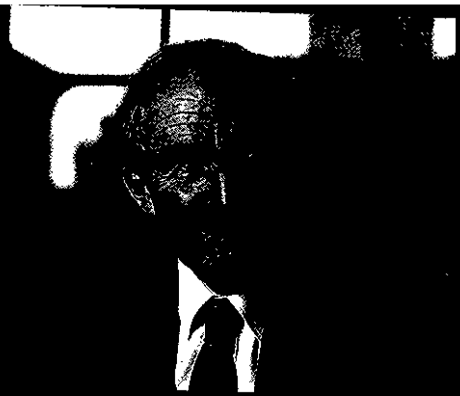
# The Royal Bank of Scotland Group plc

Interim Report 1998



Viscount Younger of Leckie
Chairman

## Financial Highlights

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | Year to 30th September 1997 £m |
|---|---|---|---|
| Profit before tax and exceptional items | **411** | 341 | 768 |
| Profit before tax | **448** | 369 | 760 |
| Bad debt and investment provisions | **135** | 78 | 148 |
| Profit attributable to ordinary shareholders | **276** | 198 | 457 |
| Cost:income ratio – UK Bank | **53.7%** | 55.8% | 56.6% |
| Earnings per ordinary share (unadjusted) | **32.0p** | 24.3p | 55.4p |
| Dividend per ordinary share | **7.13p** | 6.20p | 21.40p |

- Profit before exceptional items increased by 21% to £411 million.
- Profit before tax increased by 21% to £448 million.
- Earnings per share up 32% (unadjusted) and 20% (adjusted).
- Interim dividend up 15% to 7.13p.

**Viscount Younger, Chairman of The Royal Bank of Scotland Group plc, said:–**

"The Group has continued to make excellent progress and achieved record first half profits before exceptional items of £411 million, an increase of 21%, despite provisions of £53 million against Far East exposure. Profit before tax of £448 million was also up 21%. The UK Bank performed outstandingly well, contributing a profit of £345 million. Citizens' improved results reflect strong organic growth. Direct Line Insurance reported increased profits.

Earnings per share improved from 24.3p to 32.0p, an increase of 32%. After adjusting for the exceptional items, earnings per share improved by 20% from 22.6p to 27.1p.

The directors have declared an interim dividend of 7.13p which is in line with the Group's policy of normally seeking to pay an interim dividend equal to one-third of the total dividend for the preceding year.

We were disappointed that the Board of Birmingham Midshires Building Society did not feel able to recommend our offer for the business of the Society to its members. Discussions are continuing and our future actions will continue to take account of the best interests of our shareholders.

The record level of profits achieved in the half-year to 31st March 1998, together with the good progress made in existing businesses and in the development of new businesses, provide an excellent base for future growth."

Younger of Leckie

7th May 1998

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## Overview of results

Profit before exceptional items increased by 21% to £411 million. Profit before tax also increased by 21% to £448 million.

**Net interest income** increased significantly, by 23% to £824 million. This was due to good growth in average advances and deposits within the UK Bank and from the acquisition of Angel Train Contracts ('Angel Trains'). Average interest earning assets increased by 16% compared with the half-year ended 31st March 1997. Average loans and advances to customers, including leasing, increased by £4.9 billion, or 15%. The net interest margin improved from 2.47% to 2.63%.

**Non-interest income,** excluding general insurance, also grew strongly to £570 million, an increase of 26%. Within this, fees and commissions receivable improved by 21% to £442 million. This is partly due to increased fees of £35 million as a result of the acquisition of the Custody and Investor Services Division of S.G. Warburg & Co. Ltd. in March 1997. Investment gains contributed to an increase of £33 million in dealing profits and an increase of £22 million in other operating income. General insurance premium income, before reinsurance, improved by 12% to £358 million.

**Expenses,** excluding Investor Services and the New Retail Financial Services Businesses, increased by 13%. This was mainly the result of increased expenditure to support the growth in business volumes, principally in Corporate and Institutional Banking and the credit card businesses. Compared with the second half of last year, the Group's expenses were up only 4%.

Good progress has been made on the changes required to ensure that our computer systems are Year 2000 compliant. This is vital to the successful operation of the Group. A detailed programme of work is in place and it is expected to be completed and tested in line with the timetable, by the end of 1998. A provision of £29 million was made in the UK Bank in the year ended 30th September 1997. Expenditure of £7 million was set against this provision during the half-year to 31st March 1998 (30th September 1997 – £6 million).

**Staff numbers** have increased by 3,120 since 31st March 1997 mainly due to the growth in business volumes and the progress made in new businesses, offset by a reduction due to the disposal of the Registrars business.

**The cost:income ratio** for the UK Bank improved to 53.7% compared with 55.8% for the half-year to 31st March 1997. The Group cost:income ratio increased marginally from 51.4% to 51.6% reflecting the impact of RBS Trust Bank and the start-up costs in Tesco Personal Finance.

**General insurance claims,** before reinsurance, increased to £326 million from £302 million in the prior half year.

**Provisions for bad and doubtful debts,** excluding provisions for the Far East, were only £9 million higher than the half-year to 31st March 1997. Average credit card lending grew strongly by £600 million and, as a consequence, increased formula-driven provisions were made to reflect this growth.

The Group's total exposure to those countries in South East Asia subject to International Monetary Fund support programmes (i.e. Indonesia, South Korea and Thailand) was £605 million as at 31st March 1998, representing 0.8% of total assets. The Group has increased provisions by £53 million to cover this exposure.

**An exceptional gain** of £57 million was realised from the disposal of 3.6 million shares in Banco Santander. This reduced the Group's shareholding in Banco Santander from 4.9% to 4.2% at 31st March 1998, at which time the Group's shareholding had a market value £457 million in excess of its carrying cost. The Group's strategic alliance with Banco Santander also continues to be both successful and rewarding at an operating level. For example, through its Vista Capital joint venture the Group owns 24% of Superdiplo, a Spanish supermarket chain. Superdiplo recently registered a prospectus for an initial public offering of up to 28% of its shares, as a result of which the Group expects to book a substantial gain in the second half.

A further reduction in the corporation tax rate announced in the Government's March Budget affected tax variation clauses in finance lease contracts written by the Group. This has resulted in an exceptional charge against profit before tax of £20 million, almost totally offset by a reduction of £19 million in the tax charge.

**The tax charge** of £130 million includes £135 million on profit before exceptional items of £411 million. The net tax credit on the exceptional items reflects the gain on sale of the investment in Banco Santander and a large tax credit in respect of the write-down of finance leases.

**Earnings per share** increased by 32% from 24.3p to 32.0p. After adjusting for the exceptional items, earnings per share improved from 22.6p to 27.1p, an increase of 20%.

**The annualised pre-tax return** on ordinary shareholders equity improved to 36.8% (31st March 1997 – 34.2%) and the annualised post-tax return improved to 24.9% (31st March 1997 – 20.9%).

**Total assets** of the Group increased by £4.2 billion to £76.8 billion during the half-year to 31st March 1998. In the UK Bank, total assets increased by £3.1 billion to £59.6 billion in the half-year and this growth arose mainly from higher volumes of corporate lending, credit cards and the acquisition of Angel Trains. The growth was funded by increased retail deposits and wholesale funds. There was also continued good growth in the balance sheets of Direct Line Financial Services and RBS Advanta.

**Capital adequacy ratios** were 7.2% (tier1) and 11.5% (total). During the half-year to 31st March 1998, the Group's capital base increased by £204 million to £5,521 million. The main contributors to the change were the retained profit of £214 million, together with issues of US$£250 million preference shares and FRF 1 billion loan capital, partially offset by a rise of £167 million in deductions from the capital base. Weighted risk assets increased by 4.5% during the half-year reflecting the growth of the Group's balance sheet.

# Consolidated profit and loss account (Unaudited)

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Interest receivable | **2,504** | 1,906 | 4,125 |
| Interest payable | **1,680** | 1,237 | 2,711 |
| **Net interest income** | **824** | 669 | 1,414 |
| Dividend income | **12** | 11 | 24 |
| Fees and commissions receivable | **442** | 364 | 809 |
| Fees and commissions payable | **(48)** | (33) | (76) |
| Dealing profits (see note a) below) | **90** | 57 | 117 |
| Other operating income | **74** | 52 | 129 |
| | **570** | 451 | 1,003 |
| General insurance – earned premiums | **358** | 319 | 658 |
| – reinsurance | **(67)** | (57) | (123) |
| **Non-interest income** | **861** | 713 | 1,538 |
| **Total income** | **1,685** | 1,382 | 2,952 |
| Administrative expenses | | | |
| – staff costs | **443** | 372 | 794 |
| – staff profit share | **17** | 15 | 36 |
| – premises and equipment | **133** | 105 | 227 |
| – other | **215** | 166 | 385 |
| Depreciation and amortisation | **61** | 52 | 107 |
| Year 2000 costs* | **—** | — | 29 |
| **Operating expenses** | **869** | 710 | 1,578 |
| **Profit before other operating charges** | **816** | 672 | 1,374 |
| General insurance – gross claims | **326** | 302 | 582 |
| – reinsurance | **(56)** | (49) | (95) |
| **Profit before provisions for bad and doubtful debts** | **546** | 419 | 887 |
| Provisions for bad and doubtful debts | | | |
| – Excluding Far East | **82** | 73 | 139 |
| – Far East | **53** | 4 | 7 |
| Amounts written off investments | **—** | 1 | 2 |
| Write down of finance leases* | **20** | — | 41 |
| **Group operating profit** | **391** | 341 | 698 |

*Exceptional items

(a) Dealing profits comprise foreign exchange and arbitrage trading income, profits and losses on sales of securities and mark to market adjustments on securities held, before charging funding costs and operating expenses of these activities.

(b) Details of the acquisition and the disposal completed during the half-year to 31st March 1998 are provided in notes 8 and 9. With the exception of the disposal detailed in note 9, all other items dealt with in arriving at Group operating profit relate to continuing operations.

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| **Group operating profit** | **391** | 341 | 698 |
| Profit on sale of fixed asset investment | **57** | — | 34 |
| Profit on sale of U.S. mortgage servicing business | **—** | 28 | 28 |
| **Profit on ordinary activities before tax** | **448*** | 369* | 760* |
| Tax on Group profit on ordinary activities | **(130)** | (129) | (219) |
| **Profit on ordinary activities after tax** | **318** | 240 | 541 |
| Minority interests | **(12)** | (17) | (31) |
| **Profit after minority interests** | **306** | 223 | 510 |
| Preference dividends | **30** | 25 | 53 |
| **Profit attributable to ordinary shareholders** | **276** | 198 | 457 |
| Ordinary dividends | **62** | 48 | 179 |
| **Retained profit** | **214** | 150 | 278 |
| **Earnings per ordinary share** | **32.0p** | 24.3p | 55.4p |
| Adjustments to exclude exceptional items: | | | |
| Write-down of finance leases | **0.2p** | — | 1.5p |
| Profit on sale of fixed asset investment | **(5.1p)** | — | (4.0p) |
| Profit on sale of U.S. mortgage servicing business | **—** | (1.7p) | (1.7p) |
| Year 2000 costs | **—** | — | 2.3p |
| **Adjusted earnings per ordinary share** | **27.1p** | 22.6p | 53.5p |

## Segmental analysis of Group operating profit before exceptional items

| | £m | £m | £m |
|---|---|---|---|
| UK Bank | **345** | 306 | 636 |
| Investor Services | **(6)** | (12) | (12) |
| Direct Line Insurance | **10** | 8 | 36 |
| New Retail Financial Services Businesses | **(35)** | (19) | (35) |
| Citizens | **108** | 83 | 189 |
| Central items | **(11)** | (25) | (46) |
| Total | **411** | 341 | 768 |

*Profit on ordinary activities before tax and before the £20 million write-down of finance leases was £468 million (31st March 1997 – £369 million; 30th September 1997 – £801 million).

