Group Chief Executive Officer's Report

The 2017 financial outcome is the fifth consecutive year of earnings per share growth.

Our business continued to go from strength to strength, underpinned by a foundation of strong long term investment performance and supported by a business model that attracts and retains top investment talent. As a firm, our clients and people benefit from the investment independence our fund managers apply and from our disciplined approach to capacity management. The 2017 financial outcome is the fifth consecutive year of earnings per share growth and a result of our proven and resilient business model.

Cash NPAT, our key measure of profitability, was up 11 percent on last year, reflecting a strong increase in base management fees driven by higher average funds under management (FUM), offsetting lower performance fees. Operating expenses were lower by five percent, with employee expenses down nine percent, largely led by lower performance fees. This translated into Cash EPS of 55.3 cents per share, a 9 percent increase, and rewarded shareholders with total dividends of 45 cents per share, an increase of 7 percent.

There were no shortage of headwinds, including a stronger Australian dollar and a lower investment performance fee outcome, but the diversity of our business across investment strategies, distribution channels and client base meant we were able to continue to grow our earnings. During the 2017 Financial Year, the flows to passive investment vehicles continued unabated, the regulatory burden was raised another notch, as many of the regulatory reviews of the past few years are now being implemented, and there continued to be fee pressure across the industry. Investment markets on the other hand were generally favourable, with global markets in local currency terms on average up 13 percent.

My note this year features four key areas: the continued success we have had in generating investment flows; the importance of managing capacity so investment performance is not compromised; an ongoing focus on attracting and developing investment talent; and the global themes that are impacting our business.

Continued growth in net flows

A feature of the 2017 Financial Year has been the continued growth in net flows. During the course of the year our business recorded net inflows of $4.7 billion following a strong 2016 Financial Year where net flows were $4.4 billion. Taking into account the $0.8 billion net outflow from the retail legacy book (which is in run-off), the underlying core business generated net flows of $5.5 billion. Whilst the overall size of our FUM is now significant ($95.8 billion), with market movements impacting short term changes in FUM more than our flows, it is the ongoing net flows which drive the long term annuity stream for the business. This year's net flows of $4.7 billion represent additional annualised fee income of $31 million and combined with the previous year's net flows, represents increased annualised fee income of $54 million.

Similar to the previous year, we continue to see strong flows from our institutional channel, with total net flows of $2.2 billion. Our wholesale flows, being fund flows from financial advisers (mostly through platforms), as well as from high net worth and private clients, was $3.4 billion, of which the US pooled funds contributed $2.6 billion. The equity strategies that generated the most in net flows during the year were our Global, European and Emerging Markets strategies. A more detailed review of investment flows is covered in the Global Operating Review section.

The key to the success of our business is to steadily continue to grow our net flows and resulting fee income, and do so in a sustainable way. For this reason, capacity management is important to us because generating net flows and keeping the FUM is a function of our ongoing ability to deliver investment performance over the long term. Managing our investment capacity is in the best interests of both our clients and shareholders, as it optimises our ability to perform by staying nimble enough to move our portfolios when needed. To do this sustainably whilst continuing to grow the business, it also requires ongoing investment in new and existing investment talent.

Our business continues to go from strength to strength, built on strong long term investment performance and supported by a business model that attracts and retains top investment talent.

Talent management

Over the years we have been able to develop investment talent internally to grow our investment capacity into new or extension strategies off our existing strategies. We have also brought new investment talent into the Group that is proven and culturally aligned. This requires a long term view as it involves patience to seek out investment teams, understand their motivations, develop a track record within the Group and then market the track record to clients. Our strong preference when seeking new investment talent is to find individuals that bring a skillset that complements our existing range of investment strategies. Whilst this is harder to achieve as our range of investment strategies broadens, the opportunities remain plentiful. Talent may come from various sources: from the partners we work with in different jurisdictions who keep an eye out for talent that may come onto the market; senior management actively seeking talent; or being approached; or receiving leads from the sales team who may be aware of teams that are looking to move.

Every potential candidate is then put through a rigorous due diligence process in terms of understanding an individual's or team's history of performance, complementarity with existing strategies and importantly, feedback from the sales team (marketability) and portfolio managers (skillset) within the business. We very much value investment independence, so the individuals we consider must have the skills and confidence to act independently within the agreed investment process, but with the full backing of the business as we promote a performance culture that backs independent actions. This financial year we announced the addition of a multi-asset team based in New York to run a global income strategy. The team will be headed by Giorgio Caputo who will run an investment strategy targeted at investors seeking regular income with capital stability. He joins us from a firm where he successfully ran a similar strategy and has recently completed hiring out his team. At the same time, in Australia we have hired Michael Blayney to head the Australian multi-asset team where he will be looking to expand our existing fund offering to clients. As I stated at the beginning, bringing on new talent and extending our existing capabilities is important to continue to provide growth as some of our strategies reach capacity. It also means we invest in talent for many years before it delivers a return, but we do so with patience and confidence that in the long term, if investment performance is delivered, we can continue to grow our business and reward both our people and shareholders.

Capacity management

Although our FUM has grown substantially over the years and we have progressively soft-closed funds along the way, the growth in our investment capacity has kept pace. We currently have investment capacity of £34 billion in funds with a track record of three years or more, and investment capacity of £21 billion in strategies with a track record less than three years (more recently established). We do not expect all these strategies to be fulfilled and the timing of when strategies come in and out of favour is unpredictable, but as you can see our growth profile remains strong. To support the ongoing growth of bringing in new teams and scaling up new investment strategies, the Board has approved additional shareholder capital to be used as seed capital. Seed capital is used to either fund new investment strategies to establish a track record in its infancy or to scale up a fund to make it marketable for clients. Importantly, the funding of the seed capital is out of existing resources given our very strong balance sheet that carries no debt.

Our strategy has been resolute around the benefits of active management.

Global themes

As I mentioned earlier, the key challenges facing the industry globally at the moment include: pressures on revenue margins, higher regulatory costs and the trend to passive. I do not think any of these are up for debate but most importantly it is how you respond to them. A number of firms have looked to consolidate to try and achieve economies of scale to deal with either lack of growth or rising costs of doing business. In response to the passive debate some firms are seeking cheaper ways of accessing alpha through technology in an attempt to be able to lower fees and keep margin. Our strategy has been resolute around the benefits of active management and we believe that, as more and more people struggle to define their value proposition, our own value proposition becomes clearer. Arguably, in a world where most experts are forecasting continued low returns, the ability to generate alpha can be meaningful in adding to total return (after fees).

Critical to this is our ability to provide exceptional investment performance over the long term and this is very much reliant on the quality and skill of our investment people and a business model that supports a performance culture built on investment independence. Markets are not efficient and mispricing occurs daily. There is a credible argument that with so much more trading now linked to programs, computer models and passive money blindly following trends, there has never been a better opportunity to be active. What is required is patience, skill and a strong investment process applied in a disciplined manner that has consistently delivered over time. For this reason we strongly support the notion of independent viewpoints with a diversity of insights and approaches. It is this independent performance focus that has continued to build clients' trust and belief in our approach to investing.

The rising cost of doing business due to an ever-increasing regulatory burden is real. The cost comes through the need for more resources to be able to meet the demands of regulators who are seeking more information about what we do and increased disclosure, and ongoing market surveillance and risk monitoring. This has been particularly the case in the UK and Europe in meeting the demands of MiFID II (Markets in Financial Instruments Directive framework for the European Union (EU)). MiFID II was created on the core principles of providing a fairer, safer and more efficient market across the EU and is arguably one of the more broad pieces of regulatory legislation. The industry is still trying to come to grips with some of the key aspects around best execution, transaction reporting, the separation of payment of external research and cost of executing trades. To ensure clarity and transparency, we announced in August that JOHCM will be absorbing the costs of all external research as part of the regulatory change.

As a global business, we need to meet and embrace the higher regulatory standards that the regulators set for us, which in turn supports the confidence and trust of our clients. This will require additional costs in terms of resourcing and enhanced reporting. It also provides opportunities as higher costs associated with an increasing regulatory obligation makes it more difficult for teams to go out on their own. This in turn makes our own business proposition more appealing as we can support individual teams by providing them with investment independence with the knowledge they are backed by an investment-led business that can meet all the regulatory requirements with the distribution and support needed to be successful.

The trend to passive has been nothing short of extraordinary, particularly in the US where the active mutual fund industry has been in net outflow since 2007. In calendar 2016, US passive inflows totalled USD 505 billion, whereas outflows from actively managed funds totalled USD 340 billion. This has been particularly prevalent in large-cap US equities where passive has taken over as the dominant supplier of capital. Yet despite this tidal wave of passive money dominating flows in the US, one of our biggest growth engines for the business has been the US. Over the past five years our net flows from the US has been USD 7.8 billion. This is a result of exceptional investment performance from our International Select fund marketed in the US, a focussed sales effort as well as broadening our offering to other strategies such as Emerging Markets, Europe and Asia strategies. The difference is that our strategies have a high active share, have delivered on performance and the passive money has not dominated because of the benefits that active management has demonstrated in these types of strategies.

The US market remains an important growth story for our business and our immediate

“Our strategic focus remains unchanged in building out a global asset management business.”

task is to continue to broaden out our investment offering. In a world where fee margins are under pressure, our own overall revenue margins for the Group have been steadily increasing, from 39 basis points in FY12 to 50 basis points in FY17. This margin expansion has helped drive our revenue growth, but has come mainly as a result of a change in asset and channel mix. Our equity portfolios, which have a higher margin than other investments such as cash and fixed interest, now represent 72 percent of the total book, a 19 percentage point increase from five years ago. Furthermore, within the equity portfolio, the strong growth in the US has also helped increase base margins due to the higher revenue margins we earn (albeit without performance fees) in the US. The channel mix has also helped where growth from our wholesale channel has outpaced that of the lower margin institutional book.

Like most of our competitors we see ongoing pressure on revenue margins as clients become more price sensitive alongside the growth in passive. Our response has been firm to date in terms of pricing our services based on value and not cost. I anticipate ongoing fee discussions to remain a constant of the industry, but expect our revenue margin will be more influenced by our asset mix and the source of those assets across channel and region.

The 2017 Financial Year represents another milestone for the company and another stand-out year for the business. Whilst performance fees were considerably lower this year and when combined with the currency headwinds, I am particularly pleased that through the hard work of our people and the support of our clients we continued to grow our cash profits. Importantly, we have continued to invest in new investment strategies, launched new investment vehicles and added further support to our distribution network. Our strategy to build a global asset management business that delivers exceptional investment returns to clients by attracting and retaining superior investment talent remains core to what we do. Our business strength is demonstrated by the diversification we offer across investment strategies, distribution channels and client base.

Last year I reported on the establishment of the Global Executive Committee. With the appointment last year of Ken Lambden as Chief Executive Officer, JOHCM Group and Michael Bargholz as Chief Executive Officer for BTIM (Australia), the structure provides for continued focus on executing on the growth strategy with strong local leadership. Both Michael and Ken have made strong contributions to the business in their first 12 months and we are fortunate to have such a talented team which includes Cameron Williamson, Group CFO who has been with the business for almost 10 years. I very much look forward to continuing to work with my executive colleagues and all our people across the Group in furthering our success. Once again, I take the opportunity to thank our teams across Australia, UK, Europe, Asia and the US for their hard work and dedication. Without their efforts the success of the business and the outcomes being delivered for shareholders would not be possible.

Emilio Gonzalez, CFA
Group Chief Executive Officer