Conference Call Transcript

19 March 2021

PRE-CLOSE TRADING UPDATE

Operator
Good day ladies and gentlemen and welcome to the Investec pre-close trading update. Al participants will be in listen only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call please signal an operator by pressing * then 0. Please note that this call this being recorded. I would now like to turn the conference over to Fani Titi, the Chief Executive of the Investec Group. Please go ahead.

Fani Titi
Ladies and gentlemen, good morning and welcome. Thank you all for taking the time to join us on this call to discuss our pre-close trading update which covers the continuing operations for the 11 months ended 28 February 2021 and guidance for our full year results. Please note that our full year results for the 12 months ending 31st March will be announced on 21st May. We will take a few minutes to talk through the key highlights from our trading update and we'll then take some questions.

First a few general comments on the operating environment and our overall performance. Despite further lockdowns globally during the period under review, the actions taken by governments and central banks have continued to support economies and financial markets. We are encouraged by the momentum we are seeing across our business, the continued recovery of markets, and the positive developments related to COVID-19 vaccines.

We expect the Group's operating results for the year ended 31 March 2021 to be in line with the guidance released in our interim results in November 2020. Adjusted earnings per share from continuing operations are expected to be 20% to 29% behind the prior year. A table containing full details of our earnings guidance for FY21 can be found on page two of today's trading statement. Year on year our performance has been negatively impacted by lower interest rates, elevated costs related to the hedging of our UK structures product book as guided in November, reduced client activity over the period and circa 14% depreciation of the average Rand against Pound Sterling. This was offset by lower expected credit losses and continued cost containment.

Our expected performance also demonstrates the strength of our underlying client franchises, the continued execution of our strategic objectives, and the resilience of our people in what has been an unprecedented year. In terms of the momentum I mentioned the second half adjusted operating profit and earnings are expected to be ahead of comparable numbers reported in the first half of the financial year reflecting an improving trend particularly in the last quarter.

Now I move on to financial performance in more detail. In terms of the underlying performance over the 11 months to 28 February, funds under management increased by 26.7% to £57 billion with net inflows of just under £1 billion. Core loans increased 5.5% to £26.3 billion while deposits were up 5.9% to £34.1 billion. Turning to operating income, the expected revenue decline in FY21 reflects an environment still marked by the crisis that prevailed throughout the financial year. Risk management and risk reduction costs related to the hedging of the UK structured product book are expected to be in line with the guidance provided at our September interim results.

In the second half relative to the first half revenue benefitted from improved client activity and liability repricing. Operating costs for the full year are expected to be lower than last year by mid-single digits and these costs include costs associated with the implementation of strategic initiatives taken during the period under review. On asset quality the Group expects to report a lower credit impairment charge in the second half compared to the first half resulting in a full year forecast credit loss ratio of between 37 and 44 basis points. Capital, leverage and liquidity ratios remain sound and ahead of internal board approved minimum targets and regulatory requirements. The Group's cash and near cash on the 28th February was at £13.9 billion, representing approximately 41% of customer deposits.

Turning to the geographic performance of the business. In Southern Africa adjusted operating profit from continuing operations is expected to be 16% to 24% behind in Pound Sterling. FY2020 that number was £286 million. And in Rand terms adjusted operating profit from continuing operations is expected to be 4% to 12% behind. That number in Rands was R5.3 billion last year. In the UK and other adjusted operating profit from continuing operations is expected to be 15% to 26% behind the prior year number of £133.5 million.

Finally on the dividend, Investec paid an interim dividend of 5.5p at the half year and a final dividend will be considered as part of the normal board process leading up to the full year results on the 21st May 2021. In summary, the Group's operating results for the year ending 31st March 2021 are expected to be in line with guidance including the hedging costs related to our UK structured products book. Our underlying performance demonstrates the strength and resilience of our client franchises. We expect lower credit losses year on year and the costs remain well contained.

While the general outlook is improving, the long-term impact of the pandemic is uncertain. Investec remains well capitalised, highly liquid and well provisioned for impairments. With the simplification of the Group now substantially complete, we are positioned to pursue long-term growth. Thank you for joining the call. I would now like to open the lines for questions.

Operator
Thank you. Ladies and gentlemen, if anyone would like to ask a question you are welcome to press * and then 1 on your touchtone phone or on the keypad on your screen. If you wish to withdraw the question you may press * and then 2 to remove yourself from the question queue. If anyone would like to ask a question please press * and then 1. We will pause a moment for the queue to build. Ladies and gentlemen, if anyone would like to ask a question you are welcome to press * and then 1. We have a question from John Storey of JP Morgan.

John Storey
Good morning, Fani. Thanks very much for the detail in your guidance there. I wonder if you could give a little bit more colour just around the cost performance of the UK specialist bank. If there is anything more that you can provide than what was provided in the release this morning would be useful. Thanks very much.

Nishlan Samujh
Hi. It's Nishlan. I think what is quite relevant from a UK specialist bank perspective is the fact that we have obviously been through a period of implementing some of the strategic actions. So in this period some of the costs associated with implementation are going to be carried in the cost base. So the benefits are really going to be reflected into our 2022 financial year. Having said that, notwithstanding those particular costs we've indicated that overall our cost base will be down in mid-single digits. And that's represented across both the South African and the UK platform.

John Storey
Okay. Thanks very much, Nishlan.

Fani Titi
And obviously when we announce our results we will go into more detail and disclose what the associated costs to the restructure are and how they impacted the numbers that we're talking about.

John Storey
Excellent. Thanks very much, Fani.

Fani Titi
Thanks John.

Operator
Our next question is from David Talpert of Avior Capital Markets.

David Talpert
Good day. Thanks for the presentation today. Just a question around those hedging losses in the UK. I just want you to chat more about the outlook for those and maybe improving UK equity markets would help that unwind slightly quicker than what you previously guided to.

Fani Titi
Thanks David. You are right that improving equity markets are positive for this business. Just to remind you, we have costs of ongoing day to day hedging and we have costs related to taking of risk from the table, specifically selling portions of the book. So the costs of managing the book on a day to day basis in terms of hedging those costs are obviously moderating as markets improve that we specifically continuing to sell portions of the book. So the cost reduction element of the total cost would obviously still be there and therefore the overall costs are in line with guidance. So whenever there is an opportunity to reduce the book we will do so.

David Talpert
Thank you.

Operator
Our next question is from Chris Stewart of Ninety One.

Chris Stewart
Morning gentlemen and thanks very much for your time this morning. Just a quick question from my side, probably one for Nish. Can you just comment on the fairly dramatic uptick in the tax rate in the second half? What is driving that and what are the implications for forward looking tax rate?

Nishlan Samujh
Hi Chris, and thanks for the question. It is again pretty much associated with our actions in Australia where we did have some deferred tax assets that we've revised our outlook on which has caused a pick up in the effective tax rate.

Chris Stewart
Does that imply that the effective tax rate that you've shown for the full year is the tax rate you would expect as a sustainable rate going forward, or would the fairly elevated second half tax charges be more indicative of the going on rate?

Nishlan Samujh
No, I would say that the elevation in this period was caused much more by a once-off event, obviously noting that you do have corporate tax rates going up in 2023 in the UK as was announced, and in South Africa you have a slight decrease by 1% also coming into effect in 2023. So those will blend into the forward look tax rate.

Chris Stewart
Okay. So we shouldn't necessarily use the 2021 full year or H2 tax rate at relatively elevated levels as necessarily the pre-tax dispensation change in the two geographies' rate going forward.

Nishlan Samujh
I think previously we guided to a normalised tax rate of about 19% to 20%.

Chris Stewart
Got you. Thanks Nish.

Operator
Our next question is from James Starke of SBG Securities.

James Starke

Good morning gentlemen. Thank you for the opportunity. If you could just give us some colour around the asset quality trend you're seeing in your real estate exposures, in particular on the commercial property side and also on the mortgage book within the private bank. Thank you.

Nishlan Samujh

Sure. I think overall I would say that the asset quality trends have been relatively pleasing. I think particularly when you look at some of the relief levels being provided. Those are at relatively low levels in both the South African and the UK book. Overall loan to value levels and the collateral positions have also remained relatively strong over the period and repayment rates. We have seen maybe one or two migrations into stage 2 or stage 3, but nothing symptomatic from an asset quality perspective. If I look at our mortgage lending book I think over history we've tended to have a fairly low loss rate. In particular the book in the UK over history has been around 4 to 5 basis points. And we haven't seen any change to those long-term trends.

