

Operational review: Corporate & Investment Banking

Overview

The group's Corporate & Investment Banking franchise is underpinned by two main centres in Johannesburg and London, which work together to support its operations across a broad international footprint.

The division posted a good performance in 2005, off a high base, despite fewer trading opportunities domestically and internationally. The performance of our international operation was disappointing with lower revenue being generated across most trading areas. Low levels of credit impairment charges were experienced during the year with recoveries of prior period credit impairments and the reversal of surplus provisions resulting in an overall recovery for the year.

After a period of strong organic growth in the South African market, our focus has been on aligning our businesses in the rest of Africa and internationally along the lines of the successfully implemented customer-centric model established in South Africa over the past five years.

Operational focus over the last year was on structuring executive reporting lines, teams and systems to ensure competitive services and structured products across all operations. We continued to invest significantly in retaining and incentivising teams of talent.

Strategy

Besides the ongoing process of integration and alignment, the year was one of reflection given the changes in global wholesale banking markets. Emerging markets continued to gain in popularity, with developing countries improving their credit ratings and a growing appetite for emerging markets risk among investors. In this environment, traditional emerging market participants like ourselves are encountering increased competition from the large established global banks in our chosen markets.

In the face of these new challenges, we have had to reconsider the best way to reposition the business for sustainable growth. We identified that although we are in the appropriate markets, to remain competitive we need to enhance our regional and in-country capabilities with urgency. This has been set as a key strategic imperative in the years ahead, and will require significant further investment in people and infrastructure. The cost of this investment will inevitably have an impact on returns in the short term.

Corporate & Investment Banking has formulated a three-part growth strategy.

Growing off a high base in South Africa

This will involve:

- positioning the bank to maximise exposure to Black Economic Empowerment (BEE) activity, in terms of both empowerment financing and advisory services;
- capitalising on the financing needs arising from the infrastructure development activity planned in South Africa in the short to medium term, and the rest of Africa's development in the longer term; and
- increasing the proportion of net interest income to total income due to the increased potential for corporate loan growth.

Growing our business in the rest of Africa

This will involve:

- ensuring that we capture the banking business associated with trade flows intra-Africa and between Africa and other emerging markets;
- maintaining focus on providing customer-centric solutions to corporate customers, whilst leveraging off the group's skills and products; and
- focusing on banking the Government and International Organisation (GIO) sector and donor flows on the continent.

Growing the regions outside of Africa

This will involve:

- building depth and scale in regional businesses in emerging markets in Asia, the Americas, Europe and the Middle East;
- driving penetration of core competencies such as resource banking and global markets capabilities into the regions;
- identifying specific regional product opportunities; and
- linking existing investment banking businesses in key markets with the acquisition of commercial banks such as the pending transaction in Argentina.

Financial performance

Corporate & Investment Banking comprises 45% of the group's earnings (2004: 50%). Headline earnings grew by 7% in 2005, off a high base in the prior year. This headline earnings growth was made up of an 8% decline in global markets, an 8% increase in banking and trade finance and a 27% increase in the investment banking category.

An ROE of 27,0% (2004: 27,2%) was achieved. The cost-to-income ratio of 54,0%, compared to 51,5% in the prior year, worsened due to reduced revenue in the international business. Costs were well contained to a 7% increase.

Operational performance

Global markets

Global markets house the division's financial markets and treasury activities including the resource banking and money market funding units.

Tough trading conditions were experienced particularly in international emerging markets where low volatility, a tightening of spreads from increased competition and high levels of global liquidity significantly reduced trading opportunities.

Trading income in our international business was also adversely impacted by a continued shift from a reliance on proprietary trading, with lower value at risk utilisation, to becoming more client focused. Our strategy to build and develop a structured product capability in the international business started to yield positive results towards the end of the year, with strong customer demand for tailored solutions in capital markets and access to local emerging markets.

The foreign exchange market continued its trend of low volatility and spread tightening particularly in our core rand product. The foreign exchange business achieved good results despite the environment presenting limited opportunities.

The equities trading business performed well with increased business confidence in South Africa boosting local equity markets and strong business flows.

Strong revenue flows were generated by the securitisation and debt origination businesses. The securitisation team also successfully concluded the group's first asset-backed securitisation transactions: R4,5 billion of mortgage loans and R3 billion of vehicle and asset finance receivables.

The debt securities business experienced strong flows during the year notwithstanding tough market conditions. The international principal trading business generated increased revenues relative to 2004, despite running a lower level of market risk.

In precious metals trading, strong physical related short-dated trading flows were experienced from a well-diversified global client base. However, a strict anti-hedging stance among precious metal producers continued in 2005, resulting in a lack of long-

dated transactions which dampened revenues. Base metals trading reported good revenues against a background of significant interest in the metals markets and 20-year price highs. The growth of the Chinese economy coupled with increased hedge fund activity, continued to drive the market. Although the volatility in oil prices during the year augured well for the commodity trading business, structural changes to the team outside of Africa resulted in lower than expected revenues.

The mining finance and structured commodity finance businesses continue to be regarded as leading arrangers and providers of structured financing facilities for metal producers and the development of mining projects. The buoyant metals markets seen in 2005 resulted in increased competition from financial institutions not previously as active in the mining and metals sector. Consequently, the market also experienced downward pressure on returns and loan terms.

The energy finance team had a strong year and benefited from an expanded client base. This resulted in a well-diversified spread of risk and transaction structures. Progress was made in expanding the team's transaction capability in the power and renewable energy sectors.

The treasury funding unit in South Africa experienced continued margin pressure as a result of the significant amounts of term funding required to support the strong asset growth across the South African business, together with increasing the average long-term structure of the funding book in line with internal prudential guidelines.

Major IT investment in 2005 and 2006 will see the implementation of the latest global systems in interest rates and equities trading, credit trading and energy trading. This will enable us to introduce a fuller product range, leading to an improved customer service offering across the range of our global markets activities.

We have a strong and mature global markets team in South Africa as evidenced by the following recently awarded accolades:

- In Risk Magazine's South African market survey, Standard Bank was rated first overall and ranked first in nine categories across the interest rate and equity derivative businesses.
- Standard Bank was voted "Best Bond House" for 2005 by the Bond Exchange of South Africa Spire Awards, and also won awards in four other categories.

The challenge going forward is to export this model to the rest of our operations by scaling up our regions, completing the IT infrastructure implementation and hiring and up-skilling staff.

Operational review: Corporate & Investment Banking continued

For Corporate & Investment Banking to remain competitive internationally, we need to enhance our regional and in-country capabilities with urgency.

Banking and trade finance

The banking and trade finance business encompasses corporate lending, transactional banking businesses, custodial services and trade finance business.

Competition in the vanilla corporate lending market generally remained fierce with margins coming under pressure. The transactional banking business grew volumes, introduced new products and won major new accounts.

The electronic banking business grew market share substantially by focusing on enhancing customer service and improving technology. The project to roll out corporate electronic banking technology in the rest of Africa is progressing well.

The custody business also had a great year, achieving record volumes and assets under management.

Specialised finance continued to broaden its business, with innovative transactions closed in Turkey, Asia, the Middle East, Russia and Mexico. Most notable was the joint underwriting of a major acquisition of South-East Europe's largest oil refinery. The group also established its credentials in the rapidly expanding Islamic finance market with two significant transactions underwritten and subsequently oversubscribed in general syndication.

Loans and advances by product

	Change %	2005 Rm	2004 Rm
Gross loans and advances	30	133 620	102 662
Overnight lending	35	27 477	20 365
Term lending	17	47 639	40 610
Loans granted under resale agreements	48	26 291	17 750
Commercial property finance	34	16 196	12 095
Other loans and advances	35	16 017	11 842
Credit impairments for performing and non-performing loans	(4)	(1 439)	(1 494)
Net loans and advances	31	132 181	101 168

Telecommunications finance posted strong growth. The scale of transactions increased significantly, new risk distribution channels were developed and the client base doubled. Major successes included the largest project financing deal in the Ukraine and a first mandate in Pakistan.

Trade finance had a good year – despite further tightening of margins in key markets. Good volumes in the trade finance business also contributed significantly to the growth in profitability.

The distribution group had another successful year placing over USD10 billion of syndicated loans, trade finance and forfaiting paper, and successfully arranging 45 syndicated financings, primarily in Russia, the former Commonwealth of Independent States (CIS), Eastern Europe and the Middle East. The business retained its position as a market leader in the arranging and placing of emerging market syndicated debt and was ranked by Loanware as the top arranger and distributor of syndicated loans for financial institutions in Russia, Ukraine and Kazakhstan.

Investment banking

Investment banking includes the equity investment and advisory businesses, project finance, structured and property-related lending as well as the off-shore asset management and wealth management units.

The specialist corporate finance advisory team, the mining and metals advisory group and the equity investments businesses performed well during the year. In South Africa, BEE deals continued to drive business growth. Major transactions concluded during the year included introducing BEE partners into Medi-Clinic, SA Eagle, Assore and Tiger Brands.

Other notable deals included a fair and reasonable opinion for the Venfin board in respect of the Vodafone offer as well as a number of transactions and assignments in Papua New Guinea, Scandinavia, Central Europe and the Americas.

Standard Bank, as the global adviser for the Celtel International B.V. Group, was mandated to raise medium-term financing for Celtel Kenya Limited through a floating rate secured bond on the Nairobi Stock Exchange. The deal is the largest corporate bond on the Nairobi Stock Exchange and also in the East African Community region. Furthermore, this is the first time that Kenyan Shilling denominated debt has been placed outside of Kenya.

The low interest rate environment resulted in robust increases in property prices in South Africa. This boosted performance in the property finance and advisory services business with positive

mark-to-market profits being generated and sizeable realisations in the listed property investment portfolio. There was also significant growth in the property lending book, which contributed to increased profitability.

Structured finance encompasses longer-term structured lending to corporates, primarily in the form of asset- or project-backed financing. The structured finance division won a number of major mandates in 2005 that should generate good returns in the coming years. The project finance division is currently focused on infrastructure investment in Africa and in particular the Gautrain project which, in spite of a number of delays and some controversy, appears to be moving towards finalisation. The Gautrain is a 77km high-speed rail link that will connect Johannesburg and Pretoria.

Focus areas for 2006

Standard Bank's Corporate & Investment Banking business is focused on becoming a strong emerging markets contender and is pursuing new opportunities in market sectors that show strong growth potential.

Focus areas in the year ahead will include:

- A continued focus on building our customer base and offering better services.
- Retaining key staff and completing the programme of hiring and up-skilling staff in the international businesses to enhance our regional and in-country capabilities.
- Driving people and infrastructure development aggressively and achieving greater economies of scale in the international businesses.
- Acquisition opportunities in key markets focusing on product related businesses and commercial banking opportunities in conjunction with Personal & Business Banking.