# Interview transcript

21 May 2015

## ANNUAL RESULTS PRESENTATION

**Stephen Koseff**
Good morning everybody in London and Johannesburg. Welcome to our annual results presentation. Is everyone hooked up? I think the past year we focussed largely on the execution of our strategy. As you would be aware about 18 months ago we took some hard strategic decisions to reshape our Specialist Bank. And as a consequence we said we are going to sell our Australian bank, our UK mortgage business and our Irish mortgage business. In addition we also took a decision to sell our trust business. All these transactions have been executed and I think this is the start of the ability to really focus on building our Specialist Bank in the form that we want to.

We also accelerated the run-down of our legacy portfolio in the UK. So we are now focused on growing our core Specialist Bank and our core franchises within Specialist Bank. At the same time we have continued to invest in building our Asset Management business and our Wealth & Investment business.

I think I'm going to concentrate in these results on the ongoing business as opposed to legacy, but it is important that I just articulate what happened in the legacy business. The statutory business we grew our operating profit by 9.4%, and that is a growth of adjusted earnings per share of 4% to 39.4p. And our dividend we increased by 5% to 20p from 19p for the year.

There was an effect of the strategic disposals and we've broken it down on the slide for you. We made a profit on the sale before taxation of £25 million but there was a deconsolidation effect on portfolios relating to the sale assets which was £53 million. There was goodwill that we had to write off of £64 million, so we never recovered our goodwill. And a tax expense that relates mainly to the gain on the sale of the business in Australia. So overall there would have been an accounting charge of £113 million which would have affected the statutory results.

If I now move on to the ongoing business, I think would regard the operating environment that we've just come through as a favourable operating environment. The Sterling was strong on average against all currencies and that would have had an effect on the reported earnings. But we had good equity markets across the board and we had good levels of activity across the board. So it would be a favourable operating environment. We've come out of a period where the operating environment had been particularly tough, but we now do see some momentum. It is different in different geographies, but still it was favourable.

I think it is important to re-emphasise that our business model is diverse. Our geographic diversity is a combination of developing world and developed world. At the moment if you look at the ongoing business, UK and other, the rest of the world represents 40% of our operating profit, South Africa 60%. And I think about ten years ago it was balanced, but obviously South Africa then went through a financial crisis. If we look at mix of business, again our Wealth & Investment business combined with



our Asset Management business generated just under 40% of operating profit on an ongoing basis with the Specialist Bank about 60%.

If we look at our key earnings drivers you see good growth in third-party funds under management, both our Wealth & Investment business and our Asset Management business. That now stands at £124.1 billion. And we had very good inflows in both those businesses.

If you look at our banking key drivers we continue to build our customer accounts. At the same time we saw very good growth in our loans and advances to customers if we stripped out our sales businesses and just concentrated on our core businesses both in South Africa and the UK where we've had a fair amount of lending activity. I think this did support growth in operating income, and again I think operating income in the ongoing businesses grew by about 5.8%.

Impairments continued their downward trend. Clearly this graph shows both legacy and core. And I think it is important to note that it is down 61% since the peak in 2012. The legacy as we expect has continued to come down. Impairments in the core business are probably at a low sort of level. But we do expect that impairment number in legacy to continue to come down as we run the legacy book out.

If we look at our [unclear] our fixed costs were marginally up. Our operating income grew 5.5%. Our operating costs grew 4.4%. And if you look at the various business units you see in Asset Management we grew costs by 6.2%. That is to support a growing platform. Operating income is up slightly less than that at 5.3%. But we are building capacity and building our capability in this business.

If you look at the Wealth & Investment business our operating income grew faster than our operating costs, 8.7% versus 5.6%. And you see the overall operating margin has improved to 25%. So we are back to where we were before we bought Evolution. It took us a couple of years to integrate Evolution and get the excess cost out. We still have two businesses within the Wealth business that are break even. That is our Irish Wealth business and our Swiss business. But over time we hope to build scale in those businesses and generate a decent operating margin.

And then the cost to income ratio in the Specialist Bank ongoing business has declined from 65% to 61% as revenue grew faster than cost. In that business our head count was down 152 people. That is mainly as a consequence of the sales and the reshaping. That would result in what we would regard as a good performance for the overall group, a 15% increase in operating profit, a 10.2% increase in attributable earnings and in EPS. Shareholders' equity is flat because of the sales and the exchange rate movement. And we saw good growth in ongoing customer deposits, and as I said to you very good growth in core loans and advances at 15.4%.

For those of you in South Africa if you look at the Rand earnings operating profit would have been up 26.8%, adjusted earnings and EPS up 21.8%. So again a very good result if you look at it in Rand terms.

We have made progress on our financial targets. If we look at the statutory ROE went up from 10% to 10.6%, but if you look at the ongoing business the ROE went up from 13.1% to 13.8%. And I think one still has to bear in mind one is in a zero inflation, zero interest rate environment in the developed world. Our EPS, as I mentioned, grew by 10% which is probably about 10% above UK inflation. And our cost to income ratio is down to 66.5% from 67.5% on an ongoing basis. Clearly the change in mix of the business over the last five years where the higher cost to income ratio businesses like Asset

Management and Wealth Management do have an effect on this ratio. But nevertheless we still have a target of getting ourselves to below 65%. And dividend cover was fine.

Capital, we have a stable capital position. Obviously the regulators have continued to increase capital requirements which get phased in over many years. That is why we give you the fully-loaded numbers. And we have a very good leverage ratio. So I think you have to look at capital and leverage together. You can't look at one or the other. Many banks have very high core equity ratios of 18% but then they've got a leverage ratio of 4%. So you've got to look at these two together. We are reasonably comfortable with our capital position.

I think if we look at the individual businesses, Asset Management. Remember this business we started out in South Africa in the early 90s. We had R200 million under management. Today we manage £77.5 billion. The bigger portion of this business now exists in our global business as opposed to our South African business. Most of our earnings are now coming out of our global business. And we had very strong inflows in our global business.

We had net inflows of about £3.1 billion, which I think was a good achievement under circumstances. And I think we had a record operating profit of £149 million. So we believe that this business is in good shape. It is well diversified. It has a strong culture and excellent people. We don't really look at ROE in this business. It has been built from scratch, so it is very high. But our operating margin has lived at between 34% and 35% over many years.

I think I mentioned net inflows. We have maintained net inflows for quite a long period of time. Our average income as a percentage of funds under management is around 0.6%. And our operating margin, as I mentioned, has remained – depending on whether you get performance fees or not. In the year we didn't have much by way of performance fees – at about that 34% to 35% mark. The business gets good recognition globally as a quality organisation, and we are quite positive on the ability to grow and develop this business.

If we look at our Wealth & Investment business it is probably one of the star performers in our group in this particular period. We did benefit from higher funds under management. Operating profit is up 19.2%. Operating profit is now 25%, as I mentioned to you earlier. And funds under management from £40.8 billion to £46.1 billion are up 13%. So overall a very good performance, very good net inflows of £2.7 billion. In the UK we've now seen the operating margin go from 20.1% to 22.7%. We do believe there is still room for further improvement a we build scale in some of the businesses. And I think we have continued to benefit from investment in our platforms and we have hired additional investment managers, which is working out well.

Our Rand earnings were up just under 21%. We have successfully been leveraging off our global investment platform. And we also had strong benefit from the integrated approach towards private clients. We have launched a product called One Place which integrates banking and investment through one channel, and that has really started to work exceptionally well.

So again operating margin you can see in March 2011 before we bought Evolution at a similar sort of number to where it is today, then it dropped off while we integrated. You can see the positive net inflows over the last three years growing every year. And we had an improvement in margin as we have actually reorganised and integrated.

If you look at the Specialist Bank we had very strong performance in the South African Specialist Bank, up 36.8% in Rand terms. Good performance all across the board. Notwithstanding the difficult environment in South Africa I think there was quite good activity across both our corporate and private client businesses. We also launched a number of new products in the private bank, broadening our client base and leveraging our global platform.

I think it is very important for us as an organisation to leverage the global platform and offer our private clients the ability to transact anywhere in the world. I think that is something we have successfully achieved. For many years we have been seen as the leading private bank in South Africa.  Our corporate business benefitted from a more focussed approach to servicing the corporate market and we had very good traction in that space.

In the UK we've seen very good growth in corporate fees, mostly being our corporate finance and corporate treasury fees. Our private bank as part of enhancing its offering we launched a number of products for the high-end market and our professional high-income market. And we have developed our online and digital platform. It is still early days a lot of work still will be done on that front.

I think these results were impacted by poor returns earned on our Hong Kong investment portfolio in this particular period which would have taken some of the shine off the results. But if you look, strong growth in loans, good growth in deposits, so there is positive momentum in this business. If you look at the mix of income you can see good growth in net interest income off the back of strong growth in loans and advances. We've had a positive endowment with interest rates picking up a bit in South Africa. And we've continued to get an improvement in the cost of funds in the UK.

If you look at fees and commissions we were the number one M&A advisor and sponsor both in deal flow and value in this year. It is the first time we have been number one in both. Normally we are number one in volume and number two or three in value. But this year we managed to be number one in both. In the UK we were number one in volume and number two in value in the mid-cap space. So I think both strong achievements if we compare where we were a couple of years back.

And then we see improved customer flow in the corporate market, and I've mentioned the fact that on investment income that would have been lower this year than last year as a consequence of the poor performance of the Hong Kong portfolio.

So again we are seeing progress on the cost to income ratio which hopefully will continue to decline. Long term we said… We are below 50% in South Africa but still in the 70s in the UK. Hopefully we can get ourselves in the long term to about 55%. That was a long-term target and it will take us some time to get there. We also need interest rates a bit higher to get there, but that doesn't look like it is going to happen anytime soon.

And then our credit loss ratio and our core loans, as I said earlier, are very low but clearly still elevated on the legacy stuff. So overall you can see the very strong growth in core loans and advances.

On the legacy we made great progress. A few years back it was for the overall group almost £7 billion. This excludes the legacy that we inherited when we bought Kensington. We have done strategic sales as you are aware. We have redemptions and settlements. We have obviously had write-offs, as you can see £83m million. We have transferred a portion of the legacy back to the ongoing business



because those loans have been remediated and they are now earning a reasonable return and the credit risk on them is very minimal.

We went through quite a detailed process to get to this point, and as a consequence the legacy now is down to £729 million. A few hundred million Pounds of that is non-performing. The rest is stuff that is performing but needs work. You can see the breakdown. There was net loss, no net income. We still had expenses. Those expenses will come down quite dramatically in this particular year. And we do believe that the impairments will come down off the back of this charge. But we are looking for opportunities to accelerate dealing with this so that it is a thing of the past. But it will take us an expected three to five years to get it completely clear.

If you look at our strategic priorities I think we've always said we will organically grow the Asset Management business. So we have never made acquisitions in this business. We have built it from scratch other than in 1998 when we bought our original UK platform. We have had eight consecutive years of positive net inflows and we've got a record operating profit. I think the momentum in the business is positive, and does remain strategically exposed to what goes on in emerging markets, but that would be regarded as a headwind.

And our asset managers are cautious on financial asset prices, but I think it is important for us to continue to maintain strong momentum and build our advisor business. We need to restore positive momentum flow into our African business. I think we got a lot more money globally than we got in Africa. In fact, we lost a bit of money in Africa. So overall we continue to invest in the long term.

If we look at our Wealth & Investment business, we have always tried to broaden the internationalisation of this business. We did originally build this business by acquisition and integration overlaid with organic growth over a long period of time. We are the largest wealth and investment business in South Africa and we are a leading private client investment manager in the UK. So we have significant presence in Europe and we try to grow and develop our brand internationally.

