



# **Close Brothers**

---

**Interim Report 2003**

---



## Close Brothers

### DIRECTORS' STATEMENT

#### Profit and Dividend

The operating profit on ordinary activities before taxation and goodwill amortisation was £39.7 million compared with £37.4 million last year. The earnings per share before goodwill amortisation was 19.4p compared with 18.6p.

After deducting a charge for goodwill amortisation of £3.4 million (2002 – £3.3 million), the operating profit on ordinary activities before taxation was £36.3 million (2002 – £34.1 million), up 6 per cent., and earnings per share increased by 5 per cent. to 17.0p (2002 – 16.1p).

These results have benefited from the absence of exceptional costs in the period although earnings per share growth has been constrained by the dilutive impact of last Spring's share placing.

In the face of difficult market conditions, and over a six month period in which the FTSE All Share Index fell by 16%, our performance continues to be resilient, as demonstrated by comparison of the last four half-year periods:

	Operating income £million	Profit before taxation* £million	EPS* p
July 01	135	36.3	18.5
January 02	137	37.4	18.6
July 02	139	37.7	18.6
<b>January 03</b>	<b>148</b>	<b>39.7</b>	<b>19.4</b>

\*Before goodwill amortisation

The directors have declared an interim dividend of 9p net per share, the same level as last year. This is payable on 16th April, 2003 to shareholders on the register at the close of business on 14th March, 2003.

#### Overall Business Review

The results continue to be consistent with the statement made at our AGM in October 2002, when we expressed caution about the current year.

We have achieved continued growth in both assets and profits in our specialist **Banking** activity. The loan book at the end of the period increased 17 per cent. over the past year, margins were maintained and there has been no deterioration in the bad debt charge as a percentage of the average loan book. Our **Investment Banking** activity held up well despite the falling markets although profits have not moved forward since the previous half year. The results of our **Asset Management** division suffered with the general market malaise, but **Corporate Finance** held its own. **Market-Making** achieved a creditable result in a period of continuing low levels of retail activity in trading outside the FTSE-100, with the upturn in the market indices in late Autumn proving short lived.

The table below sets out our segmental analysis:

£million	Operating income			Profit before taxation		
	First half 2002	Second half 2002	First half 2003	First half 2002	Second half 2002	First half 2003
Investment Banking						
<i>Asset Management</i>	33.4	32.6	<b>31.2</b>	8.6	7.3	<b>4.0</b>
<i>Corporate Finance</i>	13.7	12.5	<b>12.3</b>	2.0	0.1	<b>1.4</b>
<i>Market-Making</i>	25.0	21.6	<b>26.6</b>	9.6	7.2	<b>9.3</b>
	<u>72.1</u>	<u>66.7</u>	<u><b>70.1</b></u>	<u>20.2</u>	<u>14.6</u>	<u><b>14.7</b></u>
Banking	65.9	71.2	<b>76.7</b>	26.1	29.0	<b>31.4</b>
Group	(0.8)	1.3	<b>1.2</b>	(8.9)	(5.9)	<b>(6.4)</b>
Total	<u>137.2</u>	<u>139.2</u>	<u><b>148.0</b></u>	<u>37.4</u>	<u>37.7</u>	<u><b>39.7</b></u>
Goodwill amortisation				(3.3)	(3.4)	<b>(3.4)</b>
Total				<u>34.1</u>	<u>34.3</u>	<u><b>36.3</b></u>

The divisional net assets have not changed materially during the first half year.



## Close Brothers

### DIRECTORS' STATEMENT

#### Divisional Business Review

##### Banking

Our banking division, which utilises around 45 per cent. of our shareholders' funds, had a strong six months, producing some 52 per cent. of our income and 68 per cent. of our operating profits before group central costs.

Profits were up 20 per cent. on the same period last year and the group loan book increased by 17 per cent., to £1.5 billion from £1.3 billion a year ago. This gratifying rate of growth was achieved without compromising our firm underwriting criteria and, as a result our net bad debt charge, representing 1.5 per cent. of our average loan book, remained at the same level as last year.

The analysis of our specialist loan book at the half year stage indicates a similar position to last year. We achieved excellent growth in our insurance premium financing business, where the level of outstandings was up 35 per cent. from a year ago. This reflected both significant organic growth and also the hardening of insurance premiums. Our other process-driven operations, namely our credit management businesses, performed satisfactorily although our debt factoring side is operating in a harsh climate for its small and medium-sized corporate clients.

The mix of assets by sector which we finance is shown in the table below:

	31st January, 2002	31st January, 2003
Insurance premiums	23%	27%
Printing equipment	20%	18%
Cars	18%	19%
Transport and engineering	14%	13%
Healthcare, armed services and other	10%	9%
Property	9%	9%
Debt factoring	6%	5%

Our property lending business contributed another steady result but we remain cautious, in view of the well publicised concerns about the residential property market. Our asset finance businesses

had a steady result and there was a particularly pleasing performance from our motor finance operation. Our healthcare, transport and engineering businesses also performed well, as did our operation in the Channel Islands. However, the printing equipment market continued to be weak and shows no signs of pick-up.

Our treasury operation had another good result and continues to have substantial undrawn committed funding available to finance future loan book growth.

Overall the outlook for the division remains favourable.

##### Investment Banking

##### Asset Management

The past six months has been a difficult period. Falling markets have restricted fund raising and have resulted in lower initial and recurring fees from clients. In the circumstances we were pleased that our funds under management remained steady at £3.1 billion.

Our private client businesses onshore and offshore were not immune to these conditions. Offshore, margins in our deposit business suffered as a result of continuing low interest rates. Furthermore, in the Channel Islands we are making a significant investment in new premises and a new computer system. This will increase our efficiency and capacity although in the short term profitability is affected.

Our two businesses managing unquoted funds performed well, although the current ISA/VCT fund raising season is muted. There was a particularly strong showing from our private equity business, which had some good realisations in the period. Our remaining businesses, largely managing quoted equities, had mixed fortunes, our smaller units with relatively high fixed costs suffering the most. As a result, although period turnover held up reasonably well, the operational gearing of this division contributed to a significant fall in profits. Although short term the outlook is sombre, we believe that we have the appropriate building blocks to

move forward when market conditions improve and retail investor confidence returns.

### *Corporate Finance*

For most of calendar 2002, our corporate finance division was at a low ebb as the levels of activity reflected the falling stock market. However, towards the end of that year, there was a small increase in our business levels and this, together with a reduced cost base, has enabled us to report a modest first half profit. The result is near to that for the first half last year and shows improvement from that in the second half. The restructuring team is particularly active in the troubled corporate climate. Looking forward, however, our market-place continues to be subdued.

During the period we have continued to refocus our efforts and plan for the future. In Europe we have doubled our shareholding in Atlas Capital Close Brothers (Spain) to 20 per cent. and expanded our network of associates into Switzerland and Italy. In the US we have also entered into associate relationships with Harris Williams and Chanin Capital Partners covering, respectively, M&A and corporate restructuring.

### *Market-Making*

The UK stock market has now been in a bear phase for over three years and suffered sharp falls both in Summer 2002 and in the early part of 2003. There was a rally in late Autumn but, for the second year running, this soon fizzled out.

In these circumstances we have achieved a creditable result, broadly in line with that for the first half of last year and an improvement over the second half. Over the period our costs, which now include those of the investment trust team who joined us from HSBC last August, have been well controlled. This new team is beginning to build up its business and at the half year end had been appointed corporate broker to 26 investment trusts.

The market remains edgy and volatile, and the immediate outlook for this business is unexciting. However the

withdrawal of some firms from the market should benefit us in an upturn.

### **Board**

As previously announced at our AGM on 31st October, 2002 Colin Keogh was appointed group chief executive on the retirement of Rod Kent, and Peter Winkworth and Stephen Hodges were appointed group managing directors.

