business should have an operating margin that starts with a three and we believe that is what our UK business should be achieving. Based on our current plans for the continuing business, excluding Quilter International, and assuming broadly stable market conditions with some normalised equity market growth, we expect to get to an operating margin of at least 25% by 2023, and at least 30% by 2025.
Flipping to slide seven, let me now say a few words on capital.

I know one of the first questions I'm going to get is whether there is scope for a change in our capital regime. This is something we intend to discuss with our regulators. It's important to caution that we do expect to remain Group Solvency II-regulated for the time being because all the pension assets on our UK platform are held through our Life company.

So, on technical grounds, we remain a Group Solvency II-regulated Group, regardless of whether Quilter International is part of the Group or not. By swapping the value in force both, vif, in the International business for cash, we expect the capital and cash positions of the Group to be materially enhanced immediately after the transaction before considering the return and redeployment of the sale proceeds.

As I said earlier, the International business will contribute its share to the Quilter full-year dividend on a pro-rated basis to earnings. In effect, this means a partial distribution of the net sale proceeds in the form of the full-year dividend. That is also what we did in 2019 when we sold Quilter Life Assurance using a similar locked box mechanism. So, you can regard the 2021 Quilter full-year dividend as effectively based on the same corporate perimeter as the 2020 dividend. And our dividend pay-out policy remains unchanged.

We've also announced today that we will restart the share buyback shortly to continue returning the Quilter Life Assurance sale proceeds, and we are aiming to accelerate the programme by removing the 50/50 LSE/JSE split that was in place last year.

Turning now to the timetable on slide eight.

The main points to note here are that, as I said earlier, the transaction will require shareholder and regulatory approval. We expect the Class 1 circular to be published in around six weeks, and for the general shareholder meeting to follow some five to six weeks after that. And that's a slightly extended timetable than you might typically expect due to our need to mail out documents in South Africa. If all goes to plan on the shareholder and regulatory front, we expect that the transaction should complete by late this year or early in 2022.

Just before I hand back to Paul, let me show you slide nine, which you will recognise as a summary of our financial guidance.

The key changes that I would highlight are: our revised expectation of growth in NCCF from 5% to 6%, which is just the mathematical adjustment from excluding the slower-growing Quilter International from the ongoing business; our new targets for our operating margin; a higher overall Group tax charge once we lose the benefit of low tax earnings from the Isle of Man-based business. Finally, you will note that the revenue margin for the International business in 2020 was broadly in line with the Group average so the disposal will not have much of an impact on the short-term margin, but we think a future drag is removed, which should lead to increasing stability over time.

And with that, let me hand back to Paul.

Paul Feeney: Thanks, Mark. I'm now on slide 10.

Since we listed back in 2018, we've had two main objectives: to simplify our structure, and to deliver on the growth potential of our business. 2021 has seen us make two key strides here. Selling Quilter International delivers a major simplification, and it leaves us with a faster-growing core business. And completing the migration onto our new UK platform sets us up to deliver a meaningful acceleration in growth.

This slide shows the new Quilter on a page. We cover all three parts of the wealth value chain: financial advice; platform and wrappers; and a full range of investment solutions. That covers the full spectrum from bespoke offerings for high-net-worth clients, to unitised and managed portfolios for the affluent and mass affluent market.

What also sets us apart from our peers is our two strong distribution channels, our own advisors, and the third-party open market IFAs that we serve. And as I alluded to earlier, we think the revised perimeter of the business should be capable of delivering NCCF in excess of 6% of AuMA through the cycle, with the UK platform running ahead of that level. So, we will now be targeting that as a minimum over the medium term from 2022 onwards.

So, in summary, on slide 11. We are delighted to be announcing this transaction today. With the sale of Quilter International, and the completion of PTP earlier this year, the heavy lifting to transform Quilter is now behind us. The foundations are in place to deliver on our next phase of our journey. Our focus is now on driving growth and efficiency. And under new ownership, our international business will be free to invest in its core franchise and to deliver for its customers, employees, and new shareholders. And I wish them well for the future.