James Starke

Thank you.

Operator

Our next question is from Michael Gresty of Anchor Capital.

Michael Gresty

Good morning, Fani and Nishlan. Can you hear me okay?

Fani Titi

Loud and clear. Please go ahead.

Michael Gresty

Thanks for the opportunity, guys. Just a couple from me. I just wanted to clarify the way you guys are seeing these losses relating to that structured lending book in the UK. My previous recollection was you were looking at a similar loss in the second half, which was about £100 million, and then potentially slightly smaller but not much in the next year. Fani, your comments would suggest that maybe that's looking less sizeable than it used to. If you could just be a little clearer. Is my recollection correct? And how are you seeing it now? The next question is have you made any progress in these more supportive markets in the second half in getting rid of any of any of those private equity, non-core assets that you had? And the last question. Just the big outflows in discretionary AUM in South Africa versus inflows in non-discretionary. That was quite interesting.

Fani Titi

It's actually the opposite.

Michael Gresty

Sorry. Could you chat a bit about that?

Fani Titi

Let me take the first question just to give you clarity. We had guided to approximately £106 million of losses relating to the hedging of that book for the full year, being £53 million in the first half and a similar number in the second half. We had also said that we would expect a similar number for the full year March 2022. So that was the guidance we gave. And what we are saying now is while we have benefitted from improving markets on the ongoing costs of management of the book, we have had the opportunity to take off risk as we go forward. So while the overall guidance for the financial year 2021 is the same, the proportion of where that money has been spent is different, lower ongoing management costs versus slightly higher risk reduction costs. Clearly as markets improve our position in that book should improve, but I don't want to speculate at this stage. We will give you more colour of our expectations when we report our results. But your general understanding of how the book should behave is broadly in line. The second question related to flows. Nish, do you want to deal with flows?

Nishlan Samujh

Michael, again it's very important to note that we actually saw very strong flows into our discretionary portfolios in both South Africa and the UK, I think in South Africa just under R7 billion of flows into the discretionary portfolio. Now, the non-discretionary is effectively directly managed by clients as they effectively react to various aspects. We are not concerned about the level of change that was seen on that and are holistically focussed on the discretionary element. And then your question around progress on the investment portfolio, I would say that over the period, again we have seen improving trends of late in this last quarter of this financial year. Our intention is not to offload any of these assets. Our intention is to work through the portfolio with an intention to effectively realise value because these are and remain high quality asset portfolios. We have had some success in terms of realisations, and we will report those levels in the results. And we also remain quite encourage with where markets are heading to.

Michael Gresty

Great. Thanks very much, guys.

Operator

Ladies and gentlemen, just a final reminder, if anyone would like to ask a question you are welcome to press * and then 1. We will pause a moment to see if we have any further questions. We have a question from Neil Young of Coronation.

Neil Young

Hi. Thanks very much for the update. Just a definition question for Nishlan. Just to confirm, the adjusted operating profit down 16% to 24%. That would exclude the 25% holding in Ninety One. Is that correct? In both periods.

Nishlan Samujh

No, Neil. I think it excludes the full results of Asset Management in the prior year. We would have equity accounted a piece of Ninety One from the 16th March to the end of last year. I think that number was about £1.4 million last year. And this period will include equity accounted income of Ninety One on the 25% for the full year.

Neil Young

And that is included in both the adjusted operating profit number as well as the adjusted earnings per share from continuing operations number?

Nishlan Samujh
Yeah, that's correct.

Neil Young
All right. Okay. Understood. Thanks.

Operator
Ladies and gentlemen, just another final reminder, if anyone else would like to ask a question you are welcome to press * and then 1. We will pause a moment to see if we have any further questions. It seems we have no further questions on the lines, sir. Would you like to make any closing comments?

Fani Titi
Again just to thank everyone for their interest in the business and for attending this briefing. As usual if there are follow-up questions please contact our IR team and we will deal with the questions raised. Equally if you want to talk to any of our other executives on any part of the business, please let us know and we can facilitate that. Thank you again and good day to you.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT