Interview transcript

14 March 2013

INVESTEC PRE-CLOSE BRIEFING

Stephen Koseff
Good morning everyone. Normally we only release our pre-close briefing when I start talking, but unfortunately we had trouble and it went out at 09:00 this morning so most of you know what I'm going to say. I can go pretty quickly. I think you're all aware that we expect our operating profit to be up between 20% and 23% in Pounds Sterling. We have continued to see good flows into our Asset Management and Wealth Management businesses and we expect both of those units to report results ahead of the prior year.

I think the South African Specialist Bank is expected to report a sound increase in operating profit in Rand. The Rand has been a big issue in this environment, the Rand against Pound Sterling, and that will be reflected in the results. They have seen good growth in revenue and we've contained costs at inflationary levels. The Australian Specialist Banking business has performed. Remember last year you were all very grumpy because we had large impairments. Well, the impairments have started to normalize, and so that would have given a big turnaround to those results this year. The UK Specialist Bank will report results marginally ahead of last year.

So as I've said, the Rand has been a big factor. The Rand depreciated by 13% in the period. When you look it at it today it is not looking so happy either, but we have factored that into our expectations. Revenue is between 3% and 4% higher than the prior year. That is after depreciation and leased assets. And recurring income will be approximately 67% of our total revenue.

Expenses are expected to increase by 3% to 4%. There are a number of acquisitions in these results that were not there last year. Most of them are fully integrated or in the process of being fully integrated. The large ones have been fully integrated. And we expect the cost to income ratio just within our group target. As a consequence of all that our adjusted EPS will be 14% to 17% higher than the prior year, and that would translate into 30% to 34% higher in Rand as a consequence of the weak Pound.

I think our core earnings drivers have seen some pretty good growth. Assets under management increased 13%, which is 18% on a neutral currency basis, to £110 billion. Customer accounts decreased 2% in Sterling but up 4% on a currency neutral basis. And loans and advances up 3%, and that would be 9% on a currency neutral basis. We are starting to see some activity on the lending side, but at the same time we are not trying to grow deposit growth.

On the funding and liquidity we remained reasonably liquid. We continue to diversify our funding sources. I think that is our main concentration. We have still had elevated cost of funds throughout the period, particularly in the UK and Australia. We have started to see the cost of funds come off quite substantially in the last couple of months as the global system gets more liquid, but that would not have

had any impact on these results because on average the cost of funds would still be elevated. But that does auger much better for next year.

Cash balances have remained strong and we have seen a slight increase in our advances to deposits ratio from the strategy of diversifying our funding sources and trying to reduce our overall level of surplus cash.

We have implemented Basel III in South Africa and Australia. It had moderate impact as the risk-weighted assets go up and some of the capital instruments that we have already start getting phased out at 10% per annum. So they are still within our capital target ranges, but they did have a moderate impact on Basel III. Not that much, probably 0.5% to our ratio. Our UK business still reports under Basel 2.5 because Basel III only comes in next year, and the capital ratios are expected to remain stable. And all ratios we expect to be within our target capital range.

Impairments did come down 22% compared to the prior year. They are still a bit elevated as a consequence of weak economic conditions in most of the geographies in which we operate. So it is taking longer to clear problems and to deal with problems. We expect our credit loss ratio to be between 0.83% and 0.88% against last year's 1.12% and September's 0.85%. So still not getting to our normalized level of around about between 0.6% and 0.7%, but at least quite a lot of improvement.

In Kensington the impairments are quite a lot lower than last year, but still higher than the first half. Again that is a consequence of weak economic conditions and final completion of our portfolio model as we mentioned last year. We had to realign it to best practice.

If we look at the individual divisions Asset Management continued to perform well across all of its investment capabilities. It had positive net inflows of £3.2 billion. And its financial performance will be a good few percent ahead of last year. It had a very strong recent run-up in funds under management, and that is obviously what has been happening in the markets of late as markets have gone up a lot since the back end of December when you started to see that great rotation from fixed income into equities. On a currency neutral basis funds under management are up 18%.

Our Wealth and Investment business is performing well ahead of last year, as we mentioned in November when we gave the trading update for September. The integration of Williams de Broë is fully complete. We did acquire NCD in Ireland and we are seeing good growth in their funds under management. We saw net inflows of 0.9 and overall you're seeing funds under management up 15% and on a currency neutral basis up 20%. During this particular year we are carrying the excess costs arising from the acquisition. This will disappear during the next financial year. So overall we are fairly comfortable with where this business is. I think we have done a good job of integrating the acquisition.

If we look at the Specialist Bank it is performing well ahead of last year but a little bit behind the first half. The key issue there is net interest margin. We have seen loan growth of 9%. We've seen improved margins in South Africa, but we did see elevated costs in the UK and Australia from the cost of retail deposits rising, in particular when the world started wobbling. It takes time for that to unwind. There is strong improvement on that front in the last few months, but it still is elevated during the period. And we have remained very liquid. So our net interest margin will be up in South Africa, down in the UK and up in Australia.

If we look at fees and commissions we see good private client transactional flow and professional finance activities. They are all performing quite well. We are seeing very good performance from our Agency and Advisory business. Our fees earned in the Corporate Banking space are expected to be lower than the prior year as we still wait for approvals on transactions by government etc. So activity levels have been lower mainly on the South African front. In South Africa we would see fees and commissions in the Specialist Bank down; in the UK they are up and in Australia they are up from the last year.

Our investment and trading income. We have seen a very strong performance from our property group and our unlisted investments portfolio. We are seeing lower earnings from our fixed income portfolio in the UK, but that has been partially offset by a good performance in our investment portfolios. And then we have seen lower customer flow activity as volatility has been exceptionally low. So in home currency you've seen investment trading income up in South Africa, down in the UK and up in Australia.

And then on the cost front, as I said earlier we've seen inflationary costs in the Specialist Bank in South Africa. We've seen costs in the Specialist Bank go down in the UK as a consequence of some of the rationalization that has been taking place. And we have seen costs in Australia go up as a consequence of an acquisition. We bought in May last year an asset finance business.

Our effective tax rate is still between 18% and 19%. We do expect it to start getting up to the early 20s within the next year or two. I think our number of shares in issue have remained the same at 856 million. That's what we expect the average to be, which was similar to September.

One thing that was not announced in the earlier announcement that has just gone out on SENS is that we have just entered into an agreement with key management of Investec Asset Management to sell a portion of our shareholding to them. It's a change in their basic compensation structures going forward. I think that we will sell a 15% stake to a consortium of management and they will have an option to acquire a further 5% stake over the next seven years at a maximum of 1% per year. The purchase price is £180 million in cash.

40 of the senior management employees who have been with the firm in excess of five years will participate. It will be funded through £90 million from equity provided by the individuals and £90 million of debt arrangement, of which £50 million will be provided by HSBC and £40 million will be provided by Investec. We have signed some of the agreements, but it is obviously subject to a whole host of regulatory approvals and finalization of all the documentation which we expect to happen by the end of July.

The background to the transaction is we see Investec Asset Management as a core business for Investec. I think management of Investec Asset Management has done a very good job in building this business into a global business. We've had a team of people that have been with us for a very long time. We believe that their experience is well recognized in the industry. One of the purposes of this deal is to ensure sustainability over the long term. These shares will rotate within the management structure of Investec Asset Management. They can't go out to third parties. And they can come back to the group for issue to new management as we grow ourselves out into the future and as life changes into the future.

We think that from an industry point of view our client base of global institutions, whether they are private banks, sovereign wealth funds, pension funds etc, have a need to see management very much closely linked to the organization. So we believe it does underpin long-term commitment and ensures that Asset Management are well placed to continue to deliver the value that they have over many years. As I said earlier, the stake will always be transferable to future generations, so it is not intended that the stake can go out to third parties.

We believe that the transaction is done on a very fair valuation for a minority stake and non-controlling interest. We have a fair and reasonable from a premier investment bank, Goldman Sachs, who have been the advisors to Investec on these transactions. So as I said, it is subject to certain conditions and various regulatory approvals and finalization of documentation which should take a couple of months still to implement. It is important that we let the market know about this now as we've got to a point where we are in definitive agreement.

I think if I conclude, we have continued to see good inflows into our Asset Management and Wealth Management businesses. We have seen good growth in loans in our Professional Finance, Asset Finance and Project Finance businesses. We believe that we are starting to see a big improvement in the cost of funds, and we believe that that will help our net interest income going forward. While impairments did decrease 22% they did remain elevated because of the weak economic conditions. Obviously how we progress on the impairment front going forward is very dependent on how economies do. But we do believe that our impairment charge will continue to come down.

We know that global markets have rallied strongly over the last few months, however the quantum in equities is still not reflected on the ground and we do expect if global markets continue to perform the way they're doing you should see some improvement in general economic activity going forward. Obviously we've said many times the world has been so volatile it can turn any second. It does feel like the world is getting into a better place, but there are still a lot of bombs that can go off here and there.

And so finally our operating profit is underpinned by a strong recurring revenue base and very strong business franchise in all our geographies in which we operate. That's the update. I see some of our old friends didn't rock up, so they are not here to ask questions about the Asset Management deal. I'm sure we will get lots of calls. Any questions? I will start in South Africa. Voight. Last time you fired us. When we told you about impairments in Australia you fired me, Bernard, anyone you could fire.

Voight
Stephen, looking at this deal can you give some clarity on the terms for the additional 1% per year, how you will define the purchase considerations?

Stephen Koseff
There is a formula and the price will be the current price. It is based on the run rate to EBITDA going forward and the minimum price will be the current price. That will all be in the circular, but the circular you won't see for a few weeks.

Voight
So the EBITDA multiple on the first chunk is roughly what it will be going forward?

Stephen Koseff
Yes. It moves in and out at the same formula.

Voight
Thanks.

Stephen Koseff
Ruby, you're back. You want tea today.

Ruby
Lunch actually.

Stephen Koseff
Lunch. Okay, we will organize that.

Ruby
Mr Koseff, one of your conclusions was that impairments are expected to come down subject to economic conditions. That's all fair. However, on page ten you do state with regards to impairments in Kensington that although they are lower than the prior year they are going to be higher than the first half 2013.

Stephen Koseff
Most of that is from the model adjustment on portfolio impairments.

Ruby
This of course clearly suggests that things are coming to an even keel in Kensington. Is that correct?

Stephen Koseff
Ja, it is obviously much less of an issue than it was five years ago. The biggest issue in Kensington was Ireland. Ireland blew up, and Ireland is turning. If you look at our prices they've stabilised. But still things are not moving. So it is still hard.

Ruby
That's all I wanted to know, thank you. What time is lunch incidentally?

Stephen Koseff
We will organise you a [unclear]. You're a bit early. Have we got any more questions here? Can we switch to London?

James
No questions. You've got away lightly.

Stephen Koseff
Then we can all go and have something to drink and eat. No questions here? I see Louis has still given up on us. Okay.

Steven Meintjies
Hi Steve. It's Steven Meintjies. I'm sure it will be in the pack, but I take it the players will have to sell back their shares on retirement. Do you have a compulsory retirement?

Stephen Koseff
In South Africa there is a retirement age. In the UK there is not a retirement age because it's against the law. But there is a formula by which they can keep their shares for a period post retirement if they have been here longer than 15 years. But there is a drop dead date where they have to sell them back or they drop dead. Anything else? All that stuff will be in the circular, Steve. But you will have to wait for it for a while. Sorry, Ronnie.

Ronnie
[Inaudible] to unlock value in Investec in terms of the constituent parts.

Stephen Koseff
No. It is part of ensuring that a business that is very people-driven is sustainable.

Ronnie
As transactions take place away from the first tranche will you will be doing a revaluation based on any transactions or an upgrade in terms of market prices?

Stephen Koseff
They are worked out EBITDA forward looking. And we calculate a price based on run rate EBITDA at a point in time. So that automatically adjusts it to market price. Remember it is a very liquid stake. It's not like the listed instruments that can go out to any third party. Is that it? Okay. Thanks very much and thanks for attending.

END OF TRANSCRIPT