Now, let me open up for questions.

Q&A

Operator: Thank you. If you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw your question, you may do so by pressing 02 to cancel.

Our first question comes from the line of Andy Sinclair from Bank of America. Please go ahead.

Andy Sinclair: Thanks, and morning, everyone. Well done on this disposal. Three for me, as usual, if that’s OK. Firstly, you’ve talked about material capital return, but also said about funding selected growth initiatives. You also just said that the heavy lifting to transform Quilter is now behind us. So, should we think about those growth initiatives as just adding some more financial advisors, maybe capabilities for Quilter Investors, rather than anything transformation in terms of M&A. That's question one.

Secondly, just looking at the new operating margin targets, how much of that should we think is just the original plan effectively adjusted for the QI disposal? How much is new expense opportunities? And how much is deployment into those new growth initiatives?

And thirdly, perhaps a slightly cheeky question, we're now at 1st of April, just wondered if you could give us any colour on Q1 trading and how you feel just now about the 5% target for 2021. Thanks.

Paul Feeney: Thank you, Andy. It's Paul. I will have a go at number one and number three, and hand over to Mark for number two on operating margin targets.

In terms of material capital return, as we said, if we had the money in our hands today, we'd be making that very meaningful, capital return to shareholders holders now. Of course, we have positioned Quilter front-and-centre in one of the UK's, if not the UK's, fastest secular growth market in financial services: the UK wealth market, particularly the retirement-driven UK wealth market. And that's where Quilter is now positioned. So clearly, there are opportunities there. We are not certainly saying that we want to retain everything for a major transformational move, but clearly, there are opportunities to accelerate our growth still further. So, we will consider those, and obviously, we'll update back at the Capital Markets Day in the fourth quarter.

In terms of Q1 trading, I think our update is on the 21st of April. I have said already that I'm pleased with what I'm seeing in the first couple of months of the year, given our new platform is in, and that's being driven by our new platform. So, that's nice to see. Obviously, it's early days, but so far, so good. Put it this way, I take what I'm seeing at the moment, but we'll update you on the 21st of April.

And in terms of margin targets, how much is for new expense opportunities –

Mark Satchel: When we set out optimisation phase one a couple of years ago, I spoke then about what was in perimeter and what was outside of the broad perimeter that we were looking at as a phase one and spoke about a phase two to come. So clearly, this falls upon phase two because now it's quite a different business construct with the opportunities there. So, within what we're doing, it's a combination of what we previously planned to do, but then more, because we've also got a substantially- changed business perimeter to work through on that. So, a large chunk of it is coming through on the expense side. But there are also additional revenue-enhancing initiatives that we are considering, and we'll update you on that later on, as Paul has mentioned. It's a combination of the two.

Andy Sinclair: Understood. Thanks.

Operator: And the next question comes from the line of Gurjit Kambo from JP Morgan. Please go ahead.

Gurjit Kambo: Hi. Good morning, guys. Well done on getting the deal done quickly. Just two questions from my side. Firstly, I think, Paul, you said if you had the cash today, you would give the majority of that back. I'm just thinking about the M&A environment. The reason you'd give it all back, is it because you don't see many gaps in the Quilter offering? Or if there was any M&A out there, maybe valuations are too high? So, just the landscape currently, if you had that 450 million in your pocket today, why you would give it back rather than maybe doing something else with it. That's the first question.

And secondly, just in terms of stranded costs, if we think about adjusting our models to x out Quilter International, obviously, we would take the revenues out. How should we think about taking the costs out? Do they all come out? Or will there be some which stick around for a couple of years?

Paul Feeney: Thanks, Gurjit. I'll take the first question, and then hand over to Mark for the second one.

It's actually nothing to do with that. We see the opportunities in this market, which we see as significant, as a completely separate decision to the fact that we're going to have a chunk of money. So, the fact that we have announced today the sale of International, £483 million, just because we will have that money doesn't mean to say we should make - If we felt there was good opportunities for significant investment, we'd talk to our shareholders anyway. So, I think the two are separate. We always take a decision.

First of all, what is the right strategic thing to do. This has been the right strategic thing to do. Commercially, we got a great deal, which makes it even better. Now, separately, we look at the market. We do see growth opportunities. We see opportunities to accelerate growth, but at the same time, we're very, very aware this is our shareholders' money. We've always been very capital-conscious, and so, we intend to make a meaningful return of that capital. But we see the two separately.

So, if you're asking me, do I see opportunity to accelerate growth? The answer is yes, but at the same time, it's our shareholders' money, and we're very well aware of that. So, it's nothing to do with the share price, it's nothing to do with the fact that we've got cash in hand, it's to do with two separate decisions, and we're going to update that at the Capital Markets Day on that. Mark?

Mark Satchel: On the stranded costs, we've got about £8 million of stranded costs immediately after completion. There's obviously work that we'll be doing between now and then in order to minimise the impact of that. Probably round about half of that is the more - you would remember on the sale of QLA we spoke about stubborn stranded costs - about half of that is at the more stubborn end of the spectrum - but that's all fully incorporated in the 23 and 25 guidance that we've provided to you, and that will, obviously, also form part of the overall next phase of the optimisation initiatives that are being considered.

Gurjit Kambo: OK. Great. Thank you.

Operator: And the next question comes from the line of David McCann from Numis. Please go ahead.

David McCann: Morning, all. Two questions from me. The first one's partly been addressed already, but I'll maybe ask it in a slightly different way. Just relating to the new operating margin targets for the Group, clearly, to get to 25% medium term and 30% longer term from the base of 20% where you are today, that is quite an uplift from the way you've been talking about it before. I appreciate you say you're going to give some details at the Capital Markets Day, but could you give us just a little bit more colour on the main drivers of this, short term. Is this more cost reduction in a more significant sense? Is it a combination of higher growth, at the top line kicking in? Is it something else? Just a bit more colour, just so we can get a bit more comfortable with that. It's quite a big uplift you're now talking about over that time. That's question one.

The second question is on the balance sheet. I appreciate there is a little bit of detail on the slide in terms of the solvency capital ratios themselves. Maybe, could you just walk us through some of them and what this actually does to your own funds and the regulatory capital requirement component of that, rather than just the overall percentages. I'd just like to understand those moving parts, what the deal does. Thank you.

Paul Feeney: OK. Thank you, David. It's Paul. I'm going to hand to Mark for both of these, but just very quickly on the first one. It's the two goals that I've said we've now got: growth and efficiency. So, one, of course, speaks to growth in assets, growth in revenues, growth in flows, and the other speaks to efficiency in costs. So, Mark, do you want to add some colour on the operating margin?

Mark Satchel: Paul, that's entirely right. David, there's a meaningful contribution from costs, and some of that's been planned anyway, that I've provided in previous guidance when I've spoken about optimisation phase two. But as I've referenced already, this changes the perimeter of the in-scope items on that relatively significantly, and then, there are also revenue growth opportunities, too. So, it's both. It's not either/or, and it's probably in relatively similar measures across the op margin.

On the solvency capital, you've got the own funds reference number in there, the capital requirements for the International business of £300 million. So, it reduces that part of the SCR. It effectively moves the SCR from approaching 900 to just under 600 in rounded numbers, the impact that that has on capital requirements. And on a Solvency II basis, it still keeps us at a very healthy Solvency II margin if you consider it after a post-distribution event, too.

As I've said numerous times before, the Solvency II ratio itself is not a constraining factor for the Group from a capital perspective. It's liquidity and liquidity stress tests and ensuring that we've got sufficient liquidity in a stress event that is a constraining factor when it comes to further capital returns, which you haven't said it, but I'm assuming that that underpins part of the question that that that you have around it.

So, even in a post-capital return environment, I'd still expect a Solvency II ratio that's going to be in the high-100s. I don't expect it to be over 200%, but it will be round about 180-odd percent. Obviously, that's going to change in time, but that's more or less where I would expect it to be.

John-Paul Crutchley: Thank you. Operator?

