Investec

Specialist Bank

Investor (pre-close) briefing

17 September 2009

Stephen Koseff – Chief Executive

Good morning, everybody. Welcome to our pre-close briefing. We should be connected to London and I think we are on Summit. So I am going to get moving straight away. I think it is just past 10:00 and let us get going. I think if we start off and recognise what kind of environment we have been in over the last six months, I think it is an environment where clearly the operating fundamentals have been improving and in some spaces proving a lot. In others still tracking perhaps marginally downwards, but still activity levels quite a lot below historic trends and I think that what you are really faced up with in this environment is the impact on the real economy or the financial crisis and the fact that one has seen more people in trouble than one would have historically expected but the capital markets have started returning back to normal although I doubt whether they are exactly normal yet.

Overall we expect our profits to be lower than the first half of last year. If you remember last year, our first half, we had quite a reasonable first half. It was equivalent to the first half for the previous financial year so we would expect profits to be lower and we did give you a trading update on the first quarter recently so you should be well informed on that. Our UK and European profits are actually ahead of last year and our South African behind and Australian still well behind as a consequence of a high level of impairment.

What we said to you at the last trading update or the results presentation that there were a number of things that we were concentrating on doing and one was to moderate loan growth and you can see our loans grew by about 3%, more or less flat in home currency but up in Sterling. Our customer deposits, we said we would conserve liquidity and build customer deposits. Our customer deposits grew by 16% during the period and our third parties assets under management have also grown quite strongly by 19% and I will give some colour on that in a moment.

I think we have maintained a disciplined focus on managing risk, building liquidity and building capital and I think we did say we would preserve liquidity but what we have seen over the last while is that there has been a very strong build-up in liquidity and that as a consequence our balance sheet looks particularly sound. It is low leverage and the leverage is even reduced in this period as lending has been quite muted and I think that our business model has continued to deliver a stable performance and what can still be considered to be a fairly challenging environment although as I said earlier, improving quite a lot.

I think if you look at the build-up of liquidity and we have had a very successful launch of retail investment type saving type products, both in the UK and South Africa. You can see that our liquidity has built up and our cash and near cash was about £6.6 billion as of yesterday and we are taking in on average of £200 million a month in the UK in various forms of retail products and we have been taking since we have accelerated our assault on retail deposits in South Africa. We are taking about R1.7 billion a month and as a consequence with very little loan growth you have seen a very strong build-up in liquidity from the end of March and certainly from the troughs of life after Lehman's blew approximately a year ago.

So this side of the balance sheet has built up very strongly. I think on the capital front in November we changed our capital targets and we increased our Q1 target to 11%. We said we hoped to achieve that by the end of 2010. Well, in South Africa we have achieved it as we stand here right now and we do expect to be at that sort of level by the end of September, a total capital target of 14.2 and tier 1 target of 11, and in the plc silo our total capital is about 15.8 and we expect our tier 1 to be about 10.9. So I think that we are very close to actually achieving that objective.

I think obviously in this environment one of the issues and I would guess it is the only issue that one would really have is that you have a high level of impairments as a consequence of a much weaker economic cycle and we have seen that sort of starting to stabilise in terms of the pace of increasing impairment, but certainly it is still a factor for this particular financial year. As we said to you at the end of March, in May when we announced that impairments will still be the order of the day in this particular financial year. We do expect the ratio for this trading period to be between 0.95 and 1.1 and so that still is a factor but balanced against the balance sheet and the rest of life I think that we have managed this cycle fairly well up to now.

I think if you look at the leverage, core loans to capital, it is down from 6.2 to 5.8. I think core loans to customer deposits and that is if we take out core loans that are classified, that have been securitised, is 0.9. In other words, our customer deposits cover our core loans by 10% and I do not think you find too many banks around the world with that ratio. Our total gearing is 12.1. Again, South African banks are geared between 12 and 14 but if you look at international banks, they are still 30 to 60. So I think that is why South Africa has managed the cycle a lot better than many global peers and I think that total gearing, if we exclude securitised assets is 10.7.

So still a lowly leverage balance sheet. I think if we look at the income statement, and this is what you will see, is that clearly our net interest income with flat loan, with no loan growth and much lower actual interest rates will be negatively impacted. If you look at the average interest across all our geographies it is down by about 4% in each of them in this period compared to last year. Interest rates only really got cut globally from October last year and South Africa from November last year. So I think that has had a negative impact on our net interest income. We have had lower levels of activity, as I said earlier, and that would have resulted in the decline in fees and commission receivable.

On the positive side we have been able to take advantage of dislocated credit markets and that has bolstered revenue from principal transactions and recurring income is a percentage of operating income is expected to be around 65%. Expenses are expected to be flattish, in home currency down but in Sterling flat, and net operating income after expenses is expected to be marginally down. So I think from that information you guys can work out fairly well where one expects life to be.

On private banking, I think they have done exceptionally well in building the deposit franchise. Clearly levels of activity have been exceptionally low and this is the area where impairments would have had the biggest impact as the individual is probably very much affected by what is going on in the world in terms of the real economy. So they have had a tough trading period and they will be significantly lower than the previous year.

Our private client business, that has held up fairly well. Obviously income and activity levels have been lower but they are performing marginally behind the previous year. They have seen quite a strong uplift in funds under management, about 11%. That is ignoring any movement in funds under management in Rensburg Sheppard. That is just Investec in South Africa. It us up actually more than 11%, 25%, but if you add Rensburg, but we cannot tell you where Rensburg is in life, but we will be sure that in this environment the funds under management would have gone up as a consequence of the strong shift in market levels.

Capital markets have had reasonable levels of activity across the advisory businesses. Some of the trading activities have been impacted by a lower rate environment and declining volatility and there has been an uptick in impairments in this business as they are relative to the six months of last year, not relative to the second half of last year. I am talking relative to the six months of last year September, not relative to the second half of last year which was a significantly worse, weaker trading period and they have also been able to take advantage. That is the business we would take advantage of, what have been going on in credit markets and they are actually as a consequence performing ahead of the first half of last year in 2009.

The loan portfolios were flat, down 1% and most of that is currency and translation of various currencies. So it has been quite hard to originate loans. I mean, many people say that banks are not lending but I think the reality is that people are not borrowing, more than banks are not lending. So I think that just gives you a summary of those businesses. I think if you look at Kensington, Kensington is performing reasonably well, much to the surprise of most of you as half price is stabilised. The book has come down by £300 million and arrears have increased marginally as the book becomes more seasoned but the LTVs improved slightly as a consequence of an uptick in house prices over the last few months as you have read every time you read the FT. So there has been quite a lot of improvement and stabilisation in that particular space.

We look at investment banking. Agent activity levels have started to improve. This will not yet be reflected in this month. I just know that our divisions are very busy but it will not come through in this trading period's earnings but we are starting to see a lot more activity in the agency and the advisory businesses. I think in the principal investing side South Africa still performed well. Again we have pretty good assets there that are generating good cash flows in this type of environment and that has held up their performance. In the UK you are still impacted by the consolidation of those two investments although the one is now moving, starting to improve quite significantly. The other is a developing business and we will still see some losses from those businesses in this particular period, but certainly the life is improving a lot on that front.

On the asset management, assets under management up about 25%. They have had record net inflows. Approximately £2 billion year to date across a broad set of investment strategies. I think that they will still be behind the first half of last year because equity markets were on average still quite a lot higher for this trading period than they were last year, but there is significantly improved earnings momentum which one should start expecting in the second half of this year. So very happy with where life is going there.

On the property side, I think we are having a reasonable performance from our investment property portfolio. There are lots of opportunities for value enhancement in that particular portfolio and we have been taking advantage of those opportunities. I think that obviously the property market had been weak as a consequence of what is happening in the global world, but certainly if anything that it is rent producing, it has held up pretty well and I think we are looking out for opportunities in the States. We clearly remain focused on trying to build our property funds business around the world. We have a fair amount of money that we still have to invest, but certainly an area that we are going to concentrate on in terms of building this activity.

On the central funding side, I think we have a weaker performance in South Africa as a consequence of a lower yield on our surplus cash as rates have dropped off quite significantly in this last six months. We have had a good performance in the UK as a consequence of our debt purchase programme and our central costs are in line with the first half of last year.

So that gives you a background of what we expect where we thing the earnings are in the relative business scope, where we think they are going to be. I think the tax rate is still a bit lower than the normal run rate at 20% and the expected number of shares in issue is about 669 million weighted number of shares in issue.

Looking back on the past two years of trading and I think really for us the difficult period started perhaps in August 2007 when the capital market started collapsing and we had to adopt a very defensive strategy. I think it was important that we concentrated on making sure our balance sheet was sound, increasing our capital and conserving our liquidity. I think we have very clearly done both of those and I think that that has held us in good stead for where one goes now.

We see that the financial system has started stabilising. You can feel it out there. You can feel that the fear is dissipating quite quickly and that people are getting back into business and I think we are now turning our attention on moving our organisation from defensive mode back onto the front foot, in a measured way, because I do not think we are going to see the euphoria that one saw from perhaps 2003, 2004 to 2007, but certainly we think that there are a lot of opportunities for us to take advantage of in our operating of businesses and maybe outside of them, but that is right across our core geographies and that is our mindset right now is getting the business back onto the front foot as opposed to having been in very defensive mode over the last two years. As a consequence we believe that our geographic positioning, our operation diversity, our strong balance sheet, we will be taking all that into account and we should be able to continue to navigate a steady force.

So that is really the story, I said to Michael here, he said what are you going to tell us. I said well, we are just going to tell you what we have been telling you people, that there is nothing more to tell you and I think we have been communicating with you consistently every two months and there should be no shocks. And there are no shocks. This is exactly what we said we would do and that is what we have done.

So we have now finished the briefing and ready for questions. I will start off in South Africa. Ruby, we will always let you open the batting.

Ruby

Now, Mr Koseff, could you give some detail of this debt purchase programme. It is suggested that you are buying the stressed assets paying pence on the Pound. I would like to hear a little more about it, please.

Stephen Koseff – Chief Executive

We made an announcement. I will send you a copy of the announcement. We bought back some of our own debt but we will send you a copy of the announcement.

Ruby

Thank you.

Ronnie

Just a question on the dividend policy, your capital position has improved significantly, so just looking forward, what sort of dividend cover are you looking at?

Stephen Koseff – Chief Executive

Yes, we gave you our range and we are going to stay within that range and obviously there is a lot of noise out there about capital for banks and things like that and we have got to wait for all these new so-called rules, if I can call them that, to come out. So I think we will stay on the conservative end of life for the time being until such time as we know exactly what the new rules of the game are going to be because we do not know that yet. It is just talk and the G20 is saying this and they are saying that but we do not know what they are going to say until they come out with it. So I think we have to stay on the conservative side of the range at this point in time.

Ronnie

Where are the opportunities? From the public sector, the private sector? Can you put some sort of colour as to where you think these opportunities and prospects are over the next 12, 13 months?

Stephen Koseff – Chief Executive

Well, I guess generally speaking you have had a lot of damage to the financial system. It has now been stabilised. The landscape is going to shift as a consequence of that. People are not going to do what they were doing before. Other people are going to do more what they are doing. So we just say that once you have been through this cycle people relook at themselves and say what are we going to be going forward and we think there is adjustment taking place and there will be adjustment. You may not feel it in South Africa as much because there was not trauma here in South Africa, but when you get to England and other parts of the world there was a lot of damage in the system and there will be a shifting landscape and we think that we are well-positioned to take advantage of maybe ... maybe they will not arrive but in the shifting landscape and then client, what are clients going to do? Some are going to be more defensive. Some are going to be more aggressive and we think that there is going to be activity levels as people try to take advantage of whatever has gone on.

Ronnie

As we see more and more confidence, perhaps returning to the mining sector, do we see opportunities in terms of funding, new issues, the platinum mines looking at their infrastructure, expansion? Those must look pretty large, there must be some really great opportunities going forward there?

Stephen Koseff – Chief Executive

I think there are opportunities in lots of sectors. I do not think you have to just highlight in the mining space. I think there are opportunities and some of them are more risky than others and obviously the world having been through what it has been through one is going to stay away from things that are very risky, that do not have cash flow. So I think that is the big lesson to learn from this kind of environment, where things do not have cash flow stay away from it because you cannot navigate a storm without cash flow. Clients cannot navigate a storm without cash flow, but line by line we are an opportunistic firm so we will see what opportunities are out there, but it is not any specific area. What we are saying is that we are open for business. We are moving out of defensive mode. We will not be perhaps very aggressive but we will move out of defensive mode back onto the front foot.

Ronnie

And can you just comment on the sort of latest leads you have on the commercial property exposure and particularly offshore? There is obviously still quite a lot of concern there. Are you seeing that in your arrears numbers in the recent trend?

Stephen Koseff – Chief Executive

We have not seen a big shift in our arrears numbers there over the last while and I got my colleague here, Sam Hatton, who has got a fund that buys property in Europe and every time they bid for a property they get outbid by someone else. So you guys have to watch the drama queens in this world. Yes, there are most probably some structures that are very heavily geared and the cash flow has dried up or the covenants had caused trouble, but anything that is okay where there is a decent tenant is holding up. We are actually in a structure that the banks shoot themselves in the foot with these market to market covenants because then they force a problem situation. You know, those kinds of situations can blow up, but I think people are being sensible.

Male Speaker

I would like to know, for the UK you are [unclear] Do you intend to do a recourse on these UK government [unclear] or not?

Stephen Koseff – Chief Executive

Well, you know, we are taking £200 million of retail money a month which some of it is very long dated and I just showed you our build-up of cash. So we are eligible, but whether we want to use it or not, the only think you would use it for is to stretch your liability book.

Male Speaker

The UK, you mentioned that you want to take advantage and strengthen your position in your core. What is your strategy about UK? Do you look at additional areas for acquisition? What is your view on that?

Stephen Koseff – Chief Executive

Well, I think we obviously have looked at a lot of things but we have not bought anything because the things that are for sale still would not suit us, but certainly if something fits into our overall business and it is integratable it is something we could look at, but right now we have not done anything because nothing has suited us. We are not going to buy for the sake of buying, but clearly if there is something that fits into one of our divisions like asset management or private banking, in an investment bank we rather build teams like we hired a team from Dresdner in March last year, this year. Rather bring the teams back in private banking or asset management or private portfolio management. We would look at things.

Can I go to London?

Brad

Could I ask if there has been any movement in the proportion of loans that are in arrears where no impairments has yet been taken?

Stephen Koseff – Chief Executive

You are asking if there is movement in loans in arrears where no impairment has been taken. You are saying have we got clients who moved into arrear where no impairment is taken? Is that the question? Because we certainly have enough collateral.

Brad

No, that are in arrears but no impairments had been taken, maybe because there is collateral cover or something like that, has there been a shift in the number of clients or the outstanding balances that are in arrears where you felt as yet there is no need to take impairment?

Stephen Koseff – Chief Executive

We would have situations like that where we are well collateralised, where clients who have gone into default but we have a lot of collateral where we would not have had to take an impairment, yes. We clearly have situations like that.

Thanks very much and we will see you in November.

END OF TRANSCRIPT