Preliminary Results 2002

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Results and Performance

Q.
Operating profits are down 15 per cent. How disappointed are you with this performance?

A.
They're down 15 per cent in sterling and up 8 per cent in rand and, given that a lot of our earnings are in rand what you see is that the business is affected by the gyrations of the rand. But if you look, business by business, in original currencies, you'll find that they all did pretty decently.

Q.
Do you think it's been a good performance relative to your peers?

A.
I would hope so. I'm sure in South Africa we've done pretty well. Our US life business was absolutely the highlight for us over the year because we tripled sales compared to the period prior to our purchase and earnings are a multiple of where they were last year.

Q.
But are you really different from those peers in the UK sector? After all, you can't claim you're unaffected by the markets?

A.
No, I do think we do have a different balance though. Clearly our equity businesses are affected the same way as everyone else's equity businesses. But the proportion of our sales that are in the fixed-interest based annuity markets compared to others is different. So, for example, something like 55 per cent of our sales last year were for fixed-interest based life assurance products and I think that'll be the highest of our peers.

Q.
Everyone in the UK is worried about the solvency of the life businesses. Where do you stand?

A.
Fortunately last year, our ratings were re-affirmed both by Moody's and by A.M. Best in the United States as the same level they had been in the past and our solvency in all our regulated businesses remains well above the statutory minimums and is, in fact, very strong.

Q.
The insurance sector has been criticised for using meaningless and confusing figures when reporting. Why should we believe yours?

A.
Well, I'm an actuary so I can talk to this subject with a great deal of enthusiasm!

Q.
Well, that's one reassurance but what else can you offer?

A.
I think the structure of our businesses is actually simpler than most others. You can see in our accounts how much capital there is, how much earnings have been made, and you might like or dislike it, but the number's relatively clear.

Q.
You've made a number of disposals in the UK and in the US over the last six months. What was the thinking behind that?

A.
In the UK we had businesses that didn't fit with our core asset gathering and asset management mandate; and so we disposed of the things that weren't core. And we raised about £100m. So we were quite pleased with the effect it had on our balance sheet as well as the focusing. Secondly, in the UK, those companies had big balance sheets, big risks attached to them, so in addition to raising the capital, we've actually reduced the risk. So those two things have gone together well.

Now in the United States, what we had was duplicates. We had firms that were doing the same job as the firms we wanted to keep. Really we've just sold the duplicates, so we can get our management focused on the core operations for the future and not these ones that weren't really contributing.

Q.
It has been a difficult market, we've talked about that, but are you willing to admit that you overpaid for some of those businesses that you bought during 2000 and 2001?

A.
I think I've said publicly many times we did overpay. We bought them at the top of the market and that's why we wrote them down last year. But, having said that, their strategic positioning remains good. They are businesses that fit within the Old Mutual mandate; they're businesses that add value to the other businesses around them; they're things that we're pleased to have for the future.

South Africa

Q.
Your performance in your biggest market, South Africa, has been mixed but can you continue to deliver returns which will offset the performance of the rand?

A.
Yes, I'm sure we can. We've said that our growth target is something like, in real terms, two to three times GDP. The underlying growth in South Africa last year - things like assets on the banking side, new business sales on the life side - were all within that range. The profit growth didn't quite meet the range that we'd hoped but, over the long run, the underlying effects will come through. And, of course, don't forget that the ROEs in South Africa are still the highest by a long way. We're achieving something over 20 per cent return on equity in South Africa.

Q.
But surely you can't realistically expect to add new business at the same rate you did in 2002?

A.
No, 2002 was exceptionally high and it will reduce. We had some very lumpy, group with-profit annuity cases last year. And they come and go. We won't have that next year, almost certainly. But the underlying trend, nevertheless, will be positive.

Q.
So your confident that you can continue to deliver what you call 'world-class margins', even given the uncertainty over the future economic outlook in South Africa generally?

A.
Yes, I think that the economic performance of South Africa as a whole has been very good. If you look at the budget deficit, if you look at the overall GDP growth rates over the last seven or eight years, these numbers have all been delivered by the government to a standard that, I think, South Africa can feel proud of. So it's against that background that I'm comfortable that this industry, which I think is a growth industry because South Africa needs capital formation, will continue to be the basis for growth for our company.

Q.
Nedcor reported last week but its results were poor. Has it gone ex-growth or was this just a bad year?

A.
No, there were some special features last year. The translation losses had a big impact and that won't reoccur. And they had a large loss in their business banking book, which really arose from previous years but came through in 2002. And, of course, Nedcor's big activity last year was the acquisition of BoE. So that puts them in a very sound position to get earnings

growth in the future.

Q.
BoE hasn't really bedded down yet though, has it?

A.
No, the acquisition's new and we have said that our R900m [rand] of synergy savings is going to occur in our accounts for the first time in 2006. So, we're at the beginning. There's a lot to do. But so far, it's on target.

Q.
Is it really going to make a big difference for the future?

A.
It has to make a big difference. The company last year on core earnings made about R3bn rand so R900m addition to the R3bn is a very substantial change in the company's progress.

Q.
Turning to more general issues in South Africa, just how significant is Black Economic Empowerment, BEE, for international companies like Old Mutual?

A.
It's an important issue for us to engage with in South Africa. Our shareholders? long-term interests are in a sound and secure economy and political system in South Africa. Clearly there are some things from the past that need to be dealt with. So we have to engage with it. But I don't this is something which causes us a great worry for the future or anything. It's not a great threat. It's something that we have to deal with. We have to deal with properly. And I think we all understand that value creation is what the company is about.

Q.
When will the Financial Services? Charter be agreed - it's not going well, is it?

A.
No, I think it's going fine, actually. It's not going to appear in the next month or two. I would expect it to be probably the second quarter of this year, perhaps even into the third quarter. I think it's more important to get it right than to rush it

Q.
And what effect do you think it will it have ?

A.
I think it will lay out a framework for the companies to operate in, so there's a kind of a compact between the community and the insurance companies and, indeed, the banks, so that everyone knows what part everyone will play going forward.

United States

Q.
The US businesses may have done well in terms of sales, but when are the profits coming through?

A.
I think they did come through on the life side, big time. We made $125m before tax in 2002 and we made $19m on the life side in 2001. Now that was only half a year and there were acquisition expenses and so on so that comparison is a little bit flattering. But nevertheless, the ROE's over ten per cent, so it's already exceeding our cost of capital. We priced at over 12 per cent so we're seeing only the difference between the pricing margin and the delivered margin, which is a new business strain at the moment. So we're very much on track with our targets on the life side.

Q.
Margins are key though. What sort of levels on margins do you think you can achieve?

A.
On the life side, the delivered result for 2002 was about 19 per cent, which is about what we've said is possible in that market over the long run. Now margins are tightening somewhat in the market but we don't see ourselves over the long run being outside of the 15 to 20 per cent range. So that's where we're heading.

Q.
Did you put the brakes on new business in F&G at the end of the year or was it something more fundamental

than that?

A.
No we put the brakes on. We reduced the crediting rates - the rates we pay our policyholders - in October last year and that caused sales to slow down sharply in November and December. Looking forward, of course, the fact that the interest rate curve has flattened, means that our advantage, because we're in the 10 year bond rate compared to the one year CD rate, has reduced. But we were the ones that actually reduced the sales in the fourth quarter of last year.

Q.
Will you need though, to inject further capital in order to grow the business?

A.
Yes, definitely. Broadly, the premiums take something like six to seven per cent of each premium as fresh capital. So as the business is growing so sharply, every dollar of increase will take six cents in capital.

Q.
Assets under management have reduced, so what's the underlying trend here?

A.
There are three big movements in the assets under management. First of all, we disposed of various firms during the year, so they reduced by something like $13bn or $14bn on the basis of disposals. Secondly, about two-thirds of the assets are equity and, of course, they were affected by markets. And that reduced it by another number, something of the order of $13bn or $14bn. And then the flip-side, of course, the positive side, was that the fixed-interest assets, which are generated from the life insurance business but also within our firm called Dwight, were very positively affected by the markets and they were significantly up. So there are three trends, all of which are intersecting with each other in the middle of that.

Q.
Going forward, are you confident you can continue to grow in the USA through organic growth alone?

A.
Yes, I'm very confident of that. You know, frankly, even if we halved our life assurance sales, our assets would continue to grow on that side. So, there's a growth track that's very well-established now from that perspective. Secondly, we've put a new management team into the US, starting eighteen months ago, and it's gradually been filled out during 2002. And the focus of that team is very much about creating new distribution initiatives.

United Kingdom

Q.
The UK is clearly your biggest problem. What are you doing about it?

A.
There are four UK businesses, but the biggest one is Gerrard and that's the one that everyone is worried about. And clearly its result last year, which was a profit but a small profit, isn't where we'd like it to be. But I think the key thing to note about 2002 for us, is that the management team was stable. They laid out their strategy. We put it to the analysts and explained it to everyone publicly in October. And they're now executing the various strands of it. So we're adding new product, the IT system is bedded down and the integrated IT system is now complete. We're able to look through our pricings so we can make sure that every product is priced properly. We're adding financial planning support so there's a much bigger business-gathering effort going on in the regions. We've reduced the expenses substantially, by some £25m during the year. So we've got a platform for going forward that's much stronger than it was .

Q.
Isn't the problem though, that no matter what you do, all those steps you take, any meaningful recovery is dependent on a recovery in the markets - and that seems a long way off?

A.
Of course the market recovery would help enormously but, you know, revenue went down last year by something like £25m as a result of the market falling. So you might have expected profits to go down by £25m. Actually, they went down by nothing. They actually are the same this year as last year. So there is quite a lot you can do to respond to the market. But there's no question - market recovery, customers feel better, these business prosper.

Q.
Is Gerrard scalable in the long term?

A.
Yes Gerrard can get a lot bigger. We've started to put in place a much more corporate system of management in Gerrard's which is the thing that makes it scalable. When you're simply adding on little franchises out there, actually you don't get any great scale out of that. They just replicate. But the scalability of this system that we are putting in place, we think is much greater.

Q.
Turning to the UK as a whole again, are you sticking to the timescale and targets that you outlined for the UK business in October last year?

A.
Yes, we're sticking the net cash inflow target. Clearly we've got a lot of work to do. We didn't deliver that target in 2002, so that's all to play for. On the profit target side, the original profit of £40m included profits for the businesses we've sold so we've stripped out the £15m that related to GNI, OMS and King & Shaxson. So our target is now £25m but it's not different it's an equivalent target to the £40m.

Q.
There's a gap in your UK portfolio isn't there - when are you going to make a move into the life assurance side in the UK?

A.
As I've said, we certainly do have two big businesses in the US and South Africa and therefore a smaller business, or not a big enough business, in the UK. We did spend 2002 doing what we'd promised, which was bedding down and we are now ready we believe, to take the next step on our journey. So we are looking during 2003 to think about this very hard. But we really aren't in a rush. The underlying businesses are performing well and we will always be driven by the returns we can add rather than the precise timing.

Q.
You say you're not in a rush but you've gone on record as giving a timescale for this year and you've recently been linked with Britannic.

A.
We obviously can't comment on the market rumours but this is the year when we'll be thinking hard about it. But, as I say, it's rather determined by value than by timing.

Outlook

Q.
What targets are you setting for the business in 2003?

A.
What we'd like to do is take the next steps, as I say, of our journey. First of all in South Africa, the biggest target is to make sure that we deliver the next leg of the BOE integration savings. That's the most important feature. On the life insurance side, I'd like to see us build our sales forces out some more. And we'd like to see a good resolution to the BEE and Financial Charter issues.

In the US, we'd aim to produce another significant sales year. It probably won't be as high as 2002 because we'll constrain it but, nevertheless, it will grow the asset base and the profit base. And we'd like to see the US life business making good progress towards the 12 per cent ROI target. And on the asset management side, I'd like to see us delivering another $5bn of net cashflow.

And here in the UK, I'd like to see the net cashflow coming up towards the target and Gerrards starting to move towards a target profitability.

Q.
How does all that progress relate to your stated 2004 targets?

A.
We're on track for most of those. We should be able to produce the target numbers on both profit and growth with two exceptions where we're market dependant. The US asset management ROI is dependant on market recovery. And likewise, in the UK we need some market help to get to the profit target.

Strategy

Q.
Old Mutual has been described as being in a strategic no-man's land where you're positioned between taking your first steps outside South Africa and fully finding your feet in those new markets? Is that fair?

A.
I'd certainly say that we haven't got to the end of our journey. But no journey starts and ends with one giant leap. These things have to be broken down into stages and into milestones. If you went back four years ago and you looked at the pound or the rand or the dollar you were investing in Old Mutual, almost all of that money was invested in South Africa. If you looked at the numbers at the end of 2002, something like 60 per cent of your pound or rand was invested in South African businesses, something lie 35 cents or pence was invested in US businesses and a small amount in the UK. Now, as I say, we'd like to make those roughly equal - therefore we have more to go in our journey. But the fact that we've made a lot of progress is good. The fact that we haven't gone all the way forward means we've got more work to do.

Q.
You're clearly focused on those three geographical areas - South Africa, the US and Europe. But what are the risks and opportunities to be gained by this approach?

A.
What you've seen in 2002 is the diversity of the result. The fact that we are in several different markets made our results much more resilient than many of our competitors. So the big gain from the diversity is resilience. The other thing it allows you to do, when you have that kind of spread, is that you can pick off focus areas within your markets where there are growth opportunities. So for us as a company, in South Africa we have a 30 per cent market share. That's a wonderful place to be but on the other hand, it's hard to grow market share from 30 per cent. But we can take our skills and our expertise to the US where we're 2 per cent or 3 per cent (or, depending on how you calculate the market, you might get as high as 5 per cent or as low as 1 per cent) but we can focus on something that we can actually grow. So that diversity also gives us growth opportunity.

Q.
Isn't one of the problems that because your capital resources aren't huge, you are forced to buy companies that need a lot of work doing to them?

A.
I don-t regard that as a problem. I regard that as an opportunity. If we can add value for our shareholders by applying our management skills to companies that need help, so long as we pay for them on the basis that their sellers understand they need help and aren't in good condition, then, frankly, that-s an opportunity for us to add value. So I'd rather buy a company that's cheap and needs fixing and fix it, so long as it's strategically well-positioned which, as I've said, our US businesses and, indeed Gerrards, are. The fact that we as management have to add value, is to the shareholders' advantage.
