Strategic investment with strong cost discipline

2017 has been another successful year for Schroders, as we delivered record pre-tax and exceptionals profits of £800.3 million, up 24% on 2016. Our pre-exceptional earnings per share for the year are 226.9 pence and we are recommending a final dividend of 79 pence. This results in a full year dividend of 113 pence, which represents a 50% payout ratio. After exceptional items, profit before tax was up 23% to £760.2 million, resulting in a 21% increase in basic earnings per share to 215.3 pence.

The Group Chief Executive's review on pages 10 to 15 summarises the key developments in 2017 for Schroders and the wider industry. The principal impact of these on the financial results derives from the growth in the Group's assets under management and administration (AUMA).

AUMA reached a record high in 2017, increasing by 13% to close the year at £447.0 billion (2016: £395.3 billion). This increase is driven by four factors: investment returns for clients, which added £31.6 billion (2016: £64.7 billion); net new money introduced by clients of £9.6 billion (2016: £1.1 billion); new money under management introduced through acquisitions of £8.5 billion; and the growth in assets under administration of £2.0 billion.

It is clear that the business environment in which we operate is changing and the Group Chief Executive's review sets out some of the challenges that the industry is facing.

We saw some of these changes impact upon our financial performance in 2017. For example, reductions to our fee margins restricted the growth in our net income arising from higher AUMA. However, the acquisitions we completed in 2017 and the net new business introduced have both been at higher average net operating revenue margins, offsetting some of this underlying decline. We estimate that net new business in 2017 generated annualised net new revenue of £63 million, around £24 million of which is in these results.

Overall, we believe that we are well placed to adapt to the industry challenges and to continue to grow.

The growth in our net income was partially offset by an increase to our cost base, in part driven by our investment in strategic priorities, but also as we addressed regulatory demands. In this environment our continued focus on cost management remains a priority. In 2017 the ratio of total costs to net income improved by three percentage points to 61%, one percentage point of which was due to regulatory requirements to defer a greater proportion of pay for certain employees (see page 62). The accounting impact of this will unwind by around 2019.

Two important areas of strategic investment for us in 2017 have been the development of a new front office technology platform and preparations for the move to our new headquarters in London. Both of these are expected to complete in 2018. These are important initiatives for us as they are both expected to have significant benefits to the way in which we work. The front office technology platforms are expected to bring material improvements to the operational support for our fund managers and the new London offices will deliver an innovative working environment for our people and a leading experience for our clients.

Profit before tax and exceptional items was a new record at £800.3 million

Regulation continues to be an important area of focus, requiring investment into our business to meet changing requirements. Promoting high compliance standards in each of the jurisdictions in which we operate continues to be a focus.

With our head office in the UK and a significant continental European business, we are closely monitoring the progress of Brexit negotiations between the UK and the other members of the European Union. However, we do not expect the outcome to be significant for the Group as our business model is already structured around a strong presence in continental Europe, with only modest changes anticipated in our corporate structure and regulatory profile. We are taking the necessary actions to prepare the Group for the new environment and considering the likely impact of the negotiations as they develop. Further information on the potential impact of Brexit is set out in the key risks and mitigations report on page 42.

We report both our profits and AUMA in sterling. As a net exporter of investment services from the UK, we have benefited from the devaluation of sterling which followed the UK's decision to exit from the European Union in June 2016. The Group's revenues and AUMA are predominantly denominated in non-sterling currencies, whereas the cost base is less impacted by currency changes. The weakness in sterling in the first half of the year, compared to 2016, contributed positively to profit before tax and exceptional items by around £27 million.

Overall, we believe we are well placed to deal with the industry challenges, including those related to Brexit, and remain focused on our strategic priorities alongside strong cost discipline.

Based on these strong results, the Board is recommending a final dividend of 79 pence per share (2016: 64.0 pence), bringing the total dividend for the year to 113 pence, an increase of 22% from 2016.

The following commentary provides a more detailed review of our financial results.