Operator: And the next question comes from the line of Greg Simpson from Exane BNP Paribas. Please go ahead.

Greg Simpson: Hi, good morning, and congrats on the transaction. Just a couple on my side. The first is: could you remind us of the overlaps with the International business and the rest of Quilter? And in particular, I'm wondering if any of the 23 billion of Quilter investors AuMA, is sourced from Quilter International clients, and if so, would you expect to retain it with the new owner?

And then, the second question: I think you mentioned earlier that you thought the right margin for the UK business should begin with a three, I think you said. So, just to confirm, you are seeing the 30% target as a minimum you want to be at. And in an ideal world, assuming all goes well with markets and flow, you'd hope to be above 30% by 2025? Thanks.

Paul Feeney: OK. I'll bring Mark in, as well, but there's relatively little overlap between Quilter International and the rest of Quilter. There is about 600 managed-within-portfolio bond wrappers by Quilter Cheviot, and about 970 managed within those wrappers with Quilter Investors. And yes, we do expect to retain all of that - certainly, the vast majority of that - as a result of the deal we've done. So, we don't see any real attrition or leakage from that, but of our total overall AuMA, it's relatively modest, and we've said at least 30%, or 30% plus. So, we haven't given you an actual number in the 30s, but we've said at least. So, I think that's fairly clear.

Greg Simpson: OK.

Paul Feeney: And again, we'll update, Greg, as well, at the Capital Markets Day in Q4.

Greg Simpson: Great. Thank you.

Operator: And just as a final reminder, if you do wish to ask a question, please press 01 on your telephone keypad now.

We have one more question from the line of Paul Allen from BMO. Please go ahead.

Paul Allen: Hi. Yes, thank you. Just a question on Solvency II. You mentioned earlier that you will still have to report under Solvency II, but that you will have some discussions with the regulator around that. You said it would be for the time being, potentially, so I'm just interested what your options are. You mentioned, obviously, the UK life business at the moment means you have to report under Solvency II. But what are your options going forwards for potentially transitioning out of that regime?

Mark Satchel: Paul, it's really a discussion we're having with the regulators around, as I've said, on technical fundamentals. We remain Group Solvency II-regulated, but we are a unit-linked business, we're not a traditional Life business. So, on a more practical basis, when you stand back and look at it, we don't carry the same balance sheet risks that a lot of other Group Solvency II-regulated businesses would be carrying that operate in the Life industry. But if we weren't Group Solvency II-regulated we would be CRD4 Group-regulated. We already have a component of that group regulation, but it doesn't apply to the whole Group as things currently stand. But that's really a discussion to have with the PRA. Ultimately, it's for the regulators to opine on that.

Paul Allen: But potentially, that is an option, that you could, there is a way, not using the UK Life business or somehow - ? I was just interested in why you weren’t constrained by Solvency II.

Mark Satchel: No, I'm not saying that we won't be constrained by Solvency II. I still expect the Life and Pensions business on the platform will absolutely be Solvency II-regulated on a solo basis, and we have no plans to change any of that. This is more purely at a Group supervision level in terms of where the ultimate Group supervision from a capital perspective sits.

Paul Allen: Thank you.

Operator: As there are no further questions, I'll hand it back for closing remarks.

Paul Feeney: I just want to say thank you to everybody. Thank you for your support. I’m delighted. As I said, Mark and I are both delighted with the outcome of our strategic review. We do think it is absolutely the right decision for our shareholders, for our employees, and for our customers. And it does give us now complete focus on the fast-growing secular growth UK wealth market, and we have got all three parts of the value chain. They are increasingly fully-integrated. We've got two hugely-strong distribution channels in the open market, IFA market, and our own control distribution with Quilter Financial Planning, and as a result of our new platform now in safely, securely and, quite frankly, working really well, we're hugely optimistic, And we are where we envisaged we would be. We have now completed the transformation of Quilter, and it's now up to us to focus on our two core objectives of growth and efficiency.

Thank you very much everybody.

Operator: This now concludes our conference call. Thank you, all, for attending. You may now disconnect your lines.