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Conference call transcript

15 September 2011

INVESTOR PRE-CLOSE BRIEFING

Stephen Koseff
Good morning everybody. Welcome to our pre-close briefing. Bernard just pointed out to me that our tax collector is here, Mel Roberts. So I've got to be very careful what I say. Welcome, Mel. He's the man from SARS who goes after us and makes sure that we pay tax on what we earn. Anyway, I think if we look at the period we've just traded of this last six months, well only five and a half months, we've still got two weeks to go, very clearly it has been a much more difficult environment than we would have anticipated at the end of May or middle of May when we last physically reported to you. We did give a trading update at the end of July for the first few months to the end of June which would have reflected what we have seen for most of the period. I think we all know what's going on. There are lots of headlines out there what's going on in Europe, what went on in the United States and what's going on in markets generally. And obviously for parts of our business that makes life fairly difficult.

I think we have continued to see good momentum in the Asset Management business and Wealth business, but Asset Management in particular, who have performed well as a result of increased average funds under management and have continued to see net inflows. Our Specialist Banking businesses have seen growth in net interest income and fee income, but earnings from our principle activities would have been under pressure in this kind of environment which I think most of you would expect. Then again our operational and geographic diversity will however support a sound operational performance.

So our operating profit is expected to be in line with the prior year. Four of our six operating divisions showed an improved performance. One, which was the property business, we did say to you would not meet the performance of previous years, but I will come to that in a moment. And obviously our investment bank would have battled in this environment. Our UK and South African businesses are both expected to show operating profits ahead of the prior year. Australia is still struggling as it is affected by elevated levels of impairment.

So if we look from March to the end of August our core loans and advances are markedly down in Pounds because the Rand has weakened, but have increased by about 2% in neutral currency. Deposits are still up 3% to £25.1 billion. And third party assets under management decreased both because of the Rand and because the market has come off by 4% to £85.6 billion. And that's notwithstanding the fact that we've got net inflows of £2.6 billion in the five month period.

Our cash balances remain particularly strong. We have continued to concentrate on improving the quality of our liabilities as we move towards meeting the requirements of Basel III. Limiting concentration risk, reducing reliance on wholesale funding and continuing to build our retail franchise, but at the same time we wanted to focus on reducing the cost of our liabilities. That I think we have managed to do. Our core advances are 70% of our customer deposits, so obviously well balanced from that perspective. At the time of this we had about £10.2 billion of cash and near-cash, a similar sort of number today. So it has been fairly stable.

Our risk-weighted assets, our capital assets remain well within our target range. It dropped slightly off from March because of dividend payments in August, but still (unclear) 16.4% and 11.1%. This is what we expect. Maybe it could be slightly better. And Investec Ltd 15.4% and 11.7%. You've got to remember with Investec Limited, they increased the capital requirements for equities by about 3.5 to 4 times since September last year. So we've had to absorb that as well.

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If we look at impairments we did say at the middle of May and we say it again that our impairments on core loans and advances are expected to be lower than the prior year. This is reflected in our expectation for this trading period of a credit loss ratio of 0.9% versus about 0.98% for the similar period last year, and 1.27% for the total year. We had to make additional impairments in Start, which is a vehicle in Ireland, as economic conditions have continued to weaken in that part of the world – although Ireland is the one peripheral country that probably has some chance of adjusting itself to the requirements of Europe. And then overall because of that we could be flat to marginally up at the absolute number, although the ratio would be significantly down as a percentage of loans and advances. The impairment charge is significantly lower than the second half of last year.

If we look at our divisions the recurring income as a percentage of operating income should be about 66%. And obviously that's reflective of the fact that income from principle activities is tougher in this particular world. We've seen an increase in net interest income, an increase in fees and commissions and a declining income from principle activities. Expenses are marginally ahead of operating income. That's bringing on the acquisition of Rensburg and a business called Masterlease in the UK. And we have had some increase in headcount in our Capital Markets business, which has been growing, and our Asset Management business and a little bit in infrastructure. But overall the rest of the business has seen either flat headcount or in some instances a decline. So we do see a moderate rise in the cost to income ratio, but still we are within our target range.

If we look at Asset Management I think it has continued to perform particularly well. 100% of its segregated accounts have outperformed their benchmark since inception. It saw net inflow for the first five months of £2 billion and will perform well ahead of last year overall. If we look at the Wealth & Investment business it is performing ahead of last year, but less so than Asset Management. It did have higher average funds under management, but at this point in time the funds under management are down on the end of March but certainly up on the end of September last year. And the reason for them being down is not... we had net inflows of £550 million, but markets obviously… mostly exposure to equity in some of those businesses are down. And then we would have included 100% of Rensburg for the full period, whereas last year we only had it for half the period.

Property, as I said to you, is in line with expectations but lower than last year. Last year was a particularly good year in Property, which we told you in May would not be repeatable. That's really what we're experiencing. If we look at the Private Bank it will return to profitability in this particular period. There has been some uptick in activity levels generally and we've seen a moderate increase in impairments relative to the comparative period, but significantly been lower than the second half of last year. As I said the UK also has returned to profitability. South Africa performance is marginally behind last year, but it could still end up flat or up. Remember the problem in the private bank in South Africa was big impairments in the second half of last year.

And then in Australia our professional finance business is doing very well, but we still have a run down book in the whole property sector which is still bogged by higher impairments. And that will go on for probably the rest of this financial year. But certainly the professional finance business and the business that we continue to perpetuate is doing quite well. Loans were flat since March. That is in stable currency. And deposits marginally down. As I said we're diversifying and changing the mix of our deposit base and watching pricing very carefully, so we're not driving this number at the moment.

If we look at the Investment Bank this is an area which would be very much affected by weak market conditions. Obviously there is much lower demand for equities, so there is not a lot of normalized volume in the institutional space. We saw in the UK a reasonably performance in corporate finance, but that would have been offset by a very weak performance in our securities activities as well as our direct investment and private equity assets. South Africa is well down… on reflection it's a harsh word, down on the prior year and has seen some mark-downs in listed investments held in the direct investment portfolio and lower dividends from some of our private equity assets. And then again the same problem as we've had in London, poorer performance in the institutional stockbroking business again as a consequence of lower volume. So [unclear] this part of the group would have felt the heat in this particular environment.

Capital Markets had a satisfactory performance. They're ahead of last year. You see their loan portfolios are flat. That is not in stable currency in absolute, so in stable currency it may be slightly better. Still, this is an area where corporate demand for credit has been muted. We have started seeing an uptick in activity certainly in South Africa and our guys have been fairly busy over the last couple of months doing many different things. We've seen a good performance from that business and a solid performance from the UK and Australia.

If we look at other lines that you always worry about, Central Funding and Central Costs would be largely in line with the prior year, give or take a few bob. And that's the operating side of life.

So if we move across to tax, our tax rate is expected to be between 19% and 20%. In the UK they're actually bringing the corporate tax rate down. South Africa is still the same. We expect to have weighted number of shares in issue of 792 million shares.

I think there has been a lot of noise and talk about the Independent Banking Commission and how that affects us strategically. Recommendations were public Monday, so we obviously at this stage have had a cursory look and there will be processes that we will go through over the next six months to a year because this has to be embedded into law. One is not sure exactly which aspects of the recommendations are going to be adopted by the government in the UK. These recommendations at the moment say they have to be implemented by 2019, which is still quite a long way away. So we are assessing the impact. Our initial impressions are that the bulk of our banking-type activities other than our investment bank and some of our trading businesses, a substantial portion of the Capital Markets business that requires funding could be held in the ring-fenced bank as the ring-fenced bank can deal with corporate and individual clients.

I think that there is a lot of flexibility for firms to negotiate or discuss with the regulators as to where they place the fence, and I think as a consequence of that flexibility we think the adjustment to our business model will be moderate. My friend, Mr. Ladbroke from Absa Capital, confirms he has a similar sort of view. In fact he told me that there are some exemptions which may impact on us. I'm not sure. But those are all things that we'll have to work out in life as we move forward. But clearly not as draconian as it could have been, and not as dramatic on our firm as it could have been had the line been much more tightly drawn.

The other point we made, we launched a recommended offer for Evolution Group last week on Friday morning. As a lot of you will know we have stated consistently in our strategy that we seek to maintain a balance between revenue from businesses that take operational risk compared to businesses that take financial risk. Now, Evolution is a business that runs private clients' money, and has an investment banking arm, and never took a lot of financial risk. It was all operational risk and not much trading risk either. So it fitted perfectly into our strategy. It will once fully integrated increase the portion of our non-lending revenue. It will significantly grow our private client wealth management business in the UK and globally. And these businesses are very capitalised with strong recurring revenue streams, so we believe that it fitted very well into our group. It's a well-respected leading private client wealth management business in the UK managing £6 billion, and has just acquired a further £1.8 billion from BNP Paribas, and has a very strong investment banking franchise in the mid-cap space serving an international institutional and corporate client base. So it does fit in very well with what we do.

We will issue 53.8 million shares to acquire it and we have I think letters of intent. We said 22.65%, but I know we got more yesterday. So about 30% plus irrevocable of 8% to support our offer. It will be implemented by the end of November, beginning of December, or some time in the second half of November. Now, clearly there are a lot of operational synergies, and we have said that the combined firm, there would be some adjustment in the overall headcount. We stated that in the announcement very clearly. But we can't give you any kind of idea of synergies at this point in time as this is a process that we would have to go through with the Evolution people over the next few months.

So in summary, what do we create? We create a major UK player in the private client investment management industry. The combination of Evolution and our own investment banking business positions us as a leading mid-

market investment bank in the UK. I think we already occupy some of that space, and it is a very good strategic fit for us as a group, and it does enable us to build scale in two important areas of our business. So that's the logic behind the deal. We think that it ultimately will be a very good fit for us as a firm.

So if I conclude, as I said at the start it has been a difficult environment. Markets were jumping all over the show. The politicians are confused as to how to deal with their problems. This is not a developing world problem, so we can sit here in South Africa and feel fairly comfortable that even though we have one or two issues floating around as a country we have nowhere near the kind of issues as the developed world. But certainly for our colleagues and our people in the UK they're on the foot of Europe and there are lots of issues around Europe that affect everyone, including affecting us in South Africa at a level. We believe that notwithstanding that we should manage to deliver stable operating performance because of the diversity of our revenue stream and that solid recurring revenue base that we have.

So that is our picture. It's pretty similar to the July update with a bit more fluff on it, and obviously different to what we said in the middle of May when we would have expected a much better outcome, where we thought the world was in a much better place. Obviously none of us have crystal balls, and we didn't think the Americans would go crazy about debt levels, and we thought the Europeans would actually manage to deal with some of their problems. Maybe they still will, one is hopeful that they still will, but you never know. So that's the story. We now can take questions. I'll go to London first. Steve, have we got anyone who wants to ask questions?

Question
Good morning.

Stephen Koseff
Hi, how are you?

Question
I'm good thanks. Firstly on the Evolution deal post integration, I appreciate you have't given details of synergies, but do you envisage that the operating margin of the global wealth business will go up or down post the complete integration of the Evolution business? And secondly on the Vickers report, seeing it's [unclear]. Are there any business activities in the group that you would cease doing?

Stephen Koseff
I hate to tell you I'm not going to answer your first question. You can make your own assumptions on that. We have to go through a process and there is very little one can say at this point in time. We might be in a better position to answer your question at our November results if we've made the progress we expect to make. But I'm not answering that first question now. You can make your own assumptions on that. On the second question, again it is very early days to answer that question. But as I said to you I don't expect a major adjustment. There may be some minor modifications, but I don't expect it to be major. There are certain activities that you would not be able to do in a ring-fenced bank, but they are not material to what we are in life. A ring-fenced bank only can deal with Europe basically, if you think about it. I don't think they're material and we have other banks in other parts of the world that can pick up the slack if that bank can't deal with outside of Europe activities. Any other questions?

Male speaker
I think that's all from London, Stephen.

Stephen Koseff
Okay. Then we move across to South Africa, Johannesburg. No one? They come afterwards.

Question
Stephen, the Capital Markets business, Kensington, is that still profitable within Capital Markets? And also what is your exposure there to Irish mortgages?

Stephen Koseff
It is still profitable and obviously our provisions there have been made to deal with the Irish side of life. I can't give you the exact exposure. [Unclear] will be able to give it to you. But it is still profitable. Any more questions? Okay, thank you very much for attending and have a good day. Thank you.

END OF TRANSCRIPT