Investec

Interview transcript

20 March 2014

PRE-CLOSE BRIEFING

Stephen Koseff
Good afternoon everybody. Welcome. Sorry to disturb your lunch. There will be some food left after this briefing and I'm sure it won't take too long. I think if we look at this particular year that we've been trading in I think it is a year where we have spent a lot of time in re-shaping our business with the aim of improving returns. We have successfully restructured and/or sold certain businesses, and we still have some to go.

I think the process to identify alternatives for our Australian professional finance and asset finance business is ongoing and progressing well. We have attracted strong interest from a range of parties with whom we are in confidential discussions with. Obviously we're not in a position to provide any update at this point in time, but we will provide an update as soon as we can. I think the potential sale of Kensington is at an early stage in the process, and we expect to provide further information in the second quarter of this calendar year. We have sent out a document relating to the sale and we do have significant interest in the particular transaction, but it is very early days.

If we look at our results of our various operating units I think our Wealth & Investment business results are expected to increase substantially, and Asset Management is expected to report results moderately ahead of the previously year. Both divisions have befitted from higher levels of funds under management and both have been supported by net inflows, in the case of Wealth & Investment £1.1 billion and in the case of Investec Asset Management £2.5 billion up to the end of February.

If we look at our specialist banking businesses I think they are expected to report results in Sterling marginally ahead of the prior year. As we reported at the half year the South Africa specialist banking business is performing well in Rand ahead of the previous year. The UK specialist bank is also performing well ahead of the previous year, mainly as a result of a significant decrease in impairment. And the Australian business, as we said at the half year, has been impacted by strategic restructuring. I think from after this year we will no longer be reporting our Australian business separately because it will be much more integrated into the rest of the group.

So the big impact on us in the period would have been the Rand that depreciated about 20% in the period. You can see this graph has gone from R13.98 at 31st March to just over R18 again today. Clearly that has had a big impact in terms of the translation of the results. Against this backdrop overall our operating profit will be marginally ahead of the prior year in Sterling, which translates to approximately 28% in Rand. If you look at revenue, revenue would be slightly behind in Sterling, but that would translate to about 15% up in Rand. Recurring income as a percentage of total operating income is expected to be about 72%. And expenses decrease in Sterling but are up about 17% in Rand. These things are all affected by timing as to when these expenses are incurred and timing on the revenue front as well.

So we expect adjusted earnings per share to be between 0% and 7% up in Sterling, and that would translate to between 22% and 27% up in Rand. That's really the nub of the issue. 0% to 7%, but 22% to 27% for Rand holders of our share. If you look at our earnings drivers, third party assets under management would decrease in Sterling by 3%. That is up 8% on a neutral currency basis. Customer accounts decrease by 10% in Sterling, again up 6% on a currency neutral basis. And loans and advances down 10% in Sterling and an increase of 7% on a neutral currency basis. So the exchange rate has had a big impact on the performance in the past year.

If we look at the balance sheet soundness we still remain really liquid. Our strategy has been to diversify our deposit base as well as reduce our cost of funds. We've seen this starting to work quite strongly in the UK and Australia. In South Africa the cost of funds never really went up that much post the crisis, so it is similar to what it has always been. That strategy continues. We still have a lot of cash, but we are diversifying and lengthening our liability base. Our advances as a percentage of customer deposits are still at 71%, so there is not much change in terms of the overall balance sheet structure.

With regard to capital I think Basel III CRD4 came in on 1st January. We do meet all the current ratios comfortably and our leverage ratios as an organisation are above our minimum target o 6%. The minimum rules say 3% but we are well above that because we are a lowly-leveraged organisation and don't rely on leverage to make a living.

If you look at impairments obviously impairments are significantly lower. We expect them to be down about 35%. This impairment chart gives you the trend from 2007. We are not quite yet normalised, but well on the path to being normalised. We do expect our credit loss ratio to be about 0.7% from 0.84% in March 2013 and it peaked at about 1.27%. And then on the mortgage business Kensington impairments are substantially lower than the previous year. So that has been a very positive trend.

If we look at our divisional performance Asset Management still has a competitive long-term investment performance. Because it manages a lot of money in the emerging markets it has been affected by tapering and re-pricing of emerging market assets. It did, as I said earlier, have positive net inflows of £2.5 billion up to the end of Feb, and its operating profit would be moderately ahead of the previous year in Sterling.

I think our Wealth & Investment business has performed particularly well, well ahead of the prior year, again supported by higher average funds under management. It has positive net inflows of £1.1 billion. It has improving operating margins, as we mentioned to you before. Certainly in the UK business we prior to that had an operating margin of about 25%. We are now seeing that margin migrate back to that level, but not quite at that level yet. Still some way to go. And then the South African operating margins have always been pretty solid.

We are selectively recruiting investment professionals to try and capture flows. There is a cost attached to that, but that is something we believe is strategically important to us as we continue to build a very strong organisation and a strong brand. We have been enhancing and evolving our online platform. We believe that is important as another distribution channel. And we continue to internationalise our offering. So we believe that that business is going particularly well, and hopefully we can maintain the momentum that we've seen over the last while.

If we move to the Specialist Bank, as I said overall it is performing marginally ahead of the prior year. The Rand has obviously had a big impact on this business. If you look at net interest income margin we have seen loan growth of 7% in neutral currency and stable lending margins. We've seen a reduction in cost of funds in the UK and Australia, but we also have seen some run-off of high yielding assets that we would have acquired during the crisis. And there is some reduction on the lending side as well where you are seeing more competition coming back in as banks get their act together, but still reasonable margins. And as I said earlier we remain liquid. We've seen an uptick in net interest income in South Africa and Australia, slightly down in the UK as a consequence of the run-off of some of the assets that we acquired during the crisis.

If we look at fees and commissions our private client transactional and professional funds activities have performance quite well. We've had good performance from project finance and structured finance fees in South Africa. Other corporate fees a bit lower than in the prior year. On the investment trading income we've had good performance from our South African unlisted investment portfolio as well as our UK unlisted investment portfolio. The fixed income space has been a lot tougher and we haven't seen the same kind of performance on the fixed income front as we've seen in prior years. So that would have affected our UK investment and trading income. And we are seeing improved customer flow activity.

And then costs. South Africa is in line with inflation. The UK is in line with the prior year, and Australia expected to be down as a consequence of the restructure that has taken place. If we look at other information, the effective tax rate is between 17% and 18%, similar to last year. Our net non-operational costs, you know we're doing a lot of re-shaping, so the restructuring costs related to Australia. We sold the trust business. The costs of doing those two things were partially offset by the sale of a company called Lease Direct in the UK which we made a decent gain on. So that number was much higher at the half year. It would have come down for the full year.

And then we also have minorities or non-controlling interest that relates to the piece that we sold to Investec Asset Management management that relates to that forex hedge that always jumps up and down which has been there for years. When the property fund became [unclear] we had to consolidate it, so the income and expenditure and the minorities now come through the income statement line by line, as opposed to previously it would have come in as net income.

And then we expect to have about 863 million shares in issue. I think it was about 860 million when we last reported. So we haven't really issued any shares other than those that we were required to issue for options that have been historically granted or variable remuneration where there is mandatory issue of shares under the structure that we also, also required by the regulator.

So I think in conclusion we have very clear strategic direction. Our focus over the next period would be to execute some of the strategic initiatives, at the same time running our businesses quite hard. The strategic initiatives that we are concentrating on executing are really the sale of part of the business in Australia and the Kensington business. I think if that is successfully completed we will have a business that is learner, more focussed, less complex and very client-driven. I think that is what we are trying to achieve in life, to have a very high quality client-driven organisation that is very relevant in our core markets and delivers on our promise to our key stakeholders.

So really there is not much more to say than that. So I think I will conclude there and open the floor for questions should anyone have any questions. I will start off in South Africa. I don't know if anyone has any questions. Ruby?

Ruby Rosenberg
The chart on impairment analysis as you state it shows a very welcome improvement. However, right in the middle in the light green section is a reference to Ireland where from my measurement the impairment seems to be equal to that of 2013 and 2012. Is there a specific reason why Ireland is not improving?

Stephen Koseff
I think Ireland as an economy is improving a lot. We do have a mortgage business in Ireland. House prices dropped 55% to 60%. We are starting to see house price improvement in Dublin, which is the main city, but in the rest of Ireland it is still quite slow. The effect of the bubble in Ireland, in particular the housing and construction bubble, really wiped out the economy. But the economy itself is starting to recover quite strongly. However, it will take time. I mean these financial crises take a long time to rectify. Voyt, you haven't been here for a while.

Voyt Krzychylkiewicz
I've just been hiding.

Stephen Koseff
Okay.

Voyt Krzychylkiewicz
Just a fairly easy one. Can you give an update on the rollout of the transactional offering in Australia and the UK? I know it is early days.

Stephen Koseff
We have rolled out quite a lot of the transactional offering in Australia. And that business obviously is the business that we have been talking to third parties about buying. The UK I think we've just launched the private bank card, but internally at this stage. We haven't rolled out to clients yet. It was only the other day. We are starting to see a lot of progress. There is a lot of effort and concentration on that front. I think you will see from the South African side there is a lot of stuff coming by the iPad app etc. So it will take time, but we're quite confident that with our brand and where we're positioned in the market we have a decent offering out there. You're not going to see a difference in earnings for a while. In fact, at the moment there are costs because we have to spend money on building the platforms and marketing and all those things. More questions. Nothing. Okay, I will go to the UK. I can't see anyone from the UK. Are you sure they are even linked, Brett? Oh, there is Fanie and Jonathan.

Male speaker
Thank you. Afternoon Stephen. I have a couple, one on impairments. What drove the impairment number? Was it the fall in coverage or was it economic trends? Are you seeing better work-outs? Some clarity on that would be helpful. The second one I had was are there still plans on what you're going to do with respect of the sale proceeds that come out of Kensington and Australia? Have you thought about what that would be allocated towards? And I have a last one on capital.

Stephen Koseff
Let's start off with the impairment trend. Clearly in an improved economy you work things out a lot better. You have seen significant improvement, as you're aware, in the UK housing market. So as I said the impairments in Kensington dropped significantly compared to last year and the year before. Those would be two of the bigger drivers. Just improved economic conditions, the fact that we changed our

lending philosophy at least six years ago. So stuff we would have done before we eliminated completely from our risk tolerance profile or our risk appetite. And you're getting improved economic conditions. So that would be affecting the impairment trend. I think it is early days to talk about the allocation of the capital. None of these businesses are sold yet. And we will cross that bridge and give you more detail on what we propose to do when we get to the point of having sold the businesses. It is very early days. I don't remember the third question, if there was a third question.

Male speaker
Can I just clarify? On your impairments you've not moved any of the coverage ratios in any of the different portfolios at all?

Stephen Koseff
You're saying that we've upped our charge or lowered our charge? No. Some of them we have to have impairment models, and the improvement in house prices in the UK in particular would have an effect on the need to provide. But our coverage ratios would not have deteriorated if I understand your question correctly. So we haven't dropped the coverage ratio. But we have seen an improvement in LTVs because you've had some asset price rises. Remember a couple of years back we changed our provisioning model.

Male speaker
Have you got any clarity in respect of where the PRA sits in respect of buffer for you guys, or is it still under discussion?

Stephen Koseff
No, we haven't had any issues from a capital point of view with the PRA, so I don't know if anything is under discussion or not under discussion. So we are quite comfortable at the moment. You know you go through your process with them. We haven't had any issues with them.

Male speaker
I get you are capitalised well, but I'm just wondering, most banks are looking at 11.5% to 12% as a sustainable capital [overtalking].

Stephen Koseff
Ja, but you've got balance that against the leverage ratio.

Male speaker
Was it still going to be 10% where you are sitting at or is it going to be 11%?

Stephen Koseff
We firstly are standardised. If you compare our leverage ratio you've got banks who say they have 12% core tier one, but then they have a leverage ratio of 2.9% or 3%. We have a leverage ratio of almost 7%. So you've got to look at the two hand in hand as opposed to the one. I think we're very comfortable with our capital target.

Male speaker
Thank you.

Stephen Koseff
Any more questions in London?

Brett [?]
No more questions here, Stephen.

Stephen Koseff
That it? Well, I hope you’ve got some food in London as well. Thank you very much. Anyone who wants to ask questions offline, you’re welcome. Thank you.

END OF TRANSCRIPT