Investec

Conference Call Transcript

23 September 2021

PRE-CLOSE TRADING UPDATE

Operator
Good day ladies and gentlemen and welcome to Investec's trading update conference call. All attendees will be in listen only mode. There will be an opportunity to ask questions when prompted. If you should need assistance during the call, please signal an operator by pressing * and then 0. Please note that this event is being recorded. I would now like to hand the conference over to the Group Chief Executive, Mr Fani Titi. Please go ahead, sir.

Fani Titi
Thank you, Judith, and good morning ladies and gentlemen. This is Fani Titi, Group Chief Executive of Investec. I'm joined this morning by Nishlan Samujh, Group Finance Director, and a number of our executives are also on the call with me. Thank you all for taking the time to join us on this call to discuss our pre-close trading update which covers the guidance for the six months ending on the 30th September 2021. Please note that our half year results will be announced on the 18th November 2021. We will take a few minutes to talk through some key highlights today and will then take some questions. First a few general comments on our overall performance.

The period was characterised by good growth in revenue and lower impairments. The Group's trading performance is substantially ahead of the same period last year and in line with the pre-COVID comparative period ended on the 31st August 2019. This recovery in performance underscores the resilience of our client franchises supported by improved economic conditions. For the six months ending 30th September 2021 the Group expects adjusted operating profit before tax to be significantly ahead of the prior period, between 86% and 106% up from the £142.5 million that was reported last year.

In addition, based on the current business momentum we have raised our expectations for adjusted earnings per share for the year to March 2022. We expect this to be above the upper end of the 36p to 41p range that we guided in May 2021. Looking by geography, adjusted operating profit for the South African business is expected to be at least 50% ahead in Rands for the period compared to last year's first half results of R2.184 billion. Adjusted operating profit for the UK business is expected to be at least 125% higher than the prior period at £43.4 million.

Now looking at the key drivers. Revenue benefitted from increased client activity across the business and the geographies. Funding costs were lower and in contrast to recent periods, risk management and risk production costs associated with the UK structured products book were immaterial. Expected credit loss charges were also lower aided by limited specific impairments and certain recoveries, particularly in South Africa. It is also important to note that the Group has retained its COVID-19 related overlays in order to account for the uncertainty that still remains in the economic environment. Lastly, while operating costs grew in line with increased activity and revenue levels, efficiency ratios have improved as revenue increased at a faster rate than costs.

Now turning to divisional performance. The Wealth & Investment business grew funds under management by 9.9% to £63.8 billion supported by net inflows of £1.4 billion, favourable market movements and investment performance. Operating margins were higher in the UK, while South Africa was broadly flat. In the South African business funds under management increased by 9.5% to R364.5 billion with net inflows of R16.7 billion. In the UK business funds under management increased by 9% to £45.4 billion with net inflows of £0.6 billion. Adjusted operating profit for the first half is expected to be ahead of the prior period in both South Africa and the UK.

Now moving on to the Specialist Banking business. Core loans grew by 6.5% to £28.2 billion given increased activity levels and good client acquisition within the private banking business across both geographies. The UK experienced increased demand for corporate credit across a number of our portfolios, while SA corporate credit demand remains largely muted. For both South African and UK specialist banks, adjusted operating profit for the first half is expected to be higher than the comparative period. Last month we were very proud to learn that The Banker had recognised Investec as the best performing bank in South Africa for the second year running and the best performing bank in the UK.

In summary, the Group has capitalised on opportunities arising from continued economic recovery and achieved an encouraging result year to date. Our client franchises have shown their resilience and we have good momentum as we move forward. Investec remains well capitalised and has strong liquidity, and both these are above board approved minima. The business continues to focus on its commitment to clients, offering them innovative solutions and an out of the ordinary service experience. The changes made to simplify and focus the Group are bearing fruit, positioning the Group well for sustainable long-term growth.

Finally, I would like to thank my colleagues across the globe, who have displayed extraordinary resilience, supporting our clients and communities during what continues to be an uncertain operating environment. As COVID restrictions ease, we look forward to growth alongside our clients and to increased face to face engagement which is core to our values and culture. Thank you for joining the call. I would now like to open the line for questions.

Operator
Thank you very much, sir. Ladies and gentlemen, at this time if you would like to ask a question you are welcome to press * then 1 on your touchtone phone or the keypad on your screen. If you decide to withdraw your question you are welcome to press * then 2 to exit the question queue. Just a reminder, if you would like to ask a question you are welcome to press * then 1. We will pause a moment while we wait for the question queue to build. The first question comes from Michele Donough of Ninety One.

Chris Stewart
I wonder if that's me. Am I live?

Fani Titi

You are. We can hear you loud and clear.

Chris Stewart
Fani, it's Chris. I'm not quite sure why it's coming through as Michele Donough. My apologies.

Fani Titi
I thought it was a French Michel.

Chris Stewart
I can be Michel for you if you'd like, Fani.

Fani Titi
Thank you, Michel.

Chris Stewart
Just a couple of questions for you if I may please. Can you just give us a sense of the – you talked to the non-recurrence of losses in the UK structured products book. I imagine the environment has been favourable for unwinding some of that risk. Are you out of the woods there yet, or is there still potential for residual costs on that book to come through? That's the first question. The second question, could you possibly unpack the nature of the flows into the South African wealth management business? It looks like the net inflows have been quite positive. Looking at the disclosures that might have been in the non-discretionary area, which is an area where I guess we haven't become accustomed to big net inflows in recent years. It has been traditionally into the discretionary side of the business. Maybe you can unpack that a little bit please.

Fani Titi
Thanks Chris. Let me start with the structured products book. As we say in the announcement, we're pleased that the costs are immaterial and we continue to look for opportunities to take off risk. So we still have a book and still look to manage that book as we go and take opportunities in the market to reduce the size of the book. Also depending on where market levels are some of the book will roll off. So we're pleased with the progress we have made in how we've managed the risk. Going forward if are there opportunities to reduce the book faster we are always on the lookout for that. But it is not something that is worrying us at the moment. The costs have been immaterial. On the second issue relating to flows in wealth management, we've had flows in the UK and in SA, and we've indicated a number of approximately R16.7 billion. That covers both discretionary and non-discretionary. And we've seen significant inflows in both categories. I don't know whether Nishlan wants to add any more flavour.

Nishlan Samujh
You've had flows of about R8.7 billion into the discretionary portfolio and the rest of the R16.7 billion into non-discretionary. I think what we are quite pleased with is the nature of the flows and the underlying clients and what that builds into the future.

Chris Stewart

Investec

Great. Okay. Gentlemen, thank you very much and congratulations on what looks like a pretty solid trading update. Thank you.

Fani Titi

Thanks Michel.

Operator

Thank you very much, Chris. Ladies and gentlemen, just a reminder, if you would like to ask a question you are welcome to press * and then 1 to place yourself in the question queue. The next question comes from Bankole Ubogu of Bank of America Securities.

Bankole Ubogu

Morning everyone. Thanks for the opportunity. Just a quick one from my side. It probably has two parts. The first is that you're indicating your full year performance is likely to be better than or towards the top end of your range. When do you think you will be able to give us a sense of a new range? And number two, is there anything in your first half performance that you are cautious or concerned about that may not repeat in the second half or that might give base effects or headwinds in the second half? Those are just my questions. Thank you very much.

Fani Titi

Thank you. I will ask Nishlan to answer your questions. What we said in the statement is that on current momentum we expect to be above the range, not in the top half of the range but above the range. So it's important just to clarify that. And I'll ask Nishlan to deal with the rest of the question.

Nishlan Samujh

I think two things. In November we will give you a lot more colour once we finalise the close of this particular period. That really deals with the second question in terms of whether there is anything. Fundamentally as we've indicated in this update, the key drivers have really been a return of momentum into the business as we've seen in a pre-COVID environment, and I think that is very pleasing in terms of the outlook, as well as the fact that there have been lower impairments in the period. Rather than being driven by release of overlays it is driven by recoveries in the period. So I think when we do provide some colour you will factor that into your thinking into the full year.

Operator

Bankole, does that conclude your questions?

Bankole Ubogu

Yes. Thank you very much.

Operator
Thank you. The next question comes from Mark du Toit of Oystercatcher Investments.

Mark du Toit
Good morning everyone. I wonder if you could give us some comments around the difference in the recovery between South Africa and the UK. I'm particularly interested in the corporate lending behaviour. Are we seeing SA corporates starting to lend again? Is it a similar experience across SA and UK? Just some general comments on the differences in the environment would be helpful for me. Thanks.

Fani Titi
Thank you. I'm going to ask Richard Wainwright here who runs the bank here in SA to give you a bit more colour and Ruth Leas on the UK side to give us a bit more colour.

Richard Wainwright
Thanks Fani. Morning Mark. It's Richard Wainwright here. I'll talk about South Africa. We are still seeing a reluctance of corporates in South Africa generally to borrow, so the activity across the corporate sector is muted. The corporate growth that we're seeing here is very much in line with what we've seen with our peers, which is a muted performance. So a lot of our book growth in South Africa is coming through our private client franchise which is much stronger than in the corporate franchise. And the recoveries area that Nishlan was talking about is also more in our private client franchise than it is in our corporate area. So a lot more resilience and activity through our private client franchise as opposed to our corporate here in South Africa. Ruth.

Ruth Leas
Thanks Rich. Hi Mark. So in the UK we have seen strong demand for credit across both our private client activities and our corporate client activities. I would say that last year we did have demand for corporate credit, but it was isolated to certain areas and not across the board. And we were seeing very strong redemptions at the beginning of the COVID period. We did see strong mortgage growth due to the changes to stamp duty which has now come to an end. We still have a strong pipeline, and we expect that to slow down a little but still to be ahead of the levels at which we were originating mortgages pre-COVID. And we are seeing good corporate demand across multiple business activities leading to the level of growth that you see in the numbers before you. So the UK has grown strongly over this period. It is now hitting a patch of slower growth, inflation concerns and various things ongoing related to Brexit and energy etc. So we will need to see what the next period brings, but at this point in time momentum is strong and continuing.

Mark du Toit
Perfect. Thank you so much.

Fani Titi
As always we hope to outperform the macro. So we think that position within the corporate banking space remains very strong. It's just that there is muted growth. We are seeing some activity but we're also seeing redemptions in the South African space. In the UK space, as Ruth said, there has been a lot more activity. But the latest print in terms of economic growth in both geographies has been rather muted, but the trend in the UK

remains positive given the level of reopening of that economy on the back of a high level of vaccination. In South Africa economic uncertainty and policy uncertainty will continue to be the bugbears against a far more robust growth in the economy. And corporates react much more cautiously than with individual retail clients to uncertainty. But we remain hopeful that we will continue to hold our market share if not increase our share.

Mark du Toit
Perfect. Thanks a lot.

Operator
The next question comes from Michael Gresty of Anchor Capital.

Michael Gresty
Good afternoon guys and thanks for the opportunity. Just two from my side. I was wondering, Nishlan, if there has been any progress in the last number of months in terms of getting yourselves to a position with the regulators where you can adopt the advanced approach and potentially improving your reported capital ratios. Fani, from your side has there been any progress in terms of realising various assets, private equity assets that are dragging down your returns. And how are you thinking about all of that at the moment, if I may?

Nishlan Samujh
Michael, just to answer the first question, I think we've made good progress in this period. It is one more model that is left with the regulators, which is our income producing real estate model. The key debate point is the fact that we do have that lower loss experience in those models, and therefore it is really about calibration. We have resubmitted to the regulators based on feedback. But these processes do take time. And to be definitive I think will be a little bit presumptuous, but the positive momentum and the desire to complete exists on both sides.

Fani Titi
Thanks Nish. On the second question we remain committed to optimising our capital; specifically we would like to reduce our investment portfolio as stated previously. The environment has been much tough given COVID in terms of valuations and we have generally looked to realise assets at reasonable prices. So we have been deliberate in the realisation of assets. Obviously that portfolio is much larger than just private equity assets. I think when we report in November we will give you a much better feel of the progress we're making and the moves that we would like to make with respect to that. But we're committed to that as part of the number of initiatives that we undertook to improve overall value. Operationally we're making good progress, but we continue to increase the level of capital that we have. And that can have a dampening effect on returns, so we have to deal with the issue as a matter of priority.

Michael Gresty
I mean maybe just to be clearer, Fani, when you report might we expect you to signal that you are making progress or at least the strategy is being narrowed down and refined? Certainly the issues around COVID are all fully understood. It's not an easy time. But I think there is amongst investors a sense of urgency that people are hoping to see progress there. How do you feel the last number of months have gone? Are you progressing?

Fani Titi
Look, realising assets is not a quick thing to do. We think we're making progress. We wouldn't want to – this is a trading update, so I don't want to get into the detail of the assets as such. So let's hang ten. It's a huge priority for us as I said earlier on today. If we don't address the capital step we will not make the progress that we want to make with respect to getting to higher returns to cover our cost of capital. So it is as urgent a matter for you as it is for us as a management team, really high on our priority list. But please if you could just allow us to report in full in November.

Michael Gresty
Great. Thanks very much, guys.

Operator
Thank you. Ladies and gentlemen, just a reminder, if you would like to ask a question you are welcome to press * and then 1 on your touchphone phone to place yourself in the question queue. If you decide to withdraw your question you're welcome to press * then 2 to exit the question queue. The next question comes from Megna Makan from Benguela Global Fund Managers.

Megna Makan
Hi there. Thanks. My question is just around the strong growth in the UK loans. I just wanted to know are you able to give us a bit of guidance in terms of what's happening with the NIMs in the UK with the strong loan growth?

Ruth Leas
Hi there. It's Ruth in the UK. We have also seen a positive trajectory in reduction in our cost of funds coming through at the same time that we are seeing this strong growth in the book. So yes, an improvement in our NIMs at this point in time. If you think back to last year, we needed to run very liquid towards the beginning of COVID, as everybody did, and maintain very high levels of liquidity. The trend in the market for lower rates has really helped us to bring down our cost of funds while maintaining the volume of deposits we need to fund our asset growth. And so we have seen an improvement in the NIM as indicated in the statement.

Megna Makan
Thanks.

Operator
Megna, does that conclude your questions?

Megna Makan
Yes. Thank you.

Operator
Thank you. We have a follow-up question from Chris from Ninety One.

Chris Stewart
Right. Thank you. Sorry, can you hear me?

Fani Titi
We can hear you. Thank you.

Chris Stewart
Just a quick question. I was going to ask you about the investment portfolio, but I think you've answered that very comprehensively. The other question I wanted to ask is perhaps a comment on with the robust asset growth we're seeing in the UK banking operations what is happening with risk weighted asset growth in that space. And are you confident you can continue to pay out the sort of dividends you've been paying out whilst growing your balance sheet and risk weighted assets as you are, particularly in that jurisdiction?

Nishlan Samujh
I think a couple of points. Number one is you do have strong growth in mortgages. And from a risk weight perspective that is much lighter. We are quite comfortable with the growth, and as we've indicated with regard to capital, we're operating well above regulatory minimum and above our desires minimum. So we're fairly comfortable with the buffers that are in the capital base. Sorry, Chris, could you just repeat the second question?

Fani Titi
Dividends.

Nishlan Samujh
Again the guidance we've provided, which is a 30% to 50% pay-out ratio, I think is well considered in terms of the cycles and we are quite comfortable.

Fani Titi
Just to add, Chris, I've indicated that we've been accumulating capital over this period. So that gives you the sense that we will have capacity to pay dividends within that range, probably more towards the higher end of it. With respect to growth in the UK and growth generally of loan books we have talked about the adequacy of capital to fund that growth. We've talked about the impact on dividend that we are comfortable that we can continue to pay dividends at the appropriate level. The third element of it is always risk. With that growth what is the risk profile of the book, in particular on the mortgage book? We are very comfortable with our experience given the quality of clients that we have. So, on both capital risk and dividends we're very comfortable that we are in a good space. Thanks Chris.

Chris Stewart
Super. Thank you.

Operator
The next question comes from Stephan Potgieter of UBS.

Stephan Potgieter

Good morning. Thanks very much for the update. A very good performance. Just a question on your credit quality and credit loss trends. You mentioned some recoveries bringing down the credit loss charge for the period. Maybe just in terms of the trends both in South Africa and the UK. You mentioned you are also still hanging on to coverage. Do you still expect in the UK perhaps some uplift in credit losses as the furlough schemes come to an end, some of the macro issues start to impact in the UK? If you can maybe just give some colour on that. Thank you.

Nishlan Samujh

Sure. Thanks for the question. I think we have indicated that there has been no real pressure in terms of new impairments arising, which I think talks to the quality of the book, the level of recoveries that have been experienced, and the fact that you don't have pressure from a modelling perspective or from a specific name by name perspective. I think all of that gives a real positive outlook in terms of underlying quality of the book which we've been quite pleased with in terms of behaviour. With regard to overlays, both in South Africa and the UK we remain cautious. At the end of the day it's not at levels which you've seen in the retail banks. There are provisions on the balance sheet. We think that it gives us good coverage for some of the risks that lay out there. And with regard to the unfolding of the relief aspects, particularly in the UK, we remain cautious around the outlook around that. But what's most important for us is that behaviourally from a client perspective there are really no signs at this stage of anything.

Fani Titi

Ruth, do you want to give any more colour on the UK? I think Stephan had an interest in the UK, the furlough schemes and the other

Ruth Leas

Thanks Fani. I think that Nishlan answered that comprehensively. We are watching to see the impact of the removal of the furlough scheme. The government has been seeking to manage a soft landing as it withdraws from some of these programmes and replaces with others. As Nishlan says, there is a fair amount of unpredictability and uncertainty still surrounding us in the system, and that is why we are being cautious. It's not a reflection of our own asset quality but just in terms of the unpredictability of the macro environment as we look at it today with rising inflation, slightly slowing growth and the impacts from Brexit. But in the areas and sectors which we've been operating in we've been very comfortable thus far and I'm not seeing signs of stress at this stage.

Stephan Potgieter

Thanks very much. Very clear.

Operator

Thank you. Ladies and gentlemen, just a final reminder, if you'd like to ask a question you're welcome to press * and then 1. The next question comes from Waleed Mohsin of GS.

Waleed Mohsin

Good morning. Thanks so much for the call. Two questions from my side. Perhaps if you could talk a little bit about the underlying cost trends. It's obviously pleasing to see the improvement in cost to income ratio, but perhaps you could talk about some of the cost initiatives you've been taking and how they've been bearing fruit in this period. And secondly, good deposit growth. If you could just talk about the type of deposits and the flows into both South Africa and the UK business on the deposit side. Thank you.

Nishlan Samujh

It's Nishlan here. If I take the cost base I think at the end of the day there were quite a few initiatives that were executed on in the prior year. And we are seeing the benefits of those come through particularly around our fixed cost base. And across the businesses we continue to see ourselves operating at well below inflation when you look at fixed costs. When you look at momentum obviously there is an element of variable that will follow improved underlying performance of the businesses. And we will really unpack the specifics around those when we get into the actualities of the results. Ruth, I don't know if you want to touch base on the deposit base on the UK bank.

Ruth Leas

Thanks Nish. Sure. Hi Waleed. In terms of deposits in the UK what we saw last year is that as rates came down we brought our rates down and were flooded with high levels of deposits coming towards us. We are substantially retail funded as you know, and the invested credit has seen a strong traction in this market. So we were able to build the deposit base while reducing the overall cost of funds. Given that we are seeing a pick-up in demand for credit across the market, I would say that that reduction in rates has reached a trough and we're starting to see a slight turn towards increasing retail rates in the market as lenders are now seeing stronger demand for credit. We have really used this period of time also to implement a technological infrastructure behind our deposit raising, the back end or the plumbing so to speak to be straight through processing to help us with the actual manufacturing costs of these deposits, which has come through very nicely as well, so moving a lot more of that into digital solutions. But very comfortable with the level of our retail deposits and the overall cost of funds we've been able to achieve throughout this period.

Fani Titi

If I may just go back to the cost question just to add colour, we've obviously made certain key decisions over the last two years to increase scale and critical mass. And that has a structural benefit to cost. We've also looked at operating leverage in between bank and wealth and between South Africa and the UK. We've had certain initiatives that increase operating leverage. So as we go forward we look to much more contained fixed cost, and as performance and revenue improve you obviously will see a higher degree of variability in the income that is linked to those revenues, essentially variable remuneration. But that is the way we want our business model to work. But we are pleased with the changes we have made structurally and we are pleased with the level of containment of costs. And we are also pleased that we have the level of variability in costs, particularly employment costs, linked to the performance of the business at a revenue level.

Waleed Mohsin

All right. Thank you so much. That's very helpful. Thank you.

Operator
We don’t seem to have any further questions on the lines. I will now hand over back to Mr Fani Titi for closing comments.

Fani Titi
Thank you Judith. Just in closing, we are pleased with this performance and we look forward to unpacking more of the detail in November. We are pleased also that we are now tracking at pre-COVID 2019 environment and that all our businesses are performing well. We have both wealth businesses performing well, both bank businesses performing well, costs contained, and as discussed earlier we continue to put significant focus on the reduction of the investment portfolio and the optimisation of our capital. So thank you for your interest, and we look forward to a much more detailed interaction in November when we announce the interim results. Thank you again.

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

END OF TRANSCRIPT