Investec Results
2010-03-18

Stephen Koseff

Okay, good morning everybody both in Johannesburg and London and on Summit. Welcome to our pre-close briefing. I think we talk to you about six times a year formally, so I guess that you should be pretty up to date by the end of these briefings with where we are in life.

If I move straight on to it I think overall we continue to get support from our recurring revenue base and our operational diversity. We are still in I would guess a fairly tough space. I mean economies have improved quite significantly from where they were the last time we spoke, but these little bombs go off every now and then and one still has to operate with a fair amount of caution. But as we said last time, we continually try to push our operation more onto the front foot, and it takes time for that to happen and it takes time for the world to actually get on the front foot because people I think had cardiac arrest and they're still on life support. But we are coming off life support as a world and we are starting to see signs of movement.

I think overall we expect our operating profit to be marginally higher than our prior year. We had a very strong relative performance from the UK and Australia. They are well ahead of the prior year. South Africa, being behind the curve – and I think you've seen that with all South African bank results, mainly as a result of very high impairment and low levels of activity – has traded ahead of the first half of the financial year but is expected to post a weaker overall performance. As you've seen most South African banks have been in that kind of space.

On our balance sheet side we have seen growth in core loans and advances, but not really growth because if you do it in flat exchange rate only Australia has really grown. The rest have been flat. So 10% is not really a true reflection. But we have had very strong growth in customer deposits in neutral currency, home currency and obviously in Sterling, and that's up by 37% over the year to £20 million.

And then a very strong feature of this year for us has been the very strong growth in third party funds under management, which I will talk about further on, which has seen a growth of about 42% to £69.4 billion up to the end of Feb. That is obviously a currency effect and a market effect, but we have also seen strong in-flows in our asset management business. So we have continued to focus again on managing risk, building capital and preserving liquidity, and I think that will come through quite strongly in this.

If we look at our balance sheet, liquidity has built up to very high levels. We now have a £8.8 billion of surplus cash. Clearly there is a lot of change in the liquidity regime coming to banks generally, and we have to prepare for this, and therefore we have continued to try and diversify our deposit base and continue to push our retail funding strategies. So we are probably getting to a point where we have to modify some of that because we're sitting with a lot of cash and too much cash does burn holes in one's pocket. But clearly we have to understand what liquidity regimes are. We understand them in some jurisdictions but not all jurisdictions yet. But I think we are well placed to manage with them.

I think if you look at our capital ratios we are within our targets that we set in November 2008. We expect the PLC to be around about 15.5 and 11, maybe slightly better. And Investec Ltd would be around about 15.1 and 11.5, which has seen a continuous build-up as we're not creating risk weighted assets at the moment. So comfortable on a capital perspective.

I think clearly the negative from a cycle like this is that you still have to deal with problem loans, and you don't just get rid of them straight away. It takes time to work these things off the balance sheet. We have seen still a rise in levels of default, and that's only because we can't get stuff that's on default dealt with quick enough, but at a much slower pace. So as we said last time, their life is turning and that our credit loss ratio is exactly the guidance we gave you before, around 1.1%. And we do think that that is also peaking or has peaked, providing life continues to go on the path that it's going. So we do feel a lot better about that but it's still a tough space.

We have very low leverage ratios. Loans to capital are 5.7. Loans to customer deposits I think is a strong feature of what we have done over the last year or two, 83%. That means our loans are covered by customer deposits almost 1.2 times. Gearing, 12.3. A lot of the extra gearing that you see from September till now, 0.2, comes from the extra cash that we have on the balance sheet, so we're not giving you a net gearing ratio, we're giving you a growth gearing ratio. And if we exclude securitised assets, 11.5, which is similar to where it was before.

If we look at our divisions overall I think interest income has been impacted by lower average interest rates. It's quite a material number because you take your free capital times about 5%. That comes out at about £100 million over the year. So that has had a big impact on the results. And obviously one expects lower interest rates to remain in place for a year or two but then start to normalise in time. We have still had lower levels of activity in some of our areas. We're seeing a rise in levels of activity in others. But still that would have resulted overall in a decline in fees and commissions receivable.

Clearly on the trading side is where we've had a lot of opportunity as a consequence of dislocated credit markets, and therefore we were able to bolster revenue from trading in this period. And then recurring income as a percentage of operating income is about 61%. It was higher last year, but 60% to 65% is probably your norm.

Expenses are flat in home currency in core geographies, but again due to the weakening of Sterling will reflect an increase over the year. So still fairly tightly managed.

If we look at some of the divisions, Private Banking, I mean they're obviously at the forefront of the issues around impairment and activity levels, and therefore they will be significantly lower than the previous year, but I think an improvement on the first half of this financial year. They have continued their retail deposit raising initiatives and that continues to be very successful. You can see that loans are up about 13% in home currency. As I said to you, that's primarily Australia. Deposits are up 42%. In any currency it's up a lot, and that's from the retail deposit strategy. And funds under advice were up 20% which is in essence a recovery of markets. So overall this is a division which has taken the brunt of the credit cycle in the credit crunch.

If we look at Private Client Portfolio Management and Stockbroking you can see its funds under management are up 33% in Sterling. I haven't worked out the Rand number, but they are also up a lot in Rand. And they're performing in line with the first half, just to give you guidance. And I think there has been a fair amount of recovery. This business didn't really take too much heat because it's got quite a diversified revenue stream.

Then Capital Markets have had good levels of activity across the board, mainly in the advising instruction business. The trading and balance sheet management activities have clearly been impacted by the lower rate environment and the climbing volatility, but there have been good opportunities for us in some of our areas, the expertise in structured credit and alternate energy. We are seeing this business with a fair amount of activity. Still demand for credit very flat, so very little loan growth, in fact, negative in terms of home currency. But overall good activity on the ground, and they're performing ahead of the first half of this year.

And then Kensington, you've seen house prices rise actually as opposed to fall, so they are performing slightly ahead of the previous year. The overall book is down by £500 million. You must remember that the bulk of the book is a running down book. We have some new products in the prime mortgage space that we are launching, but it's still at very low volume level. And we do believe that securitisation is starting to come back. We have seen some securitisation take place, but at very moderate levels. Arrears have increased marginally as the book becomes more seasoned, but a lot of our repossessions we've actually managed to clear in the cycle. I think at least half of them. LTVs have also improved as a consequence of house price rises from about 83% to 78%, so I think quite a stable position.

If we look at the Investment Bank we have seen activity levels start to improve, not yet reflected in earnings. Our principle investments in South Africa have done okay and performed reasonably well, but will be behind the first half of this trading period. And the UK principle investment does show a significant improvement over the previous year, but it will still make a small loss as a consequence of the consolidation of certain of its investments which are still loss-making.

So if we move to Asset Management I think Asset Management has done particularly well. They were unaffected by the crisis and therefore there has been a lot of support for their products in the marketplace. They've had inflows of £4.5 billion and I think there is still money coming in, so maybe we will end the season at £5 billion for the year. That was on opening assets under management of about £28 billion, and then with market and currency their funds under management are up 50% on the previous year, which I think is a significant jump. And it might be even higher depending on how life pans out over the next couple of weeks. And we're also seeing that as a consequence underlying performance will be much stronger than the first half. So really done exceptionally well, and I think we now have record assets under management. If you look at this chart you can see the last time we peaked at about £32 - 33 billion. Now we're at £44 billion and rising.

Property, we have a good performance from our investment portfolio. There are lots of opportunities for us to enhance value within the portfolio and we're still concentrating on trying to build property funds across all geographies, but that is still work in progress. So you'd see a fairly good performance from that unit this year.

If we look at Central Funding South Africa will be behind the first half, mainly due to interest rates on average being lower. That's obviously on our free cash. And I think interest rates are probably 2% lower on average for first half, second half. In the UK we will have a good performance with the debt repurchase programme, but that the performance of the first half is not repeated in the second half. And our central costs are in line with the prior year but marginally ahead of the first half of this year.

So on a tax rate we expect it to be around 21% for the year, and we expect to have about 686 million weighted shares in issue for you to be able to work out what you think earnings per share would be. That's the expected weighted number of shares in issue for the year.

So I think in conclusion – this is very brief but there is not much more to say – we have remained focussed on managing our balance sheet, but we are trying to move the organisation onto the front foot. You can't wave a magic wand and everyone running out there and doing deals because uptake is very slow and the economies have been through hell. So this will take time to get the momentum back, but we are feeling that the momentum is coming back.

I think that our steady and resilient performance throughout the crisis, coupled with our strong ongoing brand investment, growth in assets under management and our sound balance sheet, we believe puts us in quite a good position in this environment to take advantage of opportunities. And we're seeing every day things are falling out of firms or firms want to sell little pieces. Not that we have been able to do anything yet, because I don't think that it is something that you rush out and do, but there are opportunities out there and we are convinced that we are going to be able to capitalise on some of them going forward. Obviously one will be very measured and recognise the impact on whatever one does.

So I think we're quite happy. We think that we're in a good space and life will carry on. So thanks very much for attending and we now can take questions. I will start off in South Africa. Where's Rubie? You're in the corner, Rubie.

Steve, two questions I might ask. First of all in terms of principle trading.

Ja.

Male Speaker

Have you written back into income statements with maybe markets having consolidated? If so, could you give us some sort of idea in terms of the [unclear] in there or the type of investments that are being held, the ones that have performed better. Second Question, in terms of additional growth in your lending book there, is it now that we're seeing a lesser risk [unclear] there, things have improved, why are we seeing at the same time clients not wanting to borrow? I think in your previous presentation you mentioned that the demand for funding wasn't there. What has sort of changed in the mean time?

Stephen Koseff

Nothing. Only in Australia there's a bit of demand for credit. I think in the rest of the world where we operate there is very little demand for credit. I think if you look at private sector credit extension in South Africa as an example it's still negative. So that means that banks are not lending. And I will reiterate, it's not because they don't want to lend. They do want to lend. But the people who want to borrow you can't lend to, and the people who you can lend to don't want to borrow at the moment. So you're in that kind of phase in life. If economies continue to improve that will start to change. We are seeing a little bit of an uptick in potential activity, but it's not dramatic at the moment. So that growth as I said to you in neutral currency is flat. We write a lot of new business, but we have a lot of redemptions so things stay flat at the moment. And we'll have to see. We're expecting to see it increase next year, but time will tell. But I'm in a trading update on last year, not the future, at the moment. That we'll talk to you about in May.

On your second Question, again I'm on a trading update on what's happened in the past, not the future. But I would say that the bulk of the trading is realised trading. I mean there are always marks either left or right, but the bulk of it is from realised activity. That's not just revaluing investments. That would be a fraction of that number.

Male Speaker

Stephen, well done with regards to Investec Asset Management's increase in AUN. I see the biggest contributor, certainly from the growth perspective, is the UK international from the retail side. My Question is has this been done or achieved with low STs [?] or how have you been able to attract this massive growth from a retail perspective?

Stephen Koseff

I think that you have seen a lot of brand building over the last while. I think that Investec has been seen as one of those banks that have managed to come through a very difficult period without support from anybody, and I think that a strong brand is attributed to that. So I think there has been a lot of brand building. Are you talking about deposits or are you talking about funds under management, because they're very different things? No, I think it's about the brand. We've spent years building the brand. We have good performance in our asset management products. We're seen as a safe brand that people can put their money with and invest with. We had no drama in the crisis, nothing blew up, and therefore we have a lot of traction

Speaker	Narrative
	in our products. They are global products. We have distribution all over the world. When you guys were shouting at us in South Africa five years ago when is asset management in the UK going to come right we said these things take a long time to build. And you've seen the benefits of building over a long period of time by Hendrick and his team.
	Thank you.
	I think Rubie is before you, or Louis. Louis, you are next after Rubie.
Rubie	Thanks, Mr Koseff. Mr Koseff, I refer to your point that let's call it the subdued performance in South Africa is mainly due to lower levels of interest rates.
Stephen Koseff	No, that's part of the point.
	That's part of it. Fine. I've got a note, mainly due to…
	No, high impairments, lower levels of interest rates and lower levels of activity.
	Fair enough. However, I'm going to slide 28 headed Loans and Advances for South Africa. And in the last 11 months since 31st March the level has gone up enormously, which is very good. It went from [£]6.2 billion to [£]7.3 billion. Now, has that not taken up the slack in any way?
	That's currency, Rubie.
	Is it the currency that…
Stephen Koseff	The Rand depreciated. Look at the neutral currency number and you will see it has gone nowhere. Your UK and Europe number has gone nowhere, and the Rand number also gone nowhere. It's flat. And Australia has gone up 7% in home currency.
Rubie	Okay, so whatever additional performance you got from this was negated by the currency movements. Is that correct?
Stephen Koseff	No. In home currency the number didn't grow. So whatever new business we wrote we had redemptions on the other side.
Rubie	Okay. Thank you.
Stephen Koseff	So that says low levels of activity because we're accustomed to growing our books.
Louis	Thank you, first of all, to keep us informed like you always do. It's nice to be investing in Investec and we're proud to be shareholders. But you've already touched it, you know. It's an old story again. I mean everything is up 65%. You're building cash. You know my grandchildren's shoes have been worn through now.

Stephen Koseff You're back on the dividend, Louis?

Louis Yes. I hope you remember this in May.

I'll remember it.

Thank you.

Stephen Koseff More questions in South Africa? They will think I plant Ronnie, Rubie and Louis in the audience. No more questions? Okay, can we go to London? Any questions from London? Benji?

Rubie Ja, [unclear] here. Don't panic.

Good morning and thank you. I'd like to ask about the margin. Clearly the build-up in liquidity is great from a security perspective for the bank, and you alluded to the fact that maybe you won't be trying to grow deposits so rapidly ahead of the loans to customers. Within that on the liability side of the balance sheet would you be looking to reduce inflows by changing the prices and therefore moving the margin? And on the asset side of the balance sheet you mentioned that in local currency in the two biggest markets there was not much movement in the asset side of the balance sheet, the loans to customers. There was some replacement in there. Is it fair to assume that the replaced assets come at either a higher margin or a lower credit risk?

Stephen Koseff Ja, I think to answer the second part first I think both points are valid. We are replacing assets at a higher margin and at a significantly lower credit risk. On the first point I think that clearly we've had a lot of inflow and we're getting to a point now where we have to chuck some of our product set and re-price it because we can't just keep on having this kind of build-up. We will have 50% of our balance sheet in cash just now. So I mean obviously we are going to start tweaking because we have seen better pricing on the asset side of the portfolio but it is starting to burn us. I hope that answers your question.

Neil Walsh Neil Walsh from Macquarie. Stephen, two questions. Firstly a technical one on the tax rate. What is driving the tax rate down? And the second aspect is in terms of the impairments it sounds like what is happening is a rebalancing. You're seeing some improvement in the UK and European business and some worsening in the South African business. Is that fair that that's what's happened so far?

Stephen Koseff I'll start with the second one first. Clearly South Africa went into the crisis later and therefore it's a newer phenomenon in South Africa, whereas the UK the prices started to collapse in August 2007. In South Africa it only started in October 2008 when you really felt the effects of the crisis. That's when the impairments started coming in. So I think you're seeing more provisions relatively speaking going through in South Africa, but I think on each side we're starting to see a stabilisation on defaults. But it does, as I

	said, take time to move the stuff off your default book, which is what we're in the process of trying to do. It will take on some stuff a couple of years. So that's on the second question. The first question I can't remember exactly. Just give me a hint again.
Benji	The tax rate. What is driving the tax rate down?
Stephen Koseff	We had some non-taxable revenue, basically dividends that we received. And we had some transactions that were not taxable that drove it down. I think it normalises back at about 24%. I don't think you've got to look at that as a permanent situation.
	Thank you. Just one follow-up on the bad debt question. The gross defaults that you've shown are up to March 2009. What would that look like for the 11 months for this year?
Stephen Koseff	We said in the statement still rising but at a flatter rate.
	Thanks.
	It's rising but starting to stabilise. But off March 2009 it's still rising, as you saw at September 2009. More questions.
Neil Walsh	It's me again unfortunately for you. Can I quickly ask where I left off on the margining, the overall movement in the margin guidance and how the margin moved in the second half of the year versus the first half? And secondly, what does the pipeline look like in the asset management business? Clearly £4.5 billion is very good, and you've alluded it could be £5 billion by the period end. But I'd appreciate for institutional mandates there is quite a long lag between getting it and the money actually arriving.
Stephen Koseff	That's why I gave you £4.5 billion to £5 billion because it reflects the pipeline. But there is a pipeline, and a good pipeline. I know the question; I just don't know the exact answer. I'm looking at you. I think it's slightly better the second half versus the first half. We're seeing in some of the geographies the margin actually normalise, the cost of money normalise and the margin normalise, particularly South Africa. I see Sam. Any more questions, Bernard?
Neil Walsh	Thanks. No more questions.
Stephen Koseff	Okay, that's it. Last chance in… have they gone already? Where have they gone? Last chance in South Africa before we close shop. No one? Thank you very much for attending.

END OF TRANSCRIPT