Richard Keers
Chief Financial Officer

Assets under management and administration (AUMA)

The Group's AUMA increased to a record level of £447.0 billion in 2017 (2016: £395.3 billion). AUMA comprises assets managed or advised on behalf of clients (AUM) of £435.7 billion (2016: £386.0 billion) and assets where Schroders solely provides administrative support through the Benchmark Capital business (AUA) of £11.3 billion (2016: £9.3 billion).

Asset Management AUM was up 13% to £389.8 billion (2016: £346.4 billion). The increase was driven by the positive investment returns we achieved on behalf of clients of £29.8 billion, strategic acquisitions of £6.0 billion and net new business from our clients of £7.6 billion.

In the Intermediary sales channel, we generated net new business of £3.4 billion. Our branded fund ranges benefited from improved retail investor sentiment throughout 2017 and generated positive net new business of £7.6 billion. We generated positive net sales across all asset classes, with demand led by fixed income and equity products.

In contrast, there were net outflows of £4.2 billion from third party funds that are sub-advised by Schroders, which are also reported within the Intermediary sales channel. These outflows reflected the loss of a large sub-advisory mandate in the first half of the year as a client in North America chose to internalise its asset management activity. We generated positive net inflows in sub-advised mandates in all other regions and, excluding this mandate, in North America.

Net new business from institutional clients was relatively robust as we generated net inflows of £4.2 billion. Net inflows in the UK, North America and Asia Pacific more than offset a small number of individual client redemptions in continental Europe.

North America is a key region of strategic growth for the Group. Despite the loss of the sub-advised mandate, we have continued to build scale in the region in 2017. In late 2016, we entered into a strategic relationship with Hartford Funds to manage and distribute a 'Hartford Schroders' branded fund range to clients introduced through the Intermediary sales channel in the US. The progress of this relationship is encouraging with £1.6 billion of net new money invested into this fund range in 2017. Total AUM in the Hartford Schroders range was £4.6 billion at 31 December 2017.

We also generated a further £2.5 billion of net investment from institutional clients in the region, primarily into equity and multi-asset mandates.

Assets managed on behalf of clients based in North America totalled £53.6 billion at 31 December 2017, which represented 12% of the Group's total AUM.

North America is a key region for strategic growth and we have continued to build scale there during 2017

In Asia Pacific, we generated net investment from clients of £0.9 billion. Redemptions from institutional clients in Australia were offset by positive net new business from clients in the strategically important countries of Japan and mainland China, which together generated net inflows of £3.3 billion.

At an asset class level, we continued to see demand for fixed income products from both our institutional clients and clients introduced through our Intermediary sales channel, with combined net inflows of £3.5 billion in 2017. Investments into fixed income products now represent 18% of our total AUM. Elsewhere, there was a greater demand for risk products from clients, with £3.1 billion of inflows into equity products from the Intermediary sales channel, partially offset by outflows from institutional clients in Australia. Demand from institutional clients for multi-asset strategies continued, with net inflows of £4.6 billion.

	AUM						
£bn	Institutional	Intermediary	Asset Management	Wealth Management	Total	AUA*	AUMA
1 January 2017	**226.3**	**120.1**	**346.4**	**39.6**	**386.0**	**9.3**	**395.3**
Gross inflows	38.4	56.7	95.1	8.2	103.3		
Gross outflows	(34.2)	(53.3)	(87.5)	(6.2)	(93.7)		
Net flows	**4.2**	**3.4**	**7.6**	**2.0**	**9.6**		
Acquisitions	6.0	-	6.0	2.5	8.5		
Investment returns**	19.3	10.5	29.8	1.8	31.6		
31 December 2017	**255.8**	**134.0**	**389.8**	**45.9**	**435.7**	**11.3**	**447.0**

* Assets under administration has been restated to exclude assets from which we only derive transactional non-recurring revenues.
** Currency movements decreased assets under management by around £12 billion.

The acquisition of Adveq in July 2017 added a wide variety of private equity investment skills, including venture capital, growth capital, buyout, and turnarounds through primary or secondary listings. Adveq was established over 20 years ago and has a successful track record of growth, servicing institutional clients in Europe, North America and Asia Pacific.

Following the acquisition of Adveq we have now separately reported the Group's Private Assets and Alternatives AUM, which includes investment capabilities in real estate, infrastructure debt, insurance-linked securities, securitised credit, hedge funds and direct lending as well as the rebranded Schroder Adveq private equity business. The Private Assets and Alternatives business generated £2.5 billion of net inflows in 2017 in addition to the £6.0 billion of investment commitments acquired with Schroder Adveq. Private Assets and Alternatives represented 8% of the Group's total AUM with £33.3 billion of AUM at the end of 2017.

Wealth Management generated £2.0 billion of net new business from clients, with a further £2.5 billion of assets added through the acquisition of the wealth management business of C. Hoare & Co.

Client investment performance

Our ability to generate positive investment outcomes for clients is central to our success as an active investment manager. Investment performance over a three year period (our KPI) continued to be strong in 2017, with 74% of assets outperforming their stated comparator (2016: 74%). Five year investment outperformance was 84% (2016: 85%) and the one year figure was 70% (2016: 75%).

Client investment performance is calculated internally by Schroders to give shareholders and financial analysts general guidance on how our AUM is performing. The data is aggregated and is intended to provide information for comparison to prior reporting periods only. It is not intended for clients or potential clients investing in our products. Calculations for investment performance are made gross of fees with the exception of those for which the stated comparator is a net of fees competitor ranking.

When a product's investment performance is discussed or shared with a client or potential client it is specific to the strategy or product. For clients introduced through our Intermediary sales channel, performance will be shown net of fees at the relevant fund share-class level, whilst for institutional clients it will typically be shown gross of fees with a fee schedule for the strategy supplied. We actively monitor the performance of our individual products against their stated objectives. Further information about the calculation of investment performance is provided in the glossary on page 168.

The Group's financial performance

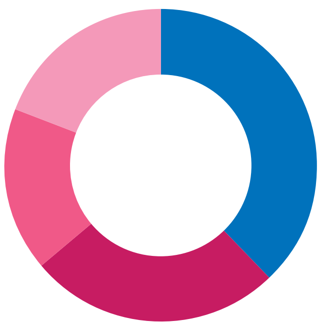
Net income before exceptional items was up 15% to £2,068.9 million (2016: £1,793.1 million), mainly as a result of increased net operating revenue of £2,010.2 million (2016: £1,712.8 million). Net operating revenue represents core operating revenues earned on the assets managed by Schroders, net of cost of sales.

The increase in net operating revenue was driven by higher average AUM, which was up 19%. The effect of higher AUM was partially offset by an expected reduction to net operating revenue margins, which decreased from 48 basis points to 47 basis points, excluding performance fees. Continued strong investment performance for our clients resulted in performance fees of £78.4 million (2016: £41.2 million).

Assets under management (£435.7bn)

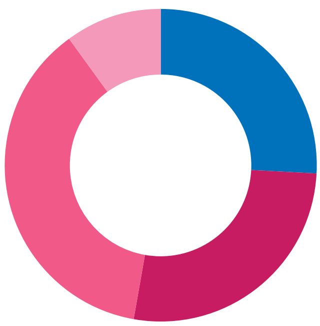
See more analysis on our assets under management on page 5.

Institutional (£255.8bn)



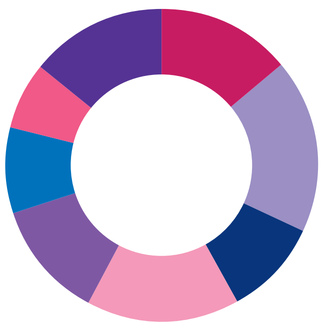
UK	38%
Asia Pacific	26%
Europe, Middle East and Africa	17%
Americas	19%

Intermediary (£134.0bn)



UK	26%
Asia Pacific	27%
Europe, Middle East and Africa	37%
Americas	10%

Wealth Management clients by portfolio size (£45.9bn)



<£1m	14%
£1m – £5m	18%
£5m – £10m	10%
£10m – £25m	16%
£25m – £50m	12%
£50m – £100m	9%
£100m – £250m	7%
>£250m	14%

Net gains on financial instruments and other income before exceptional items decreased by £23.6 million to £35.2 million (2016: £58.8 million), mainly as a result of certain one-off gains which arose in 2016. We also earn other income which includes fees we earn on AUA and other income within Benchmark Capital.

In addition, we have a number of joint ventures and associate interests across the world, including with Bank of Communications in China and with Axis Bank in India. These continued to perform well with our share of profits before exceptional items rising to £23.5 million (2016: £21.5 million).

The Group's operating expenses excluding exceptional items were £1,268.6 million (2016: £1,148.4 million). This represents a ratio of total costs to net income of 61% which is below our long-term KPI target of 65% and three percentage points better than 2016.

Compensation costs are the largest component of our cost base, making up around 70% of total operating expenses. Excluding exceptional items, compensation costs increased to £881.3 million (2016: £791.6 million). Compensation costs are managed with reference to a total compensation ratio which decreased to 43% (2016: 44%) despite an increase in headcount.

This year we have made changes to our remuneration approach for employees deemed to be material risk takers under the UCITS or AIFM Directives (UCITS / AIF MRTs). We have increased bonus deferral levels for these employees, to create further alignment with clients and shareholders and to meet the requirements of those regulations. This has resulted in an increase in the proportion of variable remuneration that is deferred. Under accounting rules, the cost of employees' deferred remuneration is charged over the period in which the remuneration becomes payable. This increase in the proportion of remuneration deferred has resulted in a reduction of around one percentage point in our total compensation ratio for 2017. This is an accounting benefit and will largely unwind over the next two years. Further information on our remuneration approach for UCITS / AIF MRTs can be found in the Remuneration report on page 62.

Non-compensation costs excluding exceptional items increased to £387.3 million (2016: £356.8 million). This increase was mainly due to weaker sterling in the first half of 2017 compared with the same period in 2016, with a proportion of our cost base incurred in non-sterling denominations. This has added around £10 million of costs. In addition, business acquisitions have increased our costs by around £10 million in 2017. We have also incurred costs in respect of regulatory requirements and investment into other strategic priorities.

Pre-exceptional profit before tax was £800.3 million (2016: £644.7 million), a 24% increase on the previous year. Basic earnings per share before exceptional items rose 22% to 226.9 pence (2016: 186.3 pence). After exceptional items, the profit before tax was £760.2 million (2016: £618.1 million) and basic earnings per share was 215.3 pence (2016: 178.3 pence).

The effective tax rate before exceptional items increased from 20.5% to 21.4% and after exceptional items increased from 20.7% to 21.8%. The increase has arisen mainly as a result of the reduction in the expected future benefit from deferred tax assets, following the decision to decrease the rate of US corporation tax effective from 1 January 2018.

Asset Management

Asset Management net operating revenue increased 17% to £1,743.3 million (2016: £1,489.5 million), including performance fees of £77.5 million (2016: £38.8 million).

Excluding performance fees, the net operating revenue margin on average AUM was 45 basis points (2016: 46 basis points). This decline was broadly in line with our expectations and was mainly due to changes in business mix, together with some external fee pressures.

In the Institutional sales channel, the net operating revenue margin before performance fees remained unchanged from 2016 at 32 basis points, with growth in higher margin private assets and alternatives and positive investment returns offsetting outflows from equity strategies. There were £57.6 million of performance fees (2016: £27.2 million).

The net operating revenue margin for the Intermediary sales channel, before performance fees, declined by one basis point to 72 basis points in 2017. The combined impact of the loss of a low margin sub-advised mandate, inflows into equity funds and investment returns in higher margin products partially offset structural changes to fee rates in the UK and Luxembourg. We generated £19.9 million of performance fees (2016: £11.6 million).

Total Asset Management net income increased by 15% to £1,757.9 million (2016: £1,534.4 million), including £20.8 million of income from our share of profits from joint ventures and associates (2016: £16.7 million).

Operating expenses before exceptional items within the Asset Management segment increased to £1,052.0 million (2016: £962.0 million) as we continued to grow the business. Headcount increased to just under 3,700, mainly as a result of investment in strategic growth opportunities including the acquisition of Adveq. Non-compensation costs increased in line with business growth and as we continued to make strategic acquisitions and investments in technology and infrastructure to support the future growth of the Group.

Profit before tax and exceptional items rose 23% to £705.9 million (2016: £572.4 million). There were exceptional items of £17.2 million, principally related to the amortisation of acquired intangible assets and costs incurred as part of the acquisition of Adveq. After exceptional items profit before tax increased by 24% to £688.7 million (2016: £553.9 million).

Wealth Management

Wealth Management net income increased by 22% to £273.3 million (2016: £224.0 million) mainly driven by net operating revenue which was up 20% to £266.9 million (2016: £223.3 million).

Net operating revenue within Wealth Management comprises management fees, performance fees, transaction fees and net banking interest income. Management fees increased by £42.3 million to £203.8 million, driven by an increase in the average AUM on which fees are earned of 27%. There were performance fees of £0.9 million (2016: £2.4 million). Transaction fees also increased to £40.8 million (2016: £38.8 million) and net banking interest rose to £21.4 million (2016: £20.6 million). The increase in average AUM included the full year impact of the acquisition of Benchmark Capital in December 2016 and the acquisition of the wealth management business of C. Hoare & Co. in February 2017.

Net operating revenue margins declined from 65 basis points in 2016 to 61 basis points in 2017. This was largely due to the acquisition of Benchmark Capital, which has brought in business at a lower average fee margin than our previous Wealth Management assets under management.

AUA within the Benchmark Capital business contributed £6.0 million to other income (2016: nil).

Operating expenses, before exceptional items, increased by £25.4 million to £183.0 million (2016: £157.6 million). This increase was mainly driven by a full year of costs relating to the Benchmark Capital business. Compensation costs were also up as we grew the business resulting in additional headcount, including those acquired with the discretionary wealth management business of C. Hoare & Co.

Profit before tax and exceptional items increased 36% to £90.3 million (2016: £66.4 million). Exceptional items within Wealth Management comprise mainly amortisation of acquired intangible assets and other costs incurred in relation to acquisitions. After exceptional items, profit before tax grew by 20% to £67.4 million (2016: £56.3 million).

Group segment

The Group segment comprises central management costs, returns on investment capital, including income from financial instruments and our associate interest in RWC Partners, together with net returns from seed capital investments after hedging and co-investments into Schroder Adveq fund ranges.

Net income for the Group segment was £37.7 million (2016: £34.7 million). Costs in the Group segment increased by £4.8 million to £33.6 million (2016: £28.8 million). Profit before tax was £4.1 million (2016: £5.9 million) and there were no exceptional items in the Group segment (2016: credit of £2.0 million).

Financial strength and liquidity

The Group's net assets increased by £318.2 million during 2017 to £3,471.0 million. We generated total comprehensive income of £580.4 million (2016: £594.4 million) and distributed £267.6 million to shareholders in the form of the 2016 final and the 2017 interim dividends (2016: £236.6 million).

The Group's total assets and liquidity are impacted by the different forms of business that we conduct. Certain assets managed on behalf of investors are recognised in the Consolidated statement of financial position, whilst others are not. The table below sets out how these assets are broken down between on-balance sheet assets and others that form part of our total AUMA.

Within Asset Management, assets that are managed for clients are not generally owned by the Group and are not recorded in the Group's Consolidated statement of financial position. Certain clients invest through life insurance policies that are managed by the Life Company. The assets backing these policies are owned by the Life Company and are included in the Consolidated statement of financial position along with a matching policyholder liability.

Wealth Management provides investment management, advisory and banking services. Certain Wealth Management subsidiaries provide banking services. These entities are legally responsible for the banking assets and liabilities and the relevant AUM is therefore included in the consolidated statement of financial position. These assets are managed to earn a net interest margin within the Wealth Management segment with consideration of the liquidity demands that may arise from investors. These assets are not made available for general corporate purposes.

	Statement of financial position £bn	Not recorded in the Statement of financial position £bn	Total £bn
Life Company	14.0	–	14.0
Other Asset Management	–	375.8	375.8
Total Asset Management	14.0	375.8	389.8
Wealth Management	3.7	53.5	57.2
Total AUMA	**17.7**	**429.3**	**447.0**
Investment capital	0.8		
Seed and co-investment capital	0.4		
Other assets	3.6		
Total Group assets excluding clients' investments	**4.8**		
Total Group assets	**22.5**		

Reflecting these structures, the Group's total assets increased by £1.5 billion to £22.5 billion at 31 December 2017. Excluding those assets that form part of AUM, the Group's total assets increased to £4.8 billion (2016: £4.2 billion). This comprises investment capital, seed and co-investment capital, and other assets.

Investment capital represents surplus assets held in excess of operating requirements. It is managed in accordance with limits set by the Board with the aim of making a low volatility return. The Group Capital Committee is responsible for monitoring the investment capital portfolio with consideration of potential capital and liquidity demands, including dividend distributions.

Investment capital is mainly comprised of investment grade corporate bonds, government and government-guaranteed bonds and our funds.

Investment capital reduced by £216 million to £843 million (2016: £1,059 million). This reduction was largely due to acquisitions which more than offset investment gains during the year. In addition, capital released from the operating businesses was more than offset by dividends paid in the year as operating capital was retained to develop our property estate and the front office technology platforms.

Seed and co-investment capital are represented by certain assets that are deployed to develop new investment strategies or co-invest selectively alongside our clients. These assets increased from £325 million at 31 December 2016 to £392 million at the end of 2017.

Other assets increased by £766 million to £3,581 million (2016: £2,815 million). These comprise assets that support the ongoing operating activities of the Group with acquisition related balances.

In 2017 acquisitions, principally comprising Adveq and the wealth management business of C. Hoare & Co., increased goodwill and intangible assets by £212.7 million. We have invested in our property estate both in London and other areas and this increased those assets by £100.4 million before depreciation. We are investing in technology to support our strategic priorities, particularly the front office technology platforms, which increased software assets by £63.7 million before amortisation. Finally, we work closely with the UK defined benefit pension scheme trustees, who use our asset management capabilities to manage the plan assets of the scheme. During 2017, the surplus on an accounting basis increased by £44.7 million to £162.9 million.

The Group's liquidity and regulatory capital position remains strong and further information on this is set out in note 19 of the financial statements.

Dividends

It is our policy to increase dividends progressively in line with the trend in profitability, having regard to overall Group strategy, capital requirements, liquidity and profitability. This approach will enable the Group to maintain sufficient surplus capital to take advantage of future investment opportunities while providing financial security to withstand possible risk scenarios and periods of economic downturn. We intend to maintain a dividend payout ratio of approximately 50%, determined as the total dividend per share in respect of the year, divided by the Group's pre-exceptional basic earnings per share.

It is our policy to increase dividends progressively in line with the trend in profitability

Circumstances that could adversely impact the Group's ability to pay dividends in line with the policy include a combination of significantly increased costs and a prolonged deterioration in markets or performance leading to reduced revenues and a consequential increase in the ratio of costs to net income.

The distributable profits of Schroders plc are £2.7 billion (2016: £2.5 billion) and include retained profits of £2.8 billion (2016: £2.6 billion). The Group's ability to pay dividends is however restricted by the need to hold regulatory capital and to maintain sufficient operating capital to support its ongoing business activities. Operating capital requirements include co-investments with clients and investing seed capital in our funds to support new investment strategies.

The Board is recommending a final dividend of 79 pence per share, bringing the total dividend for the year to 113 pence per share, an increase of 22% from 2016. This represents a payout ratio of 50%. After deducting the regulatory capital requirement and regulatory capital buffer, there continues to be sufficient capital to maintain our current dividend level for at least three years before taking account of any future profits.