# Consolidated balance sheet (Unaudited)

| | 31st March 1998 £m | 31st March 1997 £m | (Audited) 30th September 1997 £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | **1,248** | 1,414 | 1,213 |
| Treasury bills and other eligible bills | **672** | 670 | 629 |
| Loans and advances to banks | **14,071** | 14,115 | 14,091 |
| Items in course of collection due from other banks | **1,287** | 1,024 | 1,070 |
| Loans and advances to customers | **40,232** | 35,105 | 38,606 |
| Debt securities | **11,434** | 10,128 | 9,925 |
| Equity shares | **664** | 407 | 463 |
| Interests in associated undertakings | **60** | 65 | 52 |
| Tangible fixed assets | **1,080** | 998 | 1,078 |
| Other assets | **5,053** | 4,623 | 4,566 |
| Prepayments and accrued income | **982** | 887 | 908 |
| **Total assets** | **76,783** | 69,436 | 72,601 |

| | 31st March 1998 £m | 31st March 1997 £m | (Audited) 30th September 1997 £m |
|---|---|---|---|
| **Liabilities** | | | |
| Deposits by banks | **6,403** | 5,487 | 5,395 |
| Items in course of collection due to other banks | **682** | 646 | 636 |
| Customer accounts | **48,086** | 43,201 | 47,582 |
| Debt securities in issue | **7,017** | 6,093 | 4,997 |
| Other liabilities | **6,522** | 6,726 | 6,147 |
| Accruals and deferred income | **1,885** | 1,653 | 1,807 |
| Provisions for liabilities and charges | | | |
| – deferred taxation | **376** | 183 | 190 |
| – pensions and other similar obligations | **41** | 41 | 42 |
| – other provisions | **16** | — | 23 |
| Subordinated liabilities | | | |
| – dated loan capital | **1,245** | 1,408 | 1,383 |
| – undated loan capital including convertible debt | **1,229** | 1,122 | 1,167 |
| Minority interests | | | |
| – equity | **210** | 156 | 178 |
| – non-equity | **19** | — | 12 |
| Called up share capital | **218** | 206 | 216 |
| Share premium account | **1,408** | 981 | 1,229 |
| Reserves | **114** | 111 | 103 |
| Revaluation reserve | **(22)** | (26) | (19) |
| Profit and loss account | **1,334** | 1,448 | 1,513 |
| Shareholders' funds | | | |
| – equity | **2,201** | 1,994 | 2,308 |
| – non-equity | **851** | 726 | 734 |
| **Total liabilities** | **76,783** | 69,436 | 72,601 |
| **Memorandum items:** | | | |
| Contingent liabilities | **2,902** | 2,918 | 2,641 |
| Commitments (mainly standby facilities, credit lines and other commitments to lend) | **18,710** | 15,773 | 17,133 |

## Statement of total recognised gains and losses (Unaudited)

| | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Profit attributable to ordinary shareholders | **276** | 198 | 457 |
| Currency translation adjustments on foreign currency net investments | **(1)** | 3 | (1) |
| Movements in revaluations of premises | **1** | — | 3 |
| Movements in net unrealised gains and losses on debt securities and equity shares | **(4)** | (4) | (3) |
| **Total recognised gains and losses** | **272** | 197 | 456 |

## Reconciliation of movements in shareholders' funds (Unaudited)

| | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Profit attributable to ordinary shareholders | **276** | 198 | 457 |
| Ordinary dividends | **(62)** | (48) | (179) |
| Retained profit | **214** | 150 | 278 |
| Other recognised net gains and losses relating to the period | **(4)** | (1) | (1) |
| Currency translation adjustment on share premium account | **(30)** | (24) | (17) |
| Increase in share capital | **2** | 1 | 11 |
| Premium arising on issues of shares | **208** | 124 | 493 |
| Premium arising on redemption of shares | **—** | — | (132) |
| Elimination of goodwill on acquisitions | **(361)** | (50) | (58) |
| Write-back of goodwill on disposals | **1** | — | — |
| Other movements | **(20)** | 10 | (42) |
| Net increase in shareholders' funds | **10** | 210 | 532 |
| Opening shareholders' funds | **3,042** | 2,510 | 2,510 |
| **Closing shareholders' funds** | **3,052** | 2,720 | 3,042 |

# Cash flow statement (Unaudited)

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Net cash inflow from operating activities | **795** | 1,771 | 2,338 |
| Returns on investments and servicing of finance | **(135)** | (131) | (255) |
| Taxation | **(43)** | (59) | (150) |
| Capital expenditure and financial investment | **(463)** | (739) | (1,461) |
| Acquisitions and disposals | **(409)** | (7) | 36 |
| Ordinary (equity) dividends paid | **(131)** | (107) | (158) |
| Net cash (outflow)/inflow before financing | **(386)** | 728 | 350 |
| Financing | **182** | 455 | 716 |
| (Decrease)/increase in cash | **(204)** | 1,183 | 1,066 |

**Reconciliation of operating profit to net cash inflow from operating activities**

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Operating profit – the company and its subsidiary undertakings | **392** | 349 | 690 |
| Increase in interest receivable and prepaid expenses | **(59)** | (110) | (132) |
| Increase in interest payable and accrued expenses | **74** | 118 | 256 |
| (Decrease)/increase in other provisions | **(7)** | — | 23 |
| Increase/(decrease) in provisions for bad and doubtful debts | **66** | (18) | (11) |
| Interest payable on subordinated liabilities | **106** | 96 | 210 |
| Depreciation and diminution in value of fixed assets | **61** | 52 | 107 |
| Profit on sales of tangible fixed assets | **(4)** | (10) | (18) |
| Profit on sales of investment securities | **(37)** | (25) | (71) |
| Profit on sale of U.S. mortgage servicing business | **—** | (28) | (28) |
| Profit on sale of fixed asset investment | **(57)** | — | (34) |
| Other non-cash movements | **(82)** | 53 | 23 |
| Net cash inflow from trading activities | **453** | 477 | 1,015 |
| Net increase/(decrease) in deposits by banks | **1,008** | 46 | (46) |
| Net increase in customer accounts | **504** | 2,125 | 6,311 |
| Net increase/(decrease) in debt securities in issue | **1,446** | 540 | (556) |
| Net increase in loans to customers | **(879)** | (1,058) | (4,432) |
| Net increase in loans to banks | **(172)** | (644) | (536) |
| (Increase)/decrease in items in course of collection due from other banks | **(217)** | 4 | (42) |
| Increase/(decrease) in items in course of collection due to other banks | **46** | (129) | (139) |
| Increase in treasury bills and other eligible bills | **(43)** | (109) | (69) |
| (Increase)/decrease in debt securities and equity shares (other than investment securities) | **(1,197)** | (154) | 777 |
| Increase in other assets | **(213)** | (1,036) | (737) |
| Increase in other liabilities | **59** | 1,709 | 792 |
| Net cash inflow from operating activities | **795** | 1,771 | 2,338 |

## Divisional performances

### UK Bank

| | Half year 1998 | | | Half year 1997 | | | (Audited) Full Year 1997 |
|---|---|---|---|---|---|---|---|
| | Retail & Corporate Banking £m | RBSI £m | Total £m | Retail & Corporate Banking £m | RBSI £m | Total £m | Total £m |
| Net interest income | **542** | **33** | **575** | 441 | 26 | 467 | 977 |
| Non-interest income | **403** | **17** | **420** | 354 | 13 | 367 | 763 |
| **Total income** | **945** | **50** | **995** | 795 | 39 | 834 | 1,740 |
| Expenses | **512** | **22** | **534** | 448 | 17 | 465 | 985 |
| Profit before provisions | **433** | **28** | **461** | 347 | 22 | 369 | 755 |
| Provisions for bad and doubtful debts | | | | | | | |
| – excluding Far East | **63** | **—** | **63** | 58 | — | 58 | 110 |
| – Far East | **53** | **—** | **53** | 4 | — | 4 | 7 |
| Amounts written off investments | **—** | **—** | **—** | 1 | — | 1 | 2 |
| **Profit before exceptional items** | **317** | **28** | **345** | 284 | 22 | 306 | 636 |

| Total income is analysed below: | Half year 1998 | Half year 1997 |
|---|---|---|
| Retail Banking | | |
| – net interest income | **288** | 234 |
| – non-interest income | **170** | 159 |
| | **458** | 393 |
| Corporate & Institutional Banking | | |
| – net interest income | **254** | 207 |
| – non-interest income | **233** | 195 |
| | **487** | 402 |
| **Total income** | **945** | 795 |

| | Half year 1998 | Half year 1997 | Full Year 1997 |
|---|---|---|---|
| Cost:income ratio (%) | **53.7** | 55.8 | 56.6 |
| Pre-tax return on ordinary equity (%) | **38** | 42 | 40 |
| Post-tax return on ordinary equity (%) | **24** | 27 | 26 |
| Total assets (£bn) | **59.6** | 55.0 | 56.5 |
| Shareholder's funds | | | |
| – ordinary (£m) | **1,822** | 1,557 | 1,738 |
| – preference (£m) | **608** | 519 | 581 |
| Employees at period end | **19,580** | 18,470 | 19,060 |

The UK Bank continued to perform strongly with profit before provisions up £92 million to £461 million, an increase of 25%.

Net interest income increased by 23% to £575 million from a combination of volume growth, the Angel Trains acquisition and from a widening of margins.

Non-interest income increased by 14% to £420 million mainly as a result of good growth in fee income and commissions in both the retail network and corporate banking, and from increased investment gains.

Expenses were up 15% to £534 million reflecting increased expenditure to support the growing business volumes. Compared with the second half of last year, expenses were up only 3%.

The cost:income ratio for the UK Bank continued to improve, from 55.8% to 53.7%, reflecting growth of £161 million in total income and £69 million in expenses.

Provisions for bad and doubtful debts other than in the Far East are little changed at £63 million for the half year.

At 31st March 1998 the amount outstanding to counterparties in countries in South East Asia which are subject to International Monetary Fund support programmes totalled £605 million, of which 53% represented lending to banks, financial institutions and the sovereign sector. Of the balance, which is to the commercial sector, 57% is represented by Indonesia as a result of our commercial involvement in the country which spans some 25 years.

In addition to good performances from the core retail and commercial businesses, increased profits were reported by Treasury and Capital Markets and Structured Finance. Included in Structured Finance is Angel Trains which was acquired in December 1997 and contributed £12 million profit in the half year. Royal Bank of Scotland International (RBSI) continued to make excellent progress, with profits up 27% to £28 million.

Note: the UK Bank excludes Investor Services (i.e. RBS Trust Bank and RBS Global Custody), Tesco Personal Finance, Virgin Direct Personal Finance, and RBS Advanta, which are disclosed separately (see pages 14 and 17). The figures for the UK Bank assume that it had a total risk asset ratio of 10% and that the tier 1 element was 6%, split between ordinary equity and preference shares in the same 3:1 ratio as the Group. Certain expenses previously shown as Group central costs have been re-allocated to the UK Bank.

## Divisional performances (continued)

### Investor Services

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Net interest income | **10** | 5 | 20 |
| Non-interest income | **55** | 25 | 94 |
| **Total income** | **65** | 30 | 114 |
| Expenses | **71** | 42 | 126 |
| **Deficit before tax** | **(6)** | (12) | (12) |
| Analysis: | | | |
| RBS Trust Bank | **4** | — | 5 |
| RBS Global Custody | **(10)** | (9) | (20) |
| Registrars | **—** | (3) | 3 |
| | **(6)** | (12) | (12) |
| Cost:income ratio (%) | **109** | 140 | 111 |
| Shareholder's funds (£m) | **44** | 45 | 48 |
| Employees at period end | **1,190** | 1,320 | 2,020 |

**RBS Trust Bank**

RBS Trust Bank, which commenced trading in March 1997 following the acquisition of the Custody and Investor Services Division of S.G. Warburg & Co. Ltd. has continued its encouraging start and has reported first half profits of £11 million before financing costs of £7 million.

**RBS Global Custody**

RBS Global Custody represents that part of the custody business which has not yet transferred to RBS Trust Bank. It is expected that the transfer will be substantially complete by September 1998.

**Registrars**

The sale of the Registrars business was completed on 13th March 1998 when it was acquired by Computershare Limited, a company in which the Group now has a 20% shareholding. The break-even figure for the half-year to 31st March 1998 reflects 100% of Registrars' earnings to 1st January 1998, the effective date of the transfer, and 20% of Computershare's earnings thereafter (see also note 9 on page 22).

*Note:* Investor Services comprises RBS Trust Bank and the RBS Global Custody business, together with the Group's share of the Registrars business. Although sharing certain customers with Corporate and Institutional Banking, Investor Services is a distinct and separate business unit. It is different from the UK Bank in terms of capital employed, cost:income ratio, profit per employee etc.

## Direct Line Insurance

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Earned premiums | **329** | 319 | 644 |
| Reinsurers' share | **(59)** | (57) | (118) |
| Insurance premium income | **270** | 262 | 526 |
| Net interest income | **35** | 31 | 66 |
| Non-interest income | **17** | 24 | 47 |
| **Total income** | **322** | 317 | 639 |
| Expenses | **63** | 56 | 124 |
| Gross claims | **297** | 302 | 571 |
| Reinsurers' share | **(48)** | (49) | (92) |
| General insurance claims | **249** | 253 | 479 |
| **Profit before tax** | **10** | 8 | 36 |
| In-force policies (000) | | | |
| Motor | **2,061** | 2,092 | 2,063 |
| Home | **852** | 819 | 833 |
| **Total** | **2,913** | 2,911 | 2,896 |
| Gross written premium (£m) | | | |
| Motor | **224** | 218 | 472 |
| Home | **80** | 73 | 157 |
| Creditor | **26** | 16 | 39 |
| Travel | **2** | 1 | 3 |
| **Total** | **332** | 308 | 671 |
| Combined operating ratio (%) | **109** | 113 | 106 |
| Pre-tax return on equity (%) | **5.5** | 5.0 | 11.0 |
| Total assets (£m) | **1,170** | 1,076 | 1,124 |
| Insurance reserves – net (£m) | **846** | 750 | 773 |
| Shareholder's funds (£m) | **285** | 328 | 343 |
| Employees at period end | **3,250** | 2,860 | 3,020 |

The results of Direct Line Insurance are affected by seasonal factors which tend to depress the first half results. The profit of £10 million was £2 million higher than the prior half-year. This improvement was due to increased earned premium income from higher premium rates, and a reduction in the level of claims overall.

## Divisional performances (continued)

The number of in-force policies on the motor account has remained stable at 2.1 million. Premium rates on the motor account have shown a small improvement. On the home account, the number of in-force policies increased by 4% to 852,000.

Expenses have increased by £7 million to £63 million for the half-year, reflecting increased marketing costs and higher staff numbers.

In March 1998 a dividend of £70 million was declared by Direct Line Insurance, as a consequence of the strength of its balance sheet.

During the half-year, Direct Line Insurance reviewed its investment strategy and consequently increased its weighting in equities. In accordance with Group policy, gains on these equity investments are recognised in the profit and loss account only when realised. As at 31st March 1998 the market value of Direct Line Insurance's portfolio of equity investments was £39 million in excess of the carrying cost (31st March 1997 – nil).

| **New Retail Financial Services Businesses** | | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|---|
| Net interest income | | **34** | 15 | 36 |
| Non-interest income – associated companies | | **(4)** | (5) | (7) |
| – other | | **16** | 4 | 23 |
| Insurance premium income | | **21** | — | 9 |
| **Total income** | | **67** | 14 | 61 |
| Expenses | | **70** | 27 | 75 |
| General insurance claims | | **21** | — | 8 |
| Losses before provisions | | **(24)** | (13) | (22) |
| Provisions | | **11** | 6 | 13 |
| **Net investment cost** | | **(35)** | (19) | (35) |
| Analysis of net investment cost: | % owned | | | |
| Direct Line Financial Services | 100 | **2** | (5) | (10) |
| Direct Line Life and Unit Trusts | 50 | **(2)** | (3) | 3 |
| Privilege Insurance | 60 | **(2)** | (2) | (2) |
| Linea Directa | 50 | **(2)** | (3) | (5) |
| RBS Advanta | 51 | **2** | (3) | (2) |
| Tesco Personal Finance | 50 | **(23)** | — | (11) |
| Virgin Direct Personal Finance | 50 | **(5)** | — | — |
| | | **(30)** | (16) | (27) |
| Direct Line Accident Management | 100 | **(5)** | (3) | (8) |
| | | **(35)** | (19) | (35) |
| Ordinary shareholders' funds – RBSG share (£m) | | **94** | 74 | 55 |
| Total assets (£m) | | **2,449** | 1,367 | 1,984 |
| Employees at period end | | **2,280** | 960 | 1,840 |

All of the above companies are treated for accounting purposes as subsidiaries with the exception of Direct Line Life and Unit Trusts and Linea Directa, which are treated as associated companies. As a consequence, the net investment cost shown above reflects 100% of the results of those companies treated as subsidiaries. The minority interest in those subsidiaries is adjusted against the Group's profit on ordinary activities after tax.

Direct Line Financial Services has recorded a profit of £2 million, despite margins remaining tight on savings and mortgages. Mortgage balances have increased to £1.4 billion at 31st March 1998 (31st March 1997 – £0.9 billion) and deposit balances have increased to £0.5 billion (31st March 1997 – £0.4 billion).

## Divisional performances (continued)

Direct Line Life and Unit Trusts were accounted for as subsidiaries until 1st July 1997 when they became associated companies on the sale of 50% to Scottish Widows. Included in the second half of 1997 is a gain of £5 million associated with this sale. In January 1998, Direct Line Life augmented its product range by launching a new pension plan.

Privilege Insurance was accounted for as an associated company until 1st July 1997 when it became a subsidiary. At 31st March 1998 Privilege Insurance had increased its in-force policies by 43% to 185,000 (31st March 1997 –129,000).

Linea Directa increased its in-force policies to 156,000 from 95,000 at 31st March 1997, an increase of 64%.

RBS Advanta has continued to grow strongly and at 31st March 1998 had balances of over £700 million compared with £300 million at 31st March 1997. This has resulted in a profit of £2 million for the half-year to 31st March 1998 (31st March 1997 – £3 million loss).

On 28th April 1998, the Group announced that it had exercised its right to acquire the minority shareholding in RBS Advanta from Fleet Financial Group Inc. of Boston. It is anticipated that this transaction will be completed in the near future.

The launch of the savings account at Tesco Personal Finance led to significant demand resulting in increased processing costs. At 31st March 1998, total deposits were almost £600 million.

There has been an encouraging response to the Virgin 'One' Account launched by Virgin Direct Personal Finance. Start up costs for this venture amounted to £5 million for the half-year to 31st March 1998.

At Direct Line Accident Management there was continuing investment in repair centres. There are now six repair centres operational (31st March 1997 – four).

| **Citizens** | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Net interest income | **185** | 169 | 352 |
| Non-interest income | **60** | 47 | 98 |
| **Total income** | **245** | 216 | 450 |
| Expenses | **129** | 124 | 245 |
| Profit before provisions | **116** | 92 | 205 |
| Provisions | **8** | 9 | 16 |
| **Profit before exceptional items** | **108** | 83 | 189 |
| Cost:income ratio (%) | **52.7** | 57.4 | 54.4 |
| Pre-tax return on equity | | | |
| – before exceptional items (%) | **36** | 33 | 37 |
| – after exceptional items (%) | **36** | 44 | 42 |
| Total assets (£m) | **9,557** | 9,103 | 9,565 |
| Shareholders' funds (£m) | **629** | 524 | 575 |
| Employees at period end | **5,040** | 4,610 | 4,910 |
| US$/£ rate of exchange – average | **$1.65** | $1.63 | $1.63 |

The profit before exceptional items of £108 million was an increase of £25 million or 30% compared with the half-year to 31st March 1997. In dollar terms, Citizens profit increased by 32% to US$179 million.

The results from Citizens reflect a strong performance in all areas of the business.

Net interest income increased by 10% to £185 million as a result of increased volumes and the full half-year impact of the three acquisitions completed during 1997.

Non-interest income improved by 28% to £60 million reflecting increased fee income, investment gains and the impact of acquisitions, offset by a reduction in income due to the sale of the mortgage servicing business in 1997.

Expenses were 4% higher than prior year at £129 million, mainly due to the acquisitions during 1997. The cost:income ratio continued to improve to 52.7% as income growth outstripped expenses growth.

Credit quality remains good and non-performing loans were covered 250% by provisions at 31st March 1998.

On 7th April 1998, Citizens announced the acquisition of Woburn National Corporation, parent of Woburn National Bank, for US$45 million payable in cash. Completion is subject to shareholder approval and regulatory consent and is expected to take place later this year.

On 29th April 1998, Citizens announced the acquisition of four branches, including US$67 million of deposits, from Branford Savings Bank, a subsidiary of North Fork Bancorp, for a premium of US$6 million payable in cash. Completion is subject to regulatory approval and is expected to take place later this year.

## Divisional performances (continued)

### Central items

The Centre's deficit was as follows:

| | Half-year to 31st March 1998 £m | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Central income less expenses | **(1)** | (11) | (16) |
| Funding costs | **(10)** | (14) | (30) |
| Deficit before exceptional items | **(11)** | (25) | (46) |
| The Centre's balance sheet was as follows: | | | |
| Book value of investments in the ordinary equity of business units: | | | |
| UK Bank | **1,822** | 1,557 | 1,738 |
| Investor Services | **44** | 45 | 48 |
| Direct Line Insurance | **285** | 328 | 343 |
| New Retail Financial Services Businesses | **94** | 74 | 55 |
| Citizens (net of minority interests and goodwill) | **481** | 401 | 440 |
| Banco Santander (see note below) | **140** | 180 | 180 |
| | **2,866** | 2,585 | 2,804 |
| Funded by: | | | |
| Subordinated liabilities | **2,474** | 2,530 | 2,550 |
| Less: lent to the UK Bank | **(2,052)** | (2,146) | (2,207) |
| | **422** | 384 | 343 |
| Preference shares | **851** | 726 | 734 |
| Less: invested in the UK Bank | **(608)** | (519) | (581) |
| | **243** | 207 | 153 |
| Net borrowing | **665** | 591 | 496 |
| Ordinary shareholders' funds | **2,201** | 1,994 | 2,308 |
| | **2,866** | 2,585 | 2,804 |

### Investment in Banco Santander

As at 31st March 1998, the total cost of the Group's shareholding in Banco Santander was £140 million and the market value was £597 million, giving an unrealised pre-tax gain of £457 million (31st March 1997 – £144 million; 30th September 1997 – £300 million).

# Notes on results

1 The principal accounting policies as set out on pages 31, 32 and 33 of the Report and Accounts for the year to 30th September 1997 are unchanged.

2 **Provisions for bad and doubtful debts**

Group operating profit is stated after charging provisions for bad and doubtful debts of £135million (31st March 1997 – £77 million). The balance sheet provisions for bad and doubtful debts and movements thereon were:

| | Specific £m | General £m |
|---|---|---|
| At 1st October 1997 | 354 | 105 |
| Currency translation adjustment | (3) | (1) |
| Amounts written off net of recoveries | (69) | — |
| Transfers between provisions | (7) | 7 |
| Charge to profit and loss account | 99 | 36 |
| **At 31st March 1998** | **374** | **147** |
| At 31st March 1997 | 368 | 99 |

Provisions at 31st March 1998 were 1.3% of advances to customers (31st March 1997 – 1.3%).

3 The charge for taxation is based on a UK corporation tax rate of 31% for the year to 30th September 1998 (30th September 1997 – 32%) and comprises the following:

| | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m |
|---|---|---|
| Tax on profit before exceptional items | **135** | 119 |
| Tax (credit)/charge on exceptional items | **(5)** | 10 |
| | **130** | 129 |

4 Earnings per share have been calculated by reference to the weighted average of 862.5 million (31st March 1997 – 817.3 million) ordinary shares in issue during the half-year, profit attributable to ordinary shareholders of £234 million (31st March 1997 – £184 million) before the exceptional items (net of taxation) and profit attributable to ordinary shareholders of £276 million (31st March 1997 – £198 million) after the exceptional items. Fully diluted earnings per share are not given as the dilution arising from options granted is not material.

5 The directors have declared half-year dividends on the 11% and 5.5% cumulative preference shares at the rate of 3.85% and 1.925% respectively. These dividends will be paid on 29th May 1998 to those preference shareholders registered on 14th April 1998.

6 The directors have declared an interim dividend of 7.13p per share on the ordinary shares. This interim dividend will be paid on 17th July 1998 to those shareholders registered on 22nd May 1998. As an alternative to cash, a scrip dividend election is to be offered and shareholders will receive details of this by letter.

## Notes on results (continued)

7 In accordance with the Group's accounting policy of carrying out valuations of premises annually, a revaluation of premises is to be carried out in the second half of the financial year and any movement in value will be reported at the year-end.

**8 Acquisition**

The acquisition of GRS Holding Company Limited (parent company of Angel Train Contracts Limited) in December 1997 for £395 million was accounted for by the acquisition method of accounting and the contribution to Group operating profit in the half-year to 31st March 1998 was £12 million. The estimated fair value of net assets acquired was as follows:

| | Initial book value £m | Restatement to fair value £m | Fair value to Group £m |
|---|---|---|---|
| Assets for operating leases | 563 | 257 | 820 |
| Goodwill | 217 | (217)* | — |
| Current assets | 83 | — | 83 |
| | 863 | 40 | 903 |
| Current liabilities | (50) | (15) | (65) |
| Debt | (574) | — | (574) |
| Provision for maintenance | (111) | 111 | — |
| Provision for deferred tax | (127) | (77) | (204) |
| Net assets | 1 | 59 | 60 |

*Goodwill written off in accordance with Group policy.

**9 Discontinued operation**

The Registrars business was sold to Computershare Limited with effect from 1st January 1998.

The following table shows the amounts relating to Registrars which were included in Group operating profit:

| | **Half-year to 31st March 1998 £m** | Half-year to 31st March 1997 £m | (Audited) Year to 30th September 1997 £m |
|---|---|---|---|
| Net interest income | **4** | 4 | 10 |
| Non-interest income | **9** | 14 | 40 |
| Total income | **13** | 18 | 50 |
| Expenses | **13** | 21 | 47 |
| Operating profit | **—** | (3) | 3 |

10 The interim financial statements have been reviewed by the Group's auditors, Coopers & Lybrand, and their report is set out on page 23. The retained profit has been included in tier 1 capital at 31st March 1998.

# Review report by the auditors to the directors of The Royal Bank of Scotland Group plc

We have reviewed the interim financial statements for the six months ended 31st March 1998 set out on pages 6 to 22 which are the responsibility of, and have been approved by, the Directors. Our responsibility is to report on the results of our review.

Our review was carried out having regard to the Bulletin "Review of Interim Financial Information" issued by the Auditing Practices Board. This review consisted principally of applying analytical procedures to the underlying financial data, assessing whether accounting policies have been consistently applied, and making enquiries of management responsible for financial and accounting matters. The review excluded audit procedures such as tests of controls and verification of assets and liabilities and was therefore substantially less in scope than an audit performed in accordance with Auditing Standards. Accordingly we do not express an audit opinion on the interim financial statements.

On the basis of our review, in our opinion the interim financial statements have been prepared using accounting policies consistent with those adopted by the Group in its financial statements for the year ended 30th September 1997 and we are not aware of any material modifications that should be made to the interim financial statements as presented.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
Edinburgh, 7th May 1998

# Average balance sheet

| Half-year to 31st March | 1998 Average Balance £m | Rate % | 1997 Average Balance £m | Rate % |
|---|---|---|---|---|
| **Assets** | | | | |
| Treasury and other eligible bills | | | | |
| UK | **640** | **7.2** | 661 | 6.0 |
| overseas | **54** | **5.0** | 41 | 6.6 |
| Loans and advances to banks | | | | |
| UK | **11,850** | **6.3** | 10,872 | 5.2 |
| overseas | **1,635** | **6.1** | 1,724 | 5.7 |
| Loans and advances to customers | | | | |
| UK | **27,515** | **9.0** | 23,904 | 7.8 |
| overseas | **7,122** | **8.3** | 6,463 | 8.2 |
| Lease and HP receivables | | | | |
| UK | **3,697** | **9.7** | 3,074 | 8.2 |
| overseas | **109** | **7.6** | 70 | 7.5 |
| Debt securities | | | | |
| UK | **6,361** | **6.8** | 3,965 | 6.5 |
| overseas | **3,668** | **6.6** | 3,312 | 6.3 |
| Interest earning assets | **62,651** | **8.0** | 54,086 | 7.0 |
| Non-interest earning assets | **10,035** | | 7,998 | |
| **Total average assets** | **72,686** | | 62,084 | |
| **Liabilities** | | | | |
| Deposits by banks | | | | |
| UK | **4,096** | **6.2** | 3,856 | 4.9 |
| overseas | **1,360** | **5.7** | 1,671 | 5.5 |
| Customer accounts | | | | |
| UK | **33,970** | **5.9** | 27,139 | 4.8 |
| overseas | **8,610** | **4.4** | 7,725 | 4.2 |
| Debt securities in issue | | | | |
| UK | **5,368** | **7.2** | 4,976 | 6.7 |
| overseas | **758** | **5.1** | 657 | 5.4 |
| Loan capital | **2,493** | **8.5** | 2,251 | 8.6 |
| Interest bearing liabilities | **56,655** | **5.9** | 48,275 | 5.1 |
| Interest free liabilities | | | | |
| demand deposits | **2,673** | | 2,695 | |
| other liabilities | **10,379** | | 8,512 | |
| Shareholders' funds | **2,979** | | 2,602 | |
| **Total average liabilities** | **72,686** | | 62,084 | |

Average balances have been calculated on a daily basis using customers' cleared balances, netted where interest set-off arrangements exist. The analysis into UK and overseas in the above table has been compiled on the basis of location of office.

For the purposes of the average balance sheet, the prior half-year figures have been re-stated to reflect a reclassification of lending to members of the London Discount Market Association as follows:

| | 1997 Restated £m | 1997 Original £m |
|---|---|---|
| Loans and advances to banks – UK | 10,872 | 9,959 |
| Loans and advances to customers – UK | 23,904 | 24,817 |

## Average interest rates, yields, spreads and margins

| Half-year to 31st March | **1998 Average Rate %** | 1997 Average Rate % |
|---|---|---|
| United Kingdom | | |
| The Royal Bank of Scotland plc base rate | **7.2** | 6.0 |
| London inter-bank offered rate: | | |
| three month sterling | **7.6** | 6.3 |
| three month eurodollar | **5.7** | 5.5 |
| United States | | |
| Prime rate | **8.5** | 8.3 |
| Yields, spreads and margins | | |
| Gross yield (1) | | |
| Group | **8.0** | 7.0 |
| UK | **8.1** | 7.0 |
| overseas | **7.5** | 7.3 |
| Interest spread (2) | | |
| Group | **2.1** | 1.9 |
| UK | **1.9** | 1.7 |
| overseas | **2.9** | 2.8 |
| Interest margin (3) | | |
| Group | **2.6** | 2.5 |
| UK | **2.4** | 2.2 |
| overseas | **3.5** | 3.4 |

(1) Gross yield is the average interest rate earned on average interest earning assets.

(2) Interest spread is the difference between the gross yield and the average interest rate paid on average interest bearing liabilities.

(3) Interest margin is net interest income as a percentage of average interest earning assets.

## Risk elements in lending

The Group's advances control and review procedures do not include the classification of loans as non-accrual, accruing past due, restructured and potential problem loans, as defined by the Securities and Exchange Commission ('SEC') in the USA. The following table shows the estimated amount of loans which would be reported using the SEC's classifications:

| | **31st March 1998 £m** | 31st March 1997 £m | 30th September 1997 £m |
|---|---|---|---|
| Loans accounted for on a non-accrual basis: | | | |
| domestic | **411** | 560 | 462 |
| foreign | **83** | 87 | 75 |
| Accruing loans which are contractually overdue 90 days or more as to principal or interest*: | | | |
| domestic | **304** | 225 | 217 |
| foreign | **44** | 10 | 14 |
| Loans not included above which are classified as "troubled debt restructurings" by the SEC: | | | |
| domestic | **11** | 23 | 13 |
| foreign | **1** | — | — |
| **Total** | **854** | 905 | 781 |
| Provisions as a percentage of risk elements in lending | **61%** | 52% | 59% |

*Generally, lending by way of overdraft has no fixed repayment schedule and consequently is not included in this category.

Loans that are current as to payment of principal and interest and not reflected in the above table, but as to which the Group has serious doubts as to the ability of the borrower to comply with loan repayment terms, totalled approximately £120 million at 31st March 1998 (31st March 1997 – £97 million; 30th September 1997 – £116 million). In accordance with the Group's provisioning policy for bad and doubtful debts it is considered that adequate provisions for the above risk elements in lending have been made in the accounts.

Gross interest income not recognised but which would have been recognised in the half-year ended 31st March 1998 under the original terms of non-accrual and restructured loans amounted to £25 million from domestic loans and £6 million from foreign loans. Interest on non-accrual and restructured loans included in the profit and loss account in the half-year ended 31st March 1998 totalled £2 million from domestic loans and £2 million from foreign loans.

## Derivatives business

In the normal course of business, the Group enters into a variety of derivative transactions which are primarily in the foreign exchange and interest rate markets. They are used to provide financial services to customers, to take, hedge and modify positions as part of the Group's trading activities and to hedge or modify market risk exposure arising on the balance sheet from a variety of activities, including lending and securities investment.

### Notional principal

| Contract types | 31st March 1998 Trading £m | 31st March 1998 Non-trading £m | 31st March 1997 Trading £m | 31st March 1997 Non-trading £m |
|---|---|---|---|---|
| Interest rate | **76,865** | **13,095** | 88,038 | 9,467 |
| Foreign exchange | **95,963** | **1,486** | 97,797 | 2,238 |
| Equity and commodity | **222** | **566** | 120 | 367 |

The non-trading positions included in the above table incorporate the components of the Group's internal hedging programme that transfers risks to the trading portfolios in the Group or to external third parties in the derivatives markets.

### Net replacement costs

| Contract types | 31st March 1998 Trading £m | 31st March 1998 Non-trading £m | 31st March 1997 Trading £m | 31st March 1997 Non-trading £m |
|---|---|---|---|---|
| Interest rate | **414** | **30** | 356 | 69 |
| Foreign exchange | **1,428** | **3** | 2,054 | 13 |
| Equity and commodity | **20** | **19** | 4 | 12 |

The net replacement costs shown in the above table represent the gross positive fair values, without giving effect to offsetting positions with the same counterparty.

### Market Risk

The Group uses a variety of techniques to measure the risk of loss arising from adverse movements in the level of volatility of market prices. These include value at risk methodology (VAR) for quantifying exposure expressed in pounds sterling. The following table shows details of VAR analysed into market risk related (including trading) and trading activities:

| | As at 31st March 1998 £m | As at 31st March 1997 £m | Average for the half-year 31st March 1998 £m | Average for the half-year 31st March 1997 £m |
|---|---|---|---|---|
| Market risk related | **2.5** | 1.8 | **2.4** | 2.2 |
| Trading | **1.2** | 0.8 | **1.1** | 1.2 |

## Other information

| | 31st March 1998 | 31st March 1997 | 30th September 1997 |
|---|---|---|---|
| Weighted risk assets: | | | |
| on-balance sheet | **£43,106m** | £38,731m | £41,750m |
| off-balance sheet | **£4,768m** | £3,706m | £4,066m |
| | **£47,874m** | £42,437m | £45,816m |
| Risk adjusted capital ratio: | | | |
| tier 1 | **7.2%** | 6.5% | 6.8% |
| total | **11.5%** | 11.0% | 11.6% |
| Net asset value per ordinary share | **253p** | 243p | 268p |
| Share price | **928p** | 537p | 690p |
| Employees at period end: | | | |
| UK Bank | **19,580** | 18,470 | 19,060 |
| Investor Services | **1,190** | 1,320 | 2,020 |
| Direct Line Insurance | **3,250** | 2,860 | 3,020 |
| New Retail Financial Services Businesses | **2,280** | 960 | 1,840 |
| Citizens | **5,040** | 4,610 | 4,910 |
| Central | **50** | 50 | 50 |
| **Total employees** | **31,390** | 28,270 | 30,900 |
| US$/£ rate of exchange: | | | |
| spot | **$1.6755** | $1.6299 | $1.6148 |
| average | **$1.6533** | $1.6340 | $1.6327 |