

# Global Operating Review

## Funds Under Management

In the 2017 Financial Year, the Group's FUM increased by \$11.8 billion, or 14 percent, resulting in closing FUM increasing to \$95.8 billion. Growth was delivered through net inflows of \$4.7 billion, investment outperformance and positive market movements of \$7.2 billion, offset by an unfavourable foreign currency movement of \$0.1 billion on foreign denominated FUM.



### BTIM Global Executive Team

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FUM \$BILLION	30 SEPT 2016	NET FLOWS	MARKET/OTHER	FX	30 SEPT 2017
Institutional	31.2	2.2	2.5	(0.1)	35.8
Wholesale					
- Australia	6.3	0.1	-	-	6.4
- OEICs	20.5	0.7	2.5	0.2	23.9
- US Pooled	8.0	2.6	1.1	(0.2)	11.5
Westpac - Legacy	7.8	(0.8)	0.6	-	7.6
Westpac - Other	10.2	(0.1)	0.5	-	10.6
TOTAL FUM	84.0	4.7	7.2	(0.1)	95.8

Positive market performance over the year saw the S&P/ASX 300 Index climb 4 percent while the MSCI All Countries World Index (ACWI) was 16 percent higher in local currency over the same period. The average levels of the S&P/ASX 300 and the MSCI ACWI, in local currency, were higher by 9 percent and 13 percent respectively. The Australian dollar also strengthened during the year and, on average, was 17 percent higher against the British Pound and 3 percent higher against the USD, compared to the prior financial year.

Total net inflows for the year were \$4.7 billion with positive inflows of \$6.0 billion into the JOHCM funds, largely through the institutional channel and US pooled funds, while BTIM (Australia) saw net outflows of \$1.3 billion driven by the ongoing run-off of the legacy book and

redemptions associated with the MySuper portfolio changes at Westpac. The strong net flow performance was a pleasing outcome given the increased trend toward low cost, passive investments.

For the Group, the institutional channel generated net flows of \$2.2 billion over the period, in large part due to the funding of a substantial mandate into the Global Opportunities strategy. The wholesale market also saw strong flows of \$3.4 billion during the year. This was largely driven by the US pooled funds, which attracted net flows of \$2.6 billion as our presence in that market continues to build. Additionally, the OEICs took in \$0.7 billion on the back of improved investor sentiment in the UK and Europe compared to the prior year.

Investment strategies garnering the highest inflows over the course of the year included

global/international equities (+\$4.2 billion), European equities (+\$1.4 billion) and cash strategies (+\$0.8 billion). The global/international equity strategies included the Global Opportunities strategy and the International Select strategy which saw regular inflows through the year. The European flows were led by funding into the European Select Values Strategy and its extension European Concentrated Value strategy. Outflows were experienced in both Australian equities (-\$0.9 billion) and UK equities (-\$0.4 billion). UK equities were impacted by net outflows in the UK Opportunities OEIC following the retirement announcement of a long-standing fund manager. Subsequent to year-end, a large UK institutional client terminated its \$1.2 billion mandate from the UK Opportunities strategy, which is not captured in the table above.

HIGHLIGHTS	FY17	FY16	CHANGE
Cash NPAT	\$173.1m	\$156.0m	+11%
Statutory NPAT	\$147.5m	\$142.0m	+4%
Operating revenue	\$491.0m	\$493.9m	-1%
Operating expenses	\$281.9m	\$297.0m	-5%
Operating profit margin	43%	40%	+7%
Cash earnings per share (cents)	55.3	50.8	+9%
Dividends (cents per share)	45	42	+7%
Franking	27%	37%	-27%
Average FUM	\$90.4b	\$80.2b	+13%
Closing FUM	\$95.8b	\$84.0b	+14%

Across the Group long term investment performance remains strong. As at 30 September 2017, 82 percent of FUM with a sufficient track record outperformed respective benchmarks over three years and 95 percent outperformed over five years.

## Investment Performance

Fund performance over one year was mixed with a number of investment strategies under-performing benchmarks in what was a more difficult period for active managers.

However, a number of funds performed strongly through the year and outperformed their benchmarks over the 12 month period to 30 September 2017. These included:

- JOHCM UK Dynamic Fund (+9.7%)
- JOHCM UK Equity Income Fund (+9.5%)
- BT Wholesale Focus Australian Share Fund (+8.1%)
- BT Wholesale MicroCap Opportunities Fund (+7.2%)
- BT Wholesale Ethical Share Fund (+5.6%)
- BT Wholesale Australian Long Short Fund (+5.2%)
- JOHCM Japan Fund (+4.9%)
- BT Wholesale Core Australian Share Fund (+4.7%)

A number of JOHCM and BTIM (Australia) funds earn performance fees for the achievement of above benchmark returns. JOHCM earns performance fees on a calendar year basis and BTIM (Australia) earns fees on a 30 June year basis. The 2017 Financial Year saw performance fees earned from seven JOHCM investment strategies and four BTIM (Australia) investment strategies. Notable performance fees were generated from the following funds:

- JOHCM European Select Values Fund
- JOHCM UK Dynamic Fund
- JOHCM UK Equity Income Fund
- BT Wholesale Focus Australian Share Fund
- BT Wholesale Microcap Opportunities Fund
- BT Wholesale Australian Long Short Fund

## Profitability

Cash NPAT for the year was \$173.1 million, an increase of 11 percent on the previous year (2016: \$156.0 million), while statutory NPAT increased 4 percent to \$147.5 million (2016: \$142.0 million). The result was achieved by higher average FUM driven by strong inflows and higher average market levels.

Cash EPS increased 9 percent to 55.3 cents (2016: 50.8 cents).

## Revenue

Total fee revenue was \$491.0 million, which was marginally below the previous year (2016: \$493.9 million) on the back of lower performance fees.

Base management fees rose 12 percent to \$447.2 million (2016: \$399.8 million) driven by higher average FUM, which was 13 percent higher than the previous year. Average fee margins remained flat at 50 basis points. The growth in average FUM benefited from a more buoyant market environment which saw the average levels of the S&P/ASX 300 and the MSCI ACWI in local currency nine percent and 13 percent higher respectively, compared to the 2016 Financial Year.

Performance fees for the year totalled \$37.9 million, 51 percent lower than the previous year (2016: \$77.2 million). The performance fees were predominantly earned in JOHCM funds which earned \$28.0 million, while BTIM (Australia) funds delivered \$9.9 million in performance fees for the year.

ASSET CLASS	FUM 30 SEPT 2017 A\$ BILLION	% FUM OUTPERFORMED RESPECTIVE BENCHMARK AT 30 SEPT 2017 <sup>1</sup>	
		3 YEAR	5 YEAR
Equities			
Australian	14.8	84%	90%
Global/International	24.9	68%	97%
UK	11.8	94%	100%
European	10.4	100%	100%
Emerging Markets	4.0	100%	100%
Asian	3.5	56%	48%
Property	1.8	74%	74%
Cash	8.5	100%	100%
Fixed Income	7.5	53%	85%
Multi Asset	7.2	74%	100%
Other	1.4	100%	100%
TOTAL FUM	95.8	82%	95%

<sup>1</sup> Fund performance is pre-fee, pre-tax and relative to the fund benchmark; % of FUM outperforming relates to FUM with sufficient track record only

Transaction fee revenue earned in the year totalled \$4.2 million, which was down on the \$15.0 million earned in the prior year. The transaction fees represent fees earned on products which do not earn an annuity style fee and include a number of BTIM products developed for the Significant Investor Visa (SIV) market in Australia. The decrease in transaction fee revenue was not unexpected given the change in product set developed for the SIV market following a change in regulation, where fee revenue on new products is now earned over the life of the product and reported as management fees.

#### Expenses

Total operating expenses decreased by 5 percent to \$281.9 million, (2016: \$297.0 million) driven predominantly by lower variable employee expenses.

Total employee costs were \$208.1 million and 9 percent lower than last year (2016: \$227.6 million), with fixed employee costs of \$67.9 million and variable employee costs of \$140.2 million. Fixed employee costs were 4 percent higher, driven by an additional 15 full time equivalent staff across the group, which stood at 309 at 30 September 2017. This included nine additional FTE which were added into the investment teams through the year.

Variable employee costs were 14 percent lower than last year, driven by lower performance fees and the forfeiture of unvested equity awards following the departure of a Group executive during the year.

Non-staff operating costs were \$73.8 million, which is six percent higher than the prior year (2016: \$69.4 million). Fixed non-staff costs were \$53.3 million and 20 percent higher, attributable to increased IT and data related expenses, legal and regulatory costs, and increased travel costs associated with expanded operations. Non-staff variable costs were \$20.5 million, 18 percent lower as a result of lower third party performance related investment management fees during the year.

Financing costs for the year were \$0.2 million, down from last year (FY16: \$0.7 million).

The overall operating cost to income ratio was 57 percent which compared to 60 percent in the 2016 Financial Year, while the compensation ratio of 42 percent declined from 46 percent in the prior year.

#### Earnings per share

Fully diluted Cash EPS was 55.3 cents per share, a 9 percent increase versus the prior financial year (2016: 50.8 cents per share). During the year ordinary shares on issue increased from 307,430,721 to 314,998,763, due to the final conversion of converting notes issued at the time of the JOHCM transaction, the issuance of new shares as part of the Fund Linked Equity (FLE) program and shares issued as part of the Dividend Reinvestment Plan (DRP) which remained active throughout the year.

#### Dividends

The Directors declared a final dividend of 26.0 cents per share, bringing total dividends for the year to 45.0 cents per share, a 7 percent increase on last year's dividend of 42.0 cents per share. The total dividend represents a payout ratio of 81 percent, which is within the Group's payout ratio target of 80-90 percent of Cash NPAT.

The 2017 Financial Year dividends had an average of 27 percent franking level with a 30 percent franked interim dividend and 25 percent franked final dividend, reflecting the significant contribution of offshore earnings to the Group's profit. Since BTIM does not retain excess franking credits, franking levels in future years will continue to be determined by the relative profits of BTIM (Australia) and the JOHCM businesses.

The Board has maintained the use of the DRP, which was initially activated in the 2013 Financial Year. The DRP has been used over time to assist in the capital management of the Group including the repayment of external borrowings, as well as provide additional funding for the ongoing capital requirements of the business, including additional seed investments for the Group funds. Shares under the DRP are issued at a zero discount and allow shareholders to reinvest dividends to purchase BTIM shares free of commission or brokerage costs.

# Global Operating Review continued

## Financial position

BTIM actively manages its operational and strategic capital requirements using a combination of appropriate earnings retention and at times, debt and new equity issuance.

In November 2016 BTIM entered into a new AUD\$25 million multi-currency revolving loan facility with the Westpac Group. The financial covenants attached to the facility include maintaining a minimum of \$35 billion in FUM, interest coverage ratio of at least 10 times and a borrowing to earnings before interest depreciation and amortisation (EBITDA) ratio of no more than 2.5 times.

During the 2017 Financial Year the facility was not drawn upon.

Included on the Group's Balance Sheet as at 30 September 2017 were intangible assets of \$535 million consisting of goodwill and management rights associated with the acquisition of JOHCM and goodwill relating to the original purchase of BT Financial Group and Rothschild Australia Asset Management by Westpac in 2002. There was no impairment to the carrying value of goodwill during the year. The management rights associated with the acquisition of JOHCM continue to be amortised over time.

In the 2015 Financial Year, BTIM announced the first issuance of equity as part of the Fund Linked Equity (FLE) program, a remuneration scheme for certain JOHCM fund managers. Since that time, BTIM has periodically issued shares to satisfy the equity rights by fund managers under the FLE scheme. During the 2017 Financial Year, BTIM issued 3,950,793 ordinary shares as part of the FLE scheme, with additional equity requiring to be issued in November 2017.

While the exact number of shares to be issued cannot be determined at this time, the share issuance would equate to a total of 1.25 million shares, based on a valuation as at 30 September 2017. The number of shares to be issued remains subject to a number of variables until this time, including market movements, fund flows, foreign exchange and the BTIM share price.

The FLE program is designed to be broadly Cash EPS neutral due to a reduction in revenue share the fund managers subsequently receive, which has a positive contribution to BTIM earnings provided FUM is maintained post share issuance. Full details of the FLE scheme and the share issuance are set out on pages 49 to 51 in the remuneration section of this report.

## Exchange rate

BTIM earns revenue and incurs expenses in a number of different currencies with its primary currencies being the British pound (GBP), US dollar (USD) and Australian dollar (AUD). JOHCM's operating results are denominated in British pounds and for consolidation purposes, these results are converted to Australian dollars at the prevailing exchange rate each month throughout the Financial Year.

Over the course of the year the average AUD/GBP exchange rate was 0.6002, 17 percent higher compared to prior year (2016: 0.5131). The AUD/GBP rate fluctuated between 0.5676 and 0.6317 throughout the year and the spot rate as at 30 September 2017 was 0.5845.

The average level of the AUD/USD exchange rate through the 2017 Financial Year was 0.7624 and was 3 percent higher than the previous year (2016: 0.7368). The spot AUD/USD rate as at 30 September 2017 was 0.7839.

## Reconciliation of Cash and Statutory NPAT

BTIM uses Cash NPAT as its headline result in its financial reporting to reflect the underlying profitability of the business. Cash NPAT comprises Statutory NPAT adjusted for certain non-cash items, including the amortisation of employee equity grants less after-tax cash costs of ongoing equity grants in respect of the current year; together with the after-tax amortisation and impairment of intangibles. A reconciliation of Statutory NPAT to Cash NPAT is set out below.

RECONCILIATION OF STATUTORY NPAT TO CASH NPAT	FY17	FY16
Statutory NPAT	147.5	142.0
Add back: amortisation of employee equity grants	53.7	58.1
Add back: amortisation and impairment of intangibles	7.8	9.9
Deduct: cash costs of employee equity grants payable during the year	(38.8)	(49.3)
Add/(deduct): tax effect	2.9	(4.7)
Cash NPAT	173.1	156.0

## Regulation

BTIM continuously monitors regulatory changes impacting its Australian and off-shore businesses.

Heading the regulatory challenges currently facing BTIM's UK/European based operations, along with all European-based investment companies, are the reforms to the EU's Markets in Financial Instruments Directive (known as MiFID II), which will come into effect on 3 January 2018.

Among the many far-reaching operational aspects of the new MiFID II regulations is increased transparency around the cost of external research, which has historically been bundled with execution costs by the broker. In August 2017 the Group announced that JOHCM will pay for external research via its own profit and loss account, once MiFID II comes into effect. The funding of JOHCM's external research is expected to be approximately £5 million (\$8.5 million) per annum.

Beyond MiFID II, which also incorporates other areas such as dealing commissions, client reporting, human resources and product governance, the complexities around Brexit and its product distribution and staffing implications will also require close attention.

Key regulation changes impacting BTIM in Australia in 2017 are:

- the implementation of over the counter (OTC) derivatives reform,
- the requirement of enhanced fee disclosure under ASIC Regulatory Guide (RG) 97,
- the development of the Asia Region Funds Passport for investment management products, and
- ASIC's introduction of industry funding.

BTIM is an active participant in many of the global OTC derivative markets. Since 2008 governments and regulators have worked in concert to address some of the systematic risks that were inherent in these markets and were deemed to have contributed to the last global financial crisis. The resulting reforms have changed the landscape for trading and operating in those markets. Over the past 12 months BTIM has implemented several measures that have allowed us to keep pace with those reforms. Those measures comprised solutions for mandatory exchange of collateral with counterparties on a daily basis and central clearing for many OTC derivative contracts.

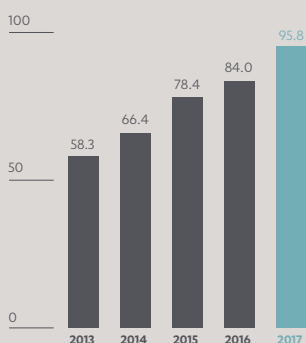
RG97 came into effect in 2017, requiring additional disclosure in BTIM's Product Disclosure Statements (PDSs) and periodic

statements to investors in relation to fees, particularly indirect fees and costs. These changes were designed to enhance transparency and comparability across investment funds. Our PDSs were reissued in September 2017 in compliance with the RG97 requirements.

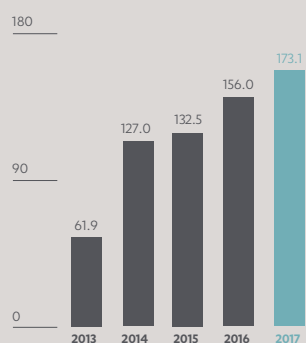
The Asia Region Funds Passport (ARFP) is a common framework of coordinated regulator oversight to facilitate the cross-border issuing of managed investment funds. It enables a fund registered in its home jurisdiction to be 'passported' to other participating countries, which include Australia, Japan, Korea, Thailand and New Zealand. We are actively involved in the ARFP proposal through industry working groups.

Under legislation passed in June 2017 an industry funding model has been introduced for ASIC. Under the new arrangements, those who create the need for, and benefit from, regulation bear the costs. This introduces an economic incentive to drive the desired regulatory outcomes for the financial system. In common with other industry participants, BTIM has established new reporting systems to provide ASIC with additional data, as well as systems to ensure that we meet our funding obligations to ASIC.

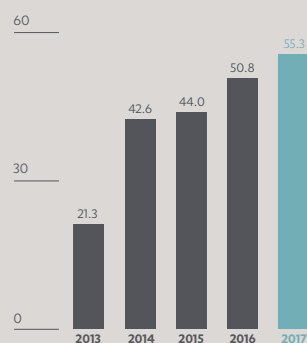
**Closing funds under management (FUM) – \$billion**



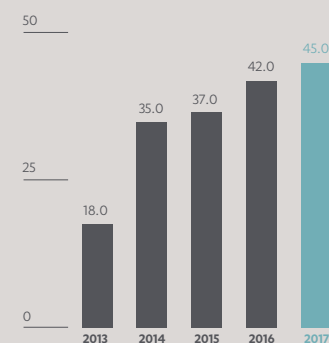
**Cash net profit after tax (NPAT) – \$million**



**Cash earnings per share (Cash EPS) – cents per share**



**Dividend per share – cents per share**





# Global Operating Review continued

## Risk Management

### Risk Management Framework

The Group has an established Risk Management Framework (Framework) in place to ensure risk management principles are met. The Framework is subject to regular review to confirm its effectiveness.

The success of the Group's business is based on taking risks that are known, understood, assessed and managed within the limits of the Board approved Risk Appetite Statement.

The BTIM Group is a pure investment manager. We use our global investment expertise to manage investment risk and generate wealth for our clients. Our goal is to provide investment products that meet or exceed our clients' expectations. The key to our success is earning the trust of our clients over the long term. We aim to grow our business by successfully investing over multiple market cycles. Our products are clear in their investment goals and transparent in their fees. Our culture encourages individuals to act with integrity and honesty and to value the interests of our clients as our first priority.

The Group seeks to proactively identify all material risks that may affect the organisation and ensure that these are dealt with appropriately. When assessing risk appetite, the Group has adopted a risk posture statement, which specifies the acceptable risk level for each of the identified risks. The Group's most conservative risk posture is in the management of critical areas such as key investment personnel, strategic alignment, reputation (business and brand), behaviour, regulation, obligations to investors and oversight of third party providers. This means that the Board has a narrower tolerance for these risks. In relation to risks associated with business growth and initiatives the Board accepts a higher risk appetite, consistent with its strategic objectives including investing shareholder funds in the form of seed capital to support growth.

The Board Risk Appetite Statement is subject to review at least annually. This process incorporates review of key aspects of the strategy and assesses whether adjustments to the risk appetite need to be made as strategy evolves.

### Roles and responsibilities

Overall accountability for risk management lies with the Board. The Audit & Risk Management Committee assists the Board in its oversight of risk management, financial and assurance matters. The Board delegates responsibility for the implementation of risk management to the Group CEO and the Global Executive Committee. The Global Executive Committee has accountability and responsibility to manage the BTIM Group in a sustainable way, to enhance and maintain the Group's reputation, to ensure compliance with legal and regulatory obligations and industry standards, to strive to achieve its objectives and to take all necessary steps to promote ongoing long term investment performance for our clients.

### Risk management principles

The Group is committed to ensuring it maintains a robust risk management framework providing oversight, internal control assurance and the advancement of a strong risk management culture within the Group.

The Board has identified the following key business risks for the 2017 Financial Year:

KEY RISK	RISK DESCRIPTION	RISK MANAGEMENT
<b>Strategic Execution</b>	The risk associated with the failure to effectively execute the Group's strategy. The risk that the strategy does not produce the expected results.	<ul style="list-style-type: none"> <li>• Annual strategy and budgeting process</li> <li>• Employee objectives aligned to strategic objectives</li> <li>• Ongoing monitoring and review of strategy</li> </ul>
<b>People and Talent Management</b>	The risk of loss of key personnel which may lead to an adverse effect on business growth and/or the retention of existing business.	<ul style="list-style-type: none"> <li>• Long term retention plans</li> <li>• Competitive remuneration structures</li> <li>• Succession planning</li> <li>• Maintenance of a strong reputation and culture which promotes an attractive workplace</li> </ul>
<b>Investment Performance</b>	The risk of loss of revenue due to ineffective investment strategies resulting in sustained underperformance relative to benchmarks and peers.	<ul style="list-style-type: none"> <li>• Talent hiring and succession planning</li> <li>• Clearly defined investment strategies and investment process</li> <li>• Ongoing review of investment strategies and performance</li> </ul>
<b>Product and Revenue Concentration</b>	The risk of uneven distribution of exposure to particular sectors, geographic regions, clients and/or products.	<ul style="list-style-type: none"> <li>• Clear strategy targeted at diversity across investment strategies, style and geographies</li> <li>• Expanded distribution network broadening the client base across channel</li> <li>• Ongoing pursuit of new investment talent to broaden investment capability</li> <li>• Monitoring and reporting to assess areas of concentration which identify elevated thresholds</li> </ul>
<b>Complexity and Pace of Change in Regulation</b>	The risk that the Group will not be able to effectively respond to a change in multi-jurisdictional laws and regulation which could materially affect the Group.	<ul style="list-style-type: none"> <li>• Clearly defined compliance framework including compliance obligations</li> <li>• Established policies and procedures supporting the risk and compliance framework</li> <li>• Participation on industry bodies who actively and constructively engage with regulators</li> <li>• Ongoing monitoring of new and proposed legislation that may impact the Group</li> <li>• Appropriate level of resources to manage obligations, change and complexity</li> </ul>

KEY RISK	RISK DESCRIPTION	RISK MANAGEMENT
<b>Compliance</b>	The risk of the Group not complying with multi-jurisdictional laws, regulations, contracts, industry codes, internal standards and policies applicable to the Group's operations.	<ul style="list-style-type: none"> <li>Clearly defined compliance framework including compliance obligations</li> <li>Established policies and procedures supporting the compliance framework</li> <li>Experienced legal, risk and compliance teams</li> <li>Ongoing monitoring, reporting and review of compliance obligations</li> </ul>
<b>Outsourced Service Providers</b>	The risk of loss from failing to manage the Group's key outsourced service providers whereby services provided by external parties are not conducted in line with the respective service level agreement.	<ul style="list-style-type: none"> <li>Robust due diligence process</li> <li>Clearly defined framework, policies and procedures</li> <li>Regular monitoring and review of service level agreements and standards</li> </ul>
<b>Operational</b>	The risk arising from inadequate or failed internal processes, people or systems or from external events.	<ul style="list-style-type: none"> <li>Independent annual audit of the design and effectiveness of internal controls</li> <li>Established policies and procedures</li> <li>Annual Business Continuity Planning and regular testing of critical systems</li> </ul>
<b>Behaviour</b>	The risk of inappropriate behaviour which is not in line with the Group's core values, including actions that may compromise the Group's clients and the integrity of the market place.	<ul style="list-style-type: none"> <li>Clearly defined Code of Conduct which outlines the expected behaviour of all individuals</li> <li>Independent whistleblowing provider</li> <li>Embedded Risk Management Framework, including ongoing risk and compliance training</li> </ul>
<b>Information Security</b>	The risk that investors or the Group may suffer service disruptions, or that investors or the Group may incur losses arising from system defects such as failures, faults or incompleteness in computer operations, or illegal or unauthorised use of computer systems, including cyber crime.	<ul style="list-style-type: none"> <li>Business Continuity and Crisis Management Plans</li> <li>Annual testing of Disaster Recovery Plans</li> <li>Independent review of the design and effectiveness of internal controls</li> <li>Cyber Security Incident Response Plans</li> <li>Ongoing consultation with cyber security specialists</li> </ul>
<b>Market</b>	The risk of an adverse impact on earnings resulting from changes in market conditions, such as foreign exchange rates, interest rates or equity markets.	<ul style="list-style-type: none"> <li>Diversification across asset classes, styles and geographies</li> <li>Diversification of investment styles and strategies</li> <li>Strong investment performance</li> </ul>
<b>Financial</b>	The risk of financial loss arising from the Group's activities in the financial and investment markets.	<ul style="list-style-type: none"> <li>Budgeting and financial forecast management</li> <li>Ongoing monitoring and review of strategy</li> <li>Maintaining of seed capital investments</li> </ul>
<b>Currency Risk</b>	The risk associated with sustaining losses by having earnings, assets and liabilities denominated in currencies other than the Australian dollar.	<ul style="list-style-type: none"> <li>Annual earnings hedged into Australian Dollars</li> <li>Ongoing monitoring and review as part of the Capital Management Plan</li> </ul>
<b>Acquisitions</b>	Risk that an acquisition is a strategic failure and adversely impacts other parts of the Group.	<ul style="list-style-type: none"> <li>Robust due diligence engaging subject matter experts</li> <li>Annual strategy and budgeting process</li> <li>Clearly articulated objectives and governance structure</li> <li>Regular monitoring and strong reporting mechanisms</li> </ul>