Conference Call transcript

25 November 2019

PRE-CLOSE CONFERENCE CALL

Operator
Good day ladies and gentlemen and welcome to the Standard Bank's pre-close conference call. All participants will be in listen-only mode and 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 everyone and thank you to the operator. We appreciate everyone dialling in this afternoon and thank you for the interest in this call. I have with me Brooks Mparutsa, the CFO of CIB, Barbara Bell, the CFO of PBB, Sayuri Govender, Head of Group Finance 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.

I think it is fair to say that the operating environment in South Africa is very challenging. As announced on Thursday last week, the Governor of the Reserve Bank expects GDP growth to be 0.5% for the year, this will be the third year in a row of a deceleration. Inflation print for October was 3.7%, an 8-year low. While some notable progress has been made on governance, the government has been slow to implement much needed policy reform. This has continued to weigh on sentiment and in turn demand for credit.

In contrast, the macro-economic environment in most of the countries in which we operate outside of South Africa has been much more favourable. Ghana and South Sudan are on track to be the fastest growing countries in the world in 2019, both with growth rates of around 9%. Kenya and Uganda are expected to grow GDP at 5.6% and 6.2% respectively. And Nigeria has emerged from a recession. Stronger economic growth, combined with increasing levels of penetration, continues to drive our faster Africa Regions loan growth.

Across the Africa Region's portfolio, inflation and interest rates have trended down. Exchange rates have remained relatively stable across the majority of the African economies in which we operate. The exceptions are Angola, Zambia and Zimbabwe. Exchange rates in these countries have deteriorated relative to the South African Rand, dampening their ZAR earnings contribution. This has been partially offset by relative currency strength in Kenya, Nigeria, Mozambique and Uganda.

Now turning to our 2019 outlook.

In PBB South Africa, the home loans portfolio continues to grow in line with the market. We have successfully gained market share in the retail vehicle and asset finance market. And our unsecured lending portfolio continues to grow in line with 1H19. The PBB Africa Regions portfolio continues to grow faster than the South African portfolio. In CIB our investment banking and TPS portfolios continue to grow. The sectors driving balance sheet growth are Financial Institutions in South Africa, Sovereign & Public Sector and Power & Infrastructure in Africa Regions and Mining & Metals across both South Africa and Africa Regions.

Average balance sheet growth will support net interest income growth. However, this will be dampened by lower margins. In South Africa, the 25 basis point cut in July 2019, together with the competitive pricing in CIB, will weigh on margins. I remind you that a 25 basis point cut in interest rates has a R300 million impact on net interest income on an annualised basis. Whilst Wealth International benefited from higher interest rate in 1H19, the reversal thereof has proven a headwind in the second half. We are pleased that the interest rate caps in Kenya have been removed, this change will only be applied prospectively and therefore the impact in 2019 is expected to be negligible.

Non-interest revenue growth is expected to continue to be softer than net interest income growth. Fees remain under pressure, as customers increasingly transact on our digital channels. As noted in our results to 30 June 2019, we have seen some customer attrition in South Africa during the year. We have taken actions and pleasingly the attrition has slowed. The Africa Regions' customer base continues to grow. Trading revenue has picked up, driven by volatility in South Africa and supported by a steady performance in Africa Regions.

Impairments continue to increase, driven by higher Stage 1 and Stage 3 charges. The increase in Stage 1 impairment charges is driven by balance sheet growth. The increase in Stage 3 impairment charges is primarily driven by a combination of extended legal processes in mortgages in South Africa and certain CIB non-performing loans in our East and South & Central Africa Regions countries. The Group's credit loss ratio is expected to remain at the lower end of the Group's through-the-cycle guidance range of 70 to 100 basis points.

Turning to costs. We continue to manage costs tightly. Despite a slowdown in revenue growth in the second half of the year, we expect to deliver positive jaws for the full year.

The Group's effective tax rate is expected to be lower than that of 2018.

Now turning to our other banking interests.

As you are aware, in September this year we impaired our investments in ICBCS from USD383 million to USD220 million. I wish to reiterate that the decision to impair the investment was driven by the deteriorating market conditions and the lower than expected client flows. These negatively impacted the outlook for the business and in turn, its valuation. The R2.4 billion impairment is recognised in earnings attributable to ordinary shareholders but outside of headline earnings.

In light of the difficult environment, ICBCS has reviewed its operations. It has announced its intentions to close its Equities and Base Metal businesses subject to shareholder approval. This management action will give rise to restructuring costs but will reduce risk weighted assets and free up capital. We have not put any additional capital into ICBCS in 2019. The current ICBCS business plan does not envisage any additional equity capital injections in the short term. We have limited opportunities to exit our shareholding in ICBCS at this time.

The sale of our 20% stake in ICBC Argentina is still subject to regulatory approval. I remind you that we stopped recording the earnings attributable to our stake from 1 September 2019.

Liberty provided an update to the market last week, we will refer you to their announcement dated 21st November.

Our capital position remains strong and will support a dividend cover at the lower end of our 1.8x - 2.2x cover range.

Looking ahead to 2020, weak employment prospects and the concerns around fiscal sustainability will weigh on South Africa's growth outlook. We urgently require structural reform to lift trend growth. We suspect the SARB will delay any rate cut until after the 2020 budget in February and the Moody's review. Africa Regions' growth prospects are expected to remain stronger than that of South Africa. We will provide more detail on our 2020 outlook when we report in March.

In closing, the Group's banking operations continue to grow their balance sheets and revenues whilst keeping a close eye on costs. ICBC Standard Bank Plc's year-to-date loses are a big disappointment and they will place a disproportionate drag on Group earnings and return on equity for the 2019 year.

We will report our 2019 results on Thursday 5th March 2020. I will now take questions. Operator, thank you.

Operator
Thank you. If you would like to ask a question, please press star and then one on your touchtone phone or on the keypad on your screen. If you decide to withdraw the question, please press star and then two to remove yourself from the list. Again, ladies and gentlemen if you wish to ask a question please press star and then one. We will pause to see if there are any questions. We have a question from Harry Botha from Avior Capital Markets. Please go ahead.

Harry Botha
Good afternoon Arno and team, thanks very much for the update. Just two quick questions, other banking interests, please, for ICBCS is it possible to give us an update on this from what you had at June and for ICBC Argentina, is it possibly to quantify the impact from stopping equity accounting? Thank you.

Arno Daehnke
Hi Harry. On ICBCS you will recall that our share of the loss, the 40% share, as of June was R752 million and Harry you will also remember that of the R752 million, R111 million was operational losses and R641 million was related to the Philadelphia Energy Solutions (PES) Refinery explosion.

In the three months to 30th September 2019, ICBCS continued to record operational losses and revenue was not sufficient to cover its costs and ICBCS has incurred additional costs related to the PES event. In terms of our expectations for the second half of 2019 we expect, therefore, continued operational losses and also additional costs related to PES, specifically legal costs. There may also be costs relating to the restructuring and that relates obviously to the closure of the Base Metals and the Equities business.

Harry we are not in a position right now to quantify the quantum of these costs at this stage as there is significant uncertainty still around the amount and the timing of all three costs incurred in the second half. In terms of the PES insurance recovery, we are still pursuing it but at this stage we have not accrued for any recovery.

On ICBC Argentina, we recorded zero earnings after the 1 September 2019. The gain on sale, the FCTR and the capital impact will only be recorded once the sale has been completed. We expect it to be in 1H20.

Operator
Okay. We have a question from James Starke of SBG Securities. Please, go ahead sir.

James Starke
Good afternoon Arno and team. Thank you for the opportunity. Just one on ROE, can you just update us on where you see that holding out against your 18% - 20% target, not only for FY19 but on into F2020?

Arno Daehnke
Hi James, our ROE target as you know is 18% - 20% over the medium term. We will not be within this ROE target range for the 2019 financial year, in other words we will be below the 18%. Looking into the medium term, so not specific 2020 but in the next three years, we continue to have confidence of entering that 18% - 20% ROE target range on a sustainable basis and maintaining our ROE within that target range.

Operator
We have a question from Jacques Conradie of Peregrine Capital. Please, go ahead sir.

Jacques Conradie
Hi Arno. Thanks for hosting the call. Just a tax question. You guys and all the other big banks have significant preference share books and obviously draconian kind of tax legislