

# Conference Call transcript

4 December 2018

## MANAGEMENT CONFERENCE CALL

### Operator

Good afternoon ladies and gentlemen and welcome to the Standard Bank's management conference call. All participants will be in listen-only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call, please signal an operator by pressing star and then zero. Please note that this call is being recorded. I would now like to turn the conference over to Arno Daehnke. Please go ahead sir.

### Arno Daehnke

Good afternoon ladies and gentlemen and thank you for joining us this afternoon. Thank you, operator. I have with me Brooks Mparutsa, who is our CFO of CIB. I also have with me Cedric Miller who is the CFO of PB, and Sarah Rivett-Carnac, Head of Investor Relations.

Today we will comment on the year to date operating environment in the countries in which we operate and the impact on our businesses. In South Africa, whilst some policy progress has been made, this has taken longer than expected, and business and consumer confidence has remained low. Early in the year we guided that we expected to see a pick-up in activity in the second half of 2018. Whilst we have seen some signs thereof there has been no significant increase in momentum.

With inflation remaining within the target band despite currency and petrol price pressures consumers continue to manage their debt relatively well. South Africa emerged from a technical recession in the third quarter of 2018, reaching GDP growth of 2.2%, which we think should lift sentiment going forward. The 25-basis point rate increase seen in November is too late to impact SBSA margins for 2018 but is expected to add positively to NII in 2019. I remind you the 25-basis point increase is equivalent to approximately R300 million of NII on an annualised basis.

In the other African economies in which we operate inflation, interest rates and exchange rates have largely stabilised with the exception being Angola where the Kwanza has continued to devalue. The East Africa region continues to show strong growth with GDP growth expected to exceed 5% in 2018 supported by better weather conditions across the region and strengthened confidence in Kenya following the prolonged election period. Higher oil prices for most of the period have helped to strengthen fiscal buffers and sustain economic growth in the West Africa region, and our portfolio continues to be supported by the recovery in the oil & gas sector in Nigeria.

Now turning to our 2018 outlook. In South Africa whilst overall growth in our retail portfolio is dampened by our large home loans portfolio which is growing at a slower rate, our vehicle and asset finance and business portfolios continued to report stronger growth. As can be seen in the September BA900 data, we are growing our market share in vehicle and asset finance in line with our stated strategy. In CIB our investment banking and TPS portfolios continued to grow. Global markets portfolio has declined as surplus liquidity held previously ahead of downgrade has been repaid. The decline in the global markets portfolio has impacted the growth of

the CIB portfolio overall, and this was already evident in the first half of 2018. Loan growth in our Africa Regions businesses continues to outpace that in South Africa. Oil & gas and industrials are driving the growth.

Non-interest revenue growth is expected to continue to exceed net interest income growth, with NII growth impacted by lower margins driven by negative endowment, tighter pricing and the impact of IFRS 9. At this point I wish to note that last week the IFRS Interpretations Committee voted in favour of presenting contractual interest earned on loans and advances that have cured out of stage three within credit impairment charges rather than within net interest income. On a pro forma basis for the six months to 30<sup>th</sup> June 2018 this would have resulted in a R545 million decline in net interest income and a commensurate decline also in credit impairment charges. It would also have negatively impacted net interest margin and jaws, but obviously positively impacting the group's credit loss ratio. We await further clarification in this regard. Underlying credit performance remains strong and continues to track better than expectations. The group's credit loss ratio is expected to remain below the lower end of our through-the-cycle guidance range of 80 to 100 basis points.

Turning to costs. In a constrained revenue environment, we continue to manage our head count and our costs carefully. Cost growth has slowed in the second half of 2018. Excluding the impact of the IFRS Interpretation Committee decision we expect jaws for the full year to improve from the negative 180 basis points printed in the first six months of 2018.

Now turning briefly to our other banking interests. I'm pleased to tell you that ICBCS has concluded the legal process relating to the stock of aluminium warehoused in Penglai and now has full and free ownership of this metal. Whilst ICBCS has recorded the recovery of this aluminium, which was fully written down in 2015, the operating environment remains difficult and the business is expected to make a loss for the year. ICBC Argentina continues to perform well in local currency, but this is diluted when translated into Rands due to the currency devaluation. Liberty as you know provided an operating update on the 22<sup>nd</sup> November.

Our capital position remains strong and will support a dividend cover at the lower end of our 1.8x to 2.2x cover range. Our medium-term targets remain relevant, and I remind you these include the following:

- A cost to income ratio over the medium-term trending down to lower 50 percentile;
- A sustainable headline earnings growth; and
- An ROE in our target range of 18% to 20%.

In closing, notwithstanding the very difficult operating environment in our biggest market, being South Africa, the group's geographic spread and diversity of earnings streams enables it to continue to grow earnings and to deliver appropriate returns whilst maintaining a resilient balance sheet. We will report our 2018 results on Thursday the 7<sup>th</sup> March 2019. I will now take questions. Operator, thank you.

#### **Operator**

Of course, sir. At this stage if you would like to ask a question please press star then one on your touchtone phone or the keypad on your screen. If you decide to withdraw the questions, please press star and then two. Our first question is from Harry Botha of Avior Capital Markets.

#### **Harry Botha**

Good afternoon everyone. Arno, thanks very much for the detailed commentary. I just wanted to get a sense of the advances growth in the Q3 update improving slightly. Could you maybe give us a bit of insight into what's driving that? Is it South Africa or Rest of Africa? Thanks.

#### **Arno Daehnke**

Hi Harry. We are seeing improved advances growth in Africa Regions as well as in South Africa. If you're interested in more detail on South Africa I will hand over to my two CFOs to specifically talk about the retail advances and wholesale advances growth.

**Harry Botha**

Thank you.

**Arno Daehnke**

Cedric, do you maybe want to cover retail, and then I will hand over to Brooks.

**Cedric Miller**

Let me just talk briefly about the SA context and then the Africa Regions context from a retail perspective. As Arno mentioned, our mortgage growth certainly has been slow in lower single digits, but we do certainly see stronger growth in our VAF products specifically and in our personal and unsecured lending spaces. Just to give a little bit of context, in the VAF space, we have seen in SA record disbursements for the last two months over the last five or six years. And similarly, in unsecured lending where we have seen quite a sharp increase in disbursements. It will not necessarily translate into a very strong balance sheet growth. The simple reason is that we are experiencing quite high run-offs in both those as well. And I think one thing that we really want to highlight is that what we would call other unsecured lending in the Africa Regions space is growing very strongly in the sense that that is in fact double-digit growth at the moment. We are seeing that across all of our countries except Malawi. So, we are particularly pleased with the growth in unsecured lending. And we have touched on mortgages already.

**Arno Daehnke**

Great. Thanks, Cedric. Brooks, on the CIB side?

**Brooks Mparutsa**

Okay. On the CIB side I think what we say is in terms of our loans and advances to our clients we've seen probably high single-digit growth year on year. The growth in Africa Regions has been higher than that we have experienced in South Africa. We've certainly seen good growth coming out of East Africa in particular. That has been the star performer in our Africa Regions portfolio followed by West Africa. In South Africa I think the credit environment has been tough in terms of demand, also in terms of early repayments, as we said at the presentation of the half year results. We have also had early settlements in our South Africa portfolio. In our South African portfolio, real estate and consumer market segments are down year on year. So, in South Africa slower than Africa Regions, but overall loans and advances in the high single-digit growth year on year.

**Arno Daehnke**

Thank you, Brooks.

**Operator**

Thank you very much. The next question we have is from James Starke of SBG Securities.

**James Starke**

Hi. Good afternoon, Arno and team. Thank you for the opportunity. Two questions from my side. Firstly, you mentioned jaws to improve from the negative print in H1 2018. Can you narrow that down further? Perhaps can we expect positive jaws for the full year? And my second question is around provisioning and perhaps how we should be thinking about new SOE exposures from a provisioning perspective from here. Thank you.

**Arno Daehnke**

Hi James. On the jaws, we will not be printing positive jaws. They will be negative for the full year, the second half slightly strong than the first half. But that is excluding the interest in suspense on cured assets which I have referred to already. So not positive jaws. On the SOEs, CIB continues to carefully manage their exposure and we do not expect significant provisioning impacts from any of our SOE positions.

**James Starke**

Thank you.

**Operator**

Thank you, sir. Ladies and gentlemen, just a reminder, if you would like to ask a question please press star and then one. Our next question is from Chris Stewart of Investec.

**Chris Stewart**

Arno, good afternoon. Thanks for the opportunity. Just a quick one. It was a little bit echoey on the line, so I might have misheard. It sounds to me as though you have got the ownership of the Penglai bonded warehouse aluminium. My understanding was that was an amount of somewhere around \$30 million. Maybe you can just confirm that. And the second question is you indicate that ICBC Standard is still loss-making for the year. Is that loss-making for the year excluding the impact of this amount? Are you crediting this amount to the P&L? If so is it going through outside of headline learnings? What exactly is the accounting treatment? And are you including that within your guidance for ICBC Standard?

**Arno Daehnke**

Thanks Chris. The total aluminium value was \$38 million. Your second question was on ICBCS loss-making. Yes, regrettably it will be loss-making including this aluminium recovery. And then 40% of this recovery is recognised through our equity-accounted associate, ICBCS, and then we also have a smaller portion which is recognised through CIB income.

**Chris Stewart**

Okay. So, the full \$38 million is not a credit to the income statement of ICBC Standard?

**Arno Daehnke**

No.

**Chris Stewart**

You know what the obviously next question is. What portion of that \$38 million is going through ICBC Standard that is still loss-making for the period?

**Arno Daehnke**

40%.

**Chris Stewart**

40% of that. Okay, perfect. Great. Thank you.

**Operator**

Ladies and gentlemen, just a final reminder, if you would like to ask a question please press star and then one. We have a question from Asanda Notshe of Mazi Asset Management.

**Asanda Notshe**

Hi. Good afternoon. Thanks for the presentation. I just want to find out on the system implementation and I guess the resulting cost savings if you will, and perhaps just how that has gone, and also their contribution to the depreciation line, and just maybe some guidance around that. Thanks.

**Arno Daehnke**

Thank you for that question. As we have communicated in March, we have now implemented the SAP core banking system in South Africa. So that's our main core banking solution for South Africa. In Africa Regions we have embedded the Finacle system which has been rolled out to all the countries, apart from three countries where we have a Temenos solution. So effectively we have completed our core banking migrations for all of our countries onto the strategic platform, and that includes the Temenos platform. The amortisation cost for 2018 will be around R2.5 billion to R2.7 billion. So, we are pleased with the performance of the system and obviously we are now extracting the benefits in terms of improved client insights and being able to serve our clients better through our core banking technology.

**Asanda Notshe**

Thank you.

**Operator**

Our next question is from Etienne de Kok of Arqaam Capital.

**Etienne de Kok**

Hi Arno and team. Thanks for the opportunity. Just perhaps regarding the capital injection for ICBCS noted at H1, the \$84 million. When do you anticipate that to flow through?

**Arno Daehnke**

\$84 million is what initially was discussed. We expected that to be injected initially at the end of this year, but we thought early next year. But the risk weighted asset utilisation in ICBCS remains low and their current plan is to inject this only at the end of 2019. There could possibly be a reduction or postponement even beyond that.

**Etienne de Kok**

Okay. Thank you very much.

**Operator**

Ladies and gentlemen, just a final reminder, if you would like to ask a question please press star and then one. We have a question from Stephan Potgieter of UBS.

**Stephan Potgieter**

Sorry, I was on mute there. Good afternoon. I just want to know the margin outlook for FY18 if you could provide some guidance on that.

**Arno Daehnke**

Hello Stephan. We have previously guided the margins down. We continue to guide in that direction on the back of endowment, as well as the IFRS 9 treatment of interest in suspense. And our guidance previously was 10 to 20 basis points down on the prior year's margin, FY17. And that guidance is still valid, 10 to 20 basis points down.

**Stephan Potgieter**

Thanks very much. Maybe just a follow-on on the interest in suspense or the IFRS 9 clarification that you mentioned. Have you factored that into your guidance? I wasn't sure in terms of what you said in terms of net interest income and credit losses.

**Arno Daehnke**

If we do factor that in we're probably closer to the higher end of the range, closer to 20 basis points down. We haven't quite seen the full calculations of that yet, so we're still going through those numbers. It was a ruling just received the other day. But we shouldn't be exceeding the 20 basis points down.

**Stephan Potgieter**

Okay. Thanks very much.

**Operator**

Sir, that was the last question that we had on the line. Do you have any closing comments?

**Arno Daehnke**

No closing comments from us. Thank you very much to the participants, and we look forward to seeing you in March in our GLC facilities.

**Operator**

Thank you very much sir. Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT