

## Discovery, Investec face off

It can't be coincidence that just as Discovery prepares to open a bank, Investec has gone into life insurance.

Given the cultural similarities between the businesses, there is a substantial client overlap.

It hasn't been such a drawn-out process for Investec as it did not have to apply for a new licence - it had a dormant licence it inherited from Fedsure.



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Harry Botha, an analyst at Avior Research, says the product will initially be sold to the 75,000 clients of the SA wealth and investment business.

But he says building up the life business will take time, as it usually doesn't make sense for clients to switch out of existing life policies, especially if new underwriting is involved.

Investec Life will form part of the One Place offering, Investec's more sophisticated version of the Alexander Forbes one-stop shop.

It will be interesting to see how the relationship between Discovery and Investec will develop.

As the two leading entrepreneurially founded groups in Sandton they have been natural allies: Investec Asset Management manages Discovery's full range of investment portfolios, for example.

But will it continue this contract once the groups are competing in both life insurance and banking?

Investec CE Stephen Koseff isn't too concerned.

"I am sure the newcomer will do something clever in banking which will appeal to some of our clients, but banking in SA isn't an uncompetitive business as it is."

Half of the Investec Specialist Banking book in SA, or R118bn, is to private clients, R56bn in nonmortgage-based lending.

Discovery could certainly chip away at this, but this unit is in good shape, with a 13.1% increase in lending.

Investec has even more room to grow in the UK.

It has a large wealth management business with 32bn on its books, 80% of which it runs on a fully discretionary basis. Yet its UK private bank lending is just 1.6bn. It doesn't even face the threat of a Vitality Bank launching in the UK for several more years.

Leonard Kruger, a portfolio manager at Allan Gray, says Investec is only now officially launching its private bank in the UK - up to now it had just 30 private bankers on the payroll.

The main driver is to increase noninterest revenue through transactional activities such as spending on its credit card. It is already improving its transactional and annuity revenue from its UK corporate bank, says Kruger.

"The group has the ability to increase revenue above inflation, certainly far more so than the large SA universal banks."

UK banking has been the weak link in the group for several years. But it is turning.

The legacy portfolio might sound quite *Downton Abbey*-ish, but it is a kind description of the bad debts acquired, much of it through acquisitions such as the subprime mortgage lender Kensington as well as a series of Irish planning and development assets.

The red ink peaked at 4.8bn in 2008. But Koseff says that largely through asset sales, redemptions and write-offs it has fallen to 476m.

It has met the schedule so far, but Koseff says the balance might take longer to wind down than initially expected. At least the returns from the ongoing section of the UK bank were up 8.2%.

Kruger says Investec needs to be looked at on a "sum of parts" basis. Investec Asset Management, which operates independently and has limited synergy with the rest of the group, also has significantly better-quality annuity income.

It has very little need for capital and no risk of impairments.

Its operating profit was up 22% to 144m and its assets under management were up 26% to 95.6bn. Koseff says there were some chunky outflows from large institutional clients, especially in the Americas and Asia Pacific, but there was a substantial turnaround in the SA market. Notably, the strong flows out of the Investec Value Fund in previous years turned.

Independently listed Investec AM could be worth at least R35bn - a third of the group total.

The wealth and investment business (the private clients) has even stickier money than Investec AM.

Henry Blumenthal, whom Koseff poached from HSBC some years ago, has a cult following in parts of Johannesburg.

Wealth's operating profit was up 8.8% and it accounts for 16% of group earnings, but it can't be seen as a stand-alone business.

Investec understands better than anyone the cross-selling opportunities between managing assets and offering credit - not just to individuals but to the businesses they run.

But Koseff says there will be differences between SA and the UK: Investec's original business was lending to professionals such as doctors, but the margins are too thin in the UK. Instead it will focus more on entrepreneurs and the wealthy - both markets it has got to know in SA.

Investec has recovered from its post-Brexit low, up 30% to R104. It is hard to see what impact the vote would have on Investec given that the majority of its UK clients are either residents or mid-cap businesses with a domestic focus.

It sits on a p/e of 12, in line with FirstRand. But Investec has increased operating profit by 17% compared with the muted 7% coming out of FirstRand.

And FirstRand, for all its cute ads, remains a bog-standard high-street bank dependent on old-fashioned banking income.

Investec has 56% of its income from capital-light activities, predominantly its quality asset management franchise, as well as activities such as property.

With no similar businesses on the JSE, it is a useful share to diversify, both geographically and by lines of business.

**Source:** *Financial Mail*

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