Servicing our clients is fundamental to this business. We do believe now it is more an organic story than an acquisition story as we have good momentum, and we are still looking to add stuff in different jurisdictions or look for opportunities to do that to leverage off our platform in Guernsey and Ireland. So our key priority hopefully by the end of this calendar year we will launch our Investec click and invest service which is an adjunct to our face-to-face service. And we believe we have built a very resilient business model with a high service ethic, and hopefully we can continue to grow and develop like you've seen over the past while.

Looking at the Specialist Bank our key focus over the last two years was to simplify and to grow. I think the strategic sales has simplified. It is a much more simple business to run. And now it is a question of trying to drive growth. You have seen some of that come through this year with strong growth in loans and advances. Obviously that has to be managed, but we are seeing very good demand from our client base.

If we look at the South African business we've been a leading private bank for many years. We have been a leading corporate advisory house over many years. We have a very highly-regarded corporate and institutional bank and we've got a leading property business which we have built over many years. So overall we think that we are very well positioned and we've had very strong growth in this particular



year. It will be hard to sustain that kind of growth rate, 36%. I don't think anyone would expect us to sustain that kind of growth rate.

But it is a very good business. We have built a resilient business model. Our growth drive is organic across the spectrum of our products. And we are in a very good space with our clients. So we need to continue to perpetuate our position it the corporate and institutional market, and there is still the opportunity for growth in sub-Saharan Africa through our African platform which is developing nicely.

If we look at the UK I think we are the 12th largest bank in the UK. We have a recognised brand and we are rapidly growing our client base. We believe that we are in a favourable environment with good levels of activity, which we have seen over the last year, which hopefully will continue to support growth momentum in our corporate and specialist businesses. And we are building traction in our private bank with the launch of a number of different products that position us quite well to grow and develop this business.

So we continue to invest in infrastructure. There is an investment story ta king place here because we believe that medium term we can really have a strong positioning in that market if we are successful in rolling out our products and services. So we are overall trying to build our client franchise businesses. We are a group that believes in relationships, that builds on relationships over many years. And we believe that that works for us in the long term. And that is what we will continue to focus on doing.

We also have always tried to build more capital-light business. Capital is very onerous, particularly you earn a zero on your capital if you leave it in the bank, or in some countries negative. So you have to build capital-light businesses. If you look at this slide you will see that over many years we have seen strong growth in our capital-light businesses. Obviously we have been flat in net interest income and investment income. We have stripped out legacy here, so that obviously will change the picture slightly. But overall we do believe that capital-light forms an important part of what we do. There is room for us to grow our capital-intensive businesses as we go forward, but we need to be mindful of the balance between the two.

Then we continue to focus on rolling out our digital strategy. We launched One Place in South Africa in this past year and that has been very successful. We launched online banking and a whole host of products in the UK. And as I said we are going to be launching click and invest in our Wealth & Investment business in the UK. We are actually are ready to launch it in South Africa. It is up and running and on time. So overall we have continued to build on the digital channel alongside our physical channel or our telephonic channel. And we think that that works well for us as an organisation.

For us our priority looking forward is that we need to focus on growth. We need to maintain momentum in the Asset Management business, focussing on investment performance, because that is about long-term performance. They want to enable their clients, who are at the end of the day pensioners, to retire with dignity. We continue to build the wealth business both internationally and thought the Wealth & Investment business both internationally and through the digital channel. And we are seeking to grow our Specialist Bank businesses in both our core markets. And we want to see continual progress on our digitisation strategy.

That is really what we are trying to achieve now. It is not about reshaping. It is not about acquisitions. It is about growing the business organically. As we come to the end of the story we believe in summary we have successfully executed our strategic initiatives. I think we are a much simpler group for us to manage and to run. And now our focus is operational and growing and developing, and ultimately hopefully we will achieve the right outcome for our clients, our stakeholders and acceptable returns to shareholders.

If we look at this together with opportunities in our two principal markets, as we said in the UK it looks like the economy is in a good space and there is a lot of activity. The South African economy is in a different space and there is intensified regulatory landscape, but these are things that are part of the game and we have to deal with it and have to manage it. But we are positive on our ability to take advantage of opportunities. So that is our story. I'm ready for questions. You're always first out of the block, James. Which one? You or Aaron first?

**James**
I will pass to Aaron. Three if I may. Firstly, a 15% growth in the bank is very good. Could you comment on the outlook for volumes in 2016 and also the margin that you're achieving on flow assets versus stock assets?

**Stephen Koseff**
There is momentum at the moment. I don't know where life ends up. It depends on how the world feels about itself. But we have got good momentum both in this part of the world and down south on the banking side. I think margins have come in slightly so there is always competitive pressure as people get their act together. But still reasonable, so we can still make a living. I don't know what your other question was. You were asking flow versus stock.

**James**
The margin gain on new loans that you're writing is slightly tighter than what you've already got.

**Stephen Koseff**
But the cost of money is also coming off. So on balance we're okay.

**James**
Broadly flat. Is that the guidance?

**Stephen Koseff**
Yes.

**James**
Okay. Secondly, on the Asset Management business could you comment on the flow performance over the last year and the outlook for flows? Obviously flows were pretty good in the year you've just passed.

**Stephen Koseff**
I think I can show it to Hendrik because he is sitting here in the room. He will probably beat you. Maybe Hendrik, do you want to answer that question? [Background chat].

**Hendrik du Toit**
The outlook for flows probably is quite similar to last year. It is always difficult when you budget. The sales guys get optimistic and they forget about the back door. Just remember if you compare us with our peer group we are just over half emerging market business. If you look at Ashmore and Aberdeen

kind of experience versus the Henderson experience which is very positive as a developed market business, we are somewhere in the middle there. So I would not get excited either way, up or down from that target. That's reasonable. What we achieved last year is probably what we hope to achieve. And who knows where markets are. If they get very rough of course the flow is lower. If performance is good across the board and competitive, there are one or two areas. The one particular area in our African range has not done well enough last year and those performances need to turn, and will not deliver the kind of flows you require in the coming 12 months because you first half to turn the performance and become competitive. But I'm quite happy to see that that is underway. But generally competitive performance particularly on the global equity side. In fact our problem is the opposite. It is capacity constraints.

**James**
Finally on the click and invest product, what is your competitive advantage and what sort of demographic are you targeting?

**Stephen Koseff**
Look, everything is competitive. We have the investment managing franchise so we have the skills to manage the money. We have a brand that is well known. We spent a lot of money in building the brand so it is well known. It is not only that channel. It is how you align that channel with the client service centre, which is a very effective telephone relationship. If you have a problem, phone them and see how quickly they sort out your problem. With the physical. It's alignment of the three together that is important. And yes, you're saying there are a lot of very effective players out there. I think the fact is that we're coming at you with the ability for you to transact in which way you choose at any point in time. So it is a high tech high touch is our differentiation as opposed to a single product being either high tech or high touch. And we have seen that work quite well for us in South Africa. But we will see how it goes. Everything is competitive. Aaron and then I must go to South Africa.

**Aaron**
Thank you. I had two questions. One was you're seeing quite good loan growth in South Africa. In the UK I was just wondering what the products you are looking at selling are. Is it largely going to be private bank to get the loan growth up? It is almost a natural hedge for the EPS into the forward years.

**Stephen Koseff**
Look, I think that we are not a product shop. We are a client shop. We provide services to clients. And we are seeing loan demand across the board, and we will continue to try and do what we need to do for our clients. This year you see loan demand across the board both in the corporate space, the asset finance space, the specialist corporate areas and in the private clients space. So it is whatever products client require. There are mortgages. There are loans into the corporate market. We do a lot of what we call fund finance. We finance private equity firms against the core of capital that they have raised. So we are obviously quite big in arranging aircraft finance. There is a whole host of areas. Project finance we've been in for decades. And there is reasonable demand across the spectrum.

**Aaron**
Thank you. And the second one would be on the dividend policy. I was just wondering, when I look at core tier one progression you've got a little bit of headwinds this year from the sale of some businesses, but as you look to the years ahead should we be thinking of progressive on EPS, or what is the accumulation you can get on core tier one as you go through, and what level are you running at? Will you still be running at 10% as you go through?



**Stephen Koseff**
Our target is to sustain about 10% against our leverage ratio of about 6%. I think our dividend policy is progressive. If our [unclear] grow our dividend will grow. And obviously the question is how quick we write assets, because that has to be a manageable number. You can’t grow too fast. You’ve got to grow at a rate that you can create capital at. We are for6tunate that we have some businesses that grow without using capital, our Wealth & Investment business and our Asset Management business. So they do support faster growth in the bank. If the bank was on a stand-alone basis we would have to be much more cautious on dividends.

**Aaron**
Thank you.

**Stephen Koseff**
Okay, we are going to South Africa. Steen, can you hear me?

**Steen [?]**
Stephen, I’m sure there will be some questions here. If people can just introduce themselves so Stephen knows who you are talking to. I’m sure before we go to any of those questions, Ruby has hunted us down – he is looking younger every year – and would like to ask a question, Stephen.

**Ruby Rosenberg**
Good morning to you, Mr Koseff. You’re looking well.

**Stephen Koseff**
Thank you, Ruby.

**Ruby Rosenberg**
Speaking of impairments, Mr Koseff, you stated that to work through what remains will take three to five years, which suggests strongly that you already have an indication of how much in the value still has to be written down. If that is the case, could you tell us what that value is?

**Stephen Koseff**
As I said, I do believe that impairments next year on the legacy book will be a lot lower than they were this year, but there will still be impairments coming through as we work the stuff out.

**Ruby Rosenberg**
What needs to be worked out? After all you’ve been writing down now for six years, so you know which assets need to be impaired.

**Stephen Koseff**
It takes ten years to get through a financial crisis. Move the ten to 15 I think. It takes a long time to clear stuff. We’ve got to be careful. We don’t dump it. It’s not worth dumping. We can work it out.

**Ruby Rosenberg**
Right. I’m somewhat hesitant to raise the next issue, but I’m a little bit puzzled about the use of the word principal in the very last paragraph of your outlook slide, the last slide. May I ask if you spelt principal correctly?



**Stephen Koseff**
I will ask my Chairman of my Audit Committee.

**Ruby Rosenberg**
And finally, whilst you are in London is there a chance of you getting some rugby tickets for me?

**Stephen Koseff**
I will bribe you, Ruby. At a price you can get anything.

**Sean Ashton**
Stephen, thanks. It's Sean Ashton from Anchor Capital. Just a bit more colour if you can on the Hong Kong extent of losses. There was some of it in the first half. What you would regard as once-off impairments that you took in your Hong Kong portfolio and the effect of that on the Specialist Bank ROE. And then a bit of guidance as to whether there is anything further lurking from an impairment perspective in that portfolio that would be out of the ordinary.

**Stephen Koseff**
I think the Hong Kong portfolio has been market related share prices on the listed stuff. So that's where the hit was. I haven't got the exact number. You can ask Ursula offline for the exact number. It would have had quite a big impact on the results, but you've got to remember that we're looking at a portfolio. There are a couple of shares that went down, and there are other areas where the investments performed particularly well. So looking at the overall portfolio our investment was down 20% on the previous year as an overall portfolio, but the hit was in the Hong Kong business. I can't predict [unclear]. It depends on the rest. Markets can do anything. What else did you ask? Is that it?

**Sean Ashton**
Yes that was it, thank you.

**Stephen Koseff**
More questions.

**Male speaker**
I think that is it, Stephen.

**Stephen Koseff**
Okay. Thanks to everybody for attending. I know that in South Africa and London there is something to eat afterwards. You can stay as long as you wish. So thank you again and we will see you sometime in the next few months. Cheers.

END OF TRANSCRIPT