Strone Macpherson was appointed a non-executive director on 3rd March, 2003. Mr. Macpherson has been a senior board member of Misys plc from 1989 until recently, when he stepped down as executive deputy chairman. He is currently the chairman of J P Morgan Fleming Smaller Companies Investment Trust plc and a non-executive director of AXA UK plc and British Empire Securities and General Trust plc.

### **Outlook**

The long bear market continues with the stock market notably weak since the turn of the year and no sign of investor confidence returning. The political situation in the Middle East and elsewhere is very concerning. This, coupled with the deteriorating economic environment in the UK, may begin to undermine consumer confidence.

Against this tough background, the near term outlook for our investment banking activity remains uncertain although for our specialist banking activity it continues to be positive. For the remainder of calendar 2003 we retain our cautious stance overall.



## Close Brothers

### CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Six months ended 31st January,		Year ended 31st July,
	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	£'000	£'000	£'000
Interest receivable	109,931	100,491	198,890
Interest payable	(47,747)	(46,074)	(88,449)
Net interest income	62,184	54,417	110,441
Fees and commissions receivable	65,760	69,945	140,795
Fees and commissions payable	(10,652)	(13,398)	(24,740)
Net dealing income – market-making	28,014	25,680	48,365
Other operating income	2,709	543	1,493
Other income	85,831	82,770	165,913
Operating income	148,015	137,187	276,354
Administrative expenses	93,706	87,245	174,383
Depreciation	3,958	3,489	7,614
Provisions for bad and doubtful debts	10,669	9,058	19,256
Amortisation of goodwill	3,389	3,325	6,681
Total operating expenses	111,722	103,117	207,934
<b>Operating profit on ordinary activities before taxation</b>	<b>36,293</b>	<b>34,070</b>	<b>68,420</b>
Taxation on profit on ordinary activities	11,377	11,060	21,839
Profit on ordinary activities after taxation	24,916	23,010	46,581
Minority interests – equity	665	1,258	2,252
Profit attributable to shareholders	24,251	21,752	44,329
Interim dividend	12,839	12,195	36,409
Retained profit	11,412	9,557	7,920
Interim dividend per share (net)	9.0p	9.0p	26.0p
Earnings per share before amortisation of goodwill	19.4p	18.6p	37.2p*
Earnings per share on profit attributable to shareholders	17.0p	16.1p	32.3p
Diluted earnings per share	16.9p	16.0p	32.0p

All income and profits are in respect of continuing operations.

\*After exceptional costs

## CONSOLIDATED BALANCE SHEET

	31st January,		31st July,
	2003	2002	2002
	(Unaudited)	(Unaudited)	(Audited)
	£'000	£'000	£'000
<b>Assets</b>			
Cash and balances at central banks	759	619	671
Loans and advances to banks	679,307	499,190	443,175
Loans and advances to customers	1,520,476	1,300,524	1,410,998
Non-recourse borrowings	(175,000)	(100,000)	(175,000)
	1,345,476	1,200,524	1,235,998
Debt securities – long positions	53,643	44,365	64,352
Debt securities – other	521,750	552,184	712,380
Settlement accounts	238,166	271,957	246,456
Equity shares – long positions	30,419	27,821	15,971
Loans to money brokers against stock advanced	87,054	86,217	90,385
Equity shares – investments	27,439	26,537	28,484
Intangible fixed assets – goodwill	109,707	117,152	113,065
Tangible fixed assets	24,031	22,966	24,667
Share of gross assets of joint ventures	18,208	13,209	14,331
Share of gross liabilities of joint ventures	(18,000)	(12,772)	(13,905)
	208	437	426
Other assets	59,405	46,683	44,299
Deferred taxation	9,514	10,276	10,345
Prepayments and accrued income	25,071	25,980	22,956
<b>Total assets</b>	<b>3,211,949</b>	<b>2,932,908</b>	<b>3,053,630</b>
<b>Liabilities</b>			
Deposits by banks	87,269	103,721	83,159
Customer accounts	1,317,314	1,150,345	1,222,541
Bank loans and overdrafts	585,802	483,843	505,655
Debt securities – loan notes issued	100,000	118,140	100,000
Debt securities – short positions	46,144	40,259	52,231
Settlement accounts	188,261	208,948	202,343
Equity shares – short positions	7,378	13,660	7,589
Loans from money brokers against stock advanced	85,679	90,438	84,299
Other liabilities	145,008	139,167	143,769
Accruals and deferred income	62,807	62,437	77,105
Subordinated loan capital	96,937	96,937	96,937
Minority interests – equity	5,881	5,717	6,079
<b>Total liabilities</b>	<b>2,728,480</b>	<b>2,513,612</b>	<b>2,581,707</b>
<b>Shareholders' funds</b>			
Called up share capital	35,971	34,187	35,920
Share premium account	249,148	194,952	248,456
Profit and loss account	198,350	190,157	187,547
<b>Total equity shareholders' funds</b>	<b>483,469</b>	<b>419,296</b>	<b>471,923</b>
<b>Total liabilities and shareholders' funds</b>	<b>3,211,949</b>	<b>2,932,908</b>	<b>3,053,630</b>
<b>Memorandum items</b>			
Contingent liabilities – guarantees	2,892	4,847	2,412
Commitments – other	160,481	158,094	166,512



## Close Brothers

### CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Six months ended 31st January,		Year ended 31st July,
	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	£'000	£'000	£'000
Profit attributable to shareholders	24,251	21,752	44,329
Exchange adjustments	(609)	17	(978)
Total recognised gains and losses	<u>23,642</u>	<u>21,769</u>	<u>43,351</u>

### CONSOLIDATED CASH FLOW STATEMENT

	Six months ended 31st January,		Year ended 31st July,
	2003 (Unaudited)	2002 (Unaudited)	2002 (Audited)
	£'000	£'000	£'000
Net cash inflow/(outflow) from operating activities (Note 1(a))	<u>41,729</u>	<u>(54,707)</u>	<u>(29,611)</u>
Returns on investments and servicing of finance:			
Interest paid on subordinated loan capital	(3,945)	(3,945)	(7,825)
Dividends paid to minorities	(170)	(133)	(178)
	<u>(4,115)</u>	<u>(4,078)</u>	<u>(8,003)</u>
Taxation:			
Taxation paid	<u>(9,039)</u>	<u>(13,828)</u>	<u>(25,586)</u>
Capital expenditure and financial investment:			
Purchase of tangible fixed assets	(3,608)	(7,729)	(14,396)
Sale of tangible fixed assets	248	1,666	2,416
Purchase of equity shares held for investment	(2,475)	(2,500)	(5,173)
Sale of equity shares held for investment	5,253	2,381	2,647
	<u>(582)</u>	<u>(6,182)</u>	<u>(14,506)</u>
Acquisitions and disposals:			
Minority interests acquired for cash	(1,467)	(1,118)	(1,194)
Purchase of subsidiaries (Note 1(b))	(1,775)	(1,170)	(6,685)
	<u>(3,242)</u>	<u>(2,288)</u>	<u>(7,879)</u>
Equity dividends paid	<u>(24,214)</u>	<u>(22,927)</u>	<u>(35,122)</u>
Net cash inflow/(outflow) before financing	<u>537</u>	<u>(104,010)</u>	<u>(120,707)</u>
Financing:			
Issue of ordinary share capital including premium	743	1,831	57,068
Increase/(decrease) in cash	<u>1,280</u>	<u>(102,179)</u>	<u>(63,639)</u>

In the directors' view, cash is an integral part of the operating activities of the group, since it is a bank's stock in trade. Nevertheless, as required by Financial Reporting Standard No. 1 (Revised), cash is not treated as cash flow from operating activities but is required to be shown separately in accordance with the format above.

## THE NOTES

### 1. Consolidated cash flow statement

	Six months ended 31st January,		Year ended 31st July,
	2003	2002	2002
	(Unaudited)	(Unaudited)	(Audited)
	£'000	£'000	£'000
<b>(a) Reconciliation of operating profit on ordinary activities before taxation to net cash inflow/(outflow) from operating activities</b>			
Operating profit on ordinary activities before taxation	36,293	34,070	68,420
(Increase)/decrease in:			
Interest receivable and prepaid expenses	(2,115)	(2,117)	907
Net settlement accounts	(5,792)	(29,433)	(10,537)
Net equity shares held for trading	(14,659)	9,658	15,437
Net debt securities held for trading	4,622	(6,524)	(14,539)
(Decrease)/increase in interest payable and accrued expenses	(14,298)	(9,473)	4,911
Depreciation and amortisation	7,347	6,814	14,295
Net cash inflow from trading activities	11,398	2,995	78,894
(Increase)/decrease in:			
Debt securities held for liquidity	190,630	(70,248)	(230,444)
Loans and advances to customers	(109,478)	(111,119)	(221,593)
Loans and advances to banks not repayable on demand	(234,940)	(7,508)	86,995
Other assets less other liabilities	5,089	33,691	28,749
Increase/(decrease) in:			
Deposits by banks	4,110	48,078	27,516
Customer accounts	94,773	6,190	78,386
Bank loans and overdrafts	80,147	(123,786)	(101,974)
Non-recourse borrowings	–	67,000	142,000
Debt securities – loan notes issued	–	100,000	81,860
Net cash inflow/(outflow) from operating activities	41,729	(54,707)	(29,611)
<b>(b) Analysis of net cash outflow in respect of purchase of subsidiaries</b>			
Cash consideration in respect of current year purchases	–	(648)	(1,150)
Loan stock redemptions and deferred consideration paid in respect of prior year purchases	(1,775)	(522)	(6,865)
Net movement in cash balances	–	–	1,330
	(1,775)	(1,170)	(6,685)
<b>(c) Analysis of changes in financing</b>			
Share capital (including premium) and subordinated loan capital:			
Opening balance	381,313	324,245	324,245
Shares issued for cash	743	1,831	57,068
Closing balance	382,056	326,076	381,313
<b>(d) Analysis of cash balances</b>			
	Movement in the period £'000		
Cash and balances at central banks	88	759	671
Loans and advances to banks repayable on demand	1,192	159,210	119,530
	1,280	159,969	120,149
			158,689



# Close Brothers

## THE NOTES

### 2. Basis of preparation

The interim accounts, which are unaudited, have been prepared on the basis of the accounting policies set out in the Annual Report 2002. The figures shown for the full year ended 31st July, 2002 represent an abridged version of the audited financial statements of Close Brothers Group plc for that year, which have been filed with the Registrar of Companies and on which the auditors have given an unqualified report which did not contain statements under Section 237(2) or (3) of the Companies Act 1985. The financial information contained in this interim report does not constitute the group's statutory accounts within the meaning of Section 240 of the Companies Act 1985.

### 3. Earnings per share

The calculation of earnings per share on profit attributable to shareholders is based on profit after taxation and minority interests of £24,251,000 (2002 – £21,752,000) and on 142,516,000 (2002 – 135,154,000) ordinary shares, being the weighted average number of shares in issue during the period excluding those held by the employee share benefit trust.

The diluted earnings per share is based on the same profit after taxation and minority interests disclosed above, and on 143,114,000 (2002 – 136,265,000) ordinary shares, being the weighted average number of shares in issue also disclosed above, plus the weighted dilutive potential on ordinary shares of exercisable employee share options in issue during the period.

## INDEPENDENT REVIEW REPORT

### Independent Review Report to Close Brothers Group plc

#### Introduction

We have been instructed by the company to review the financial information for the six months ended 31st January, 2003 which comprises the consolidated profit and loss account, the consolidated balance sheet, the consolidated cash flow statement and related notes 1 to 3. We have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the company in accordance with Bulletin 1999/4 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

#### Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

#### Review work performed

We conducted our review in accordance with the guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with United Kingdom auditing standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

#### Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 31st January, 2003.

#### **Deloitte & Touche**

Chartered Accountants

London

3rd March, 2003

Copies of this report are available at the Registered Office of Close Brothers Group plc, 10 Crown Place, London EC2A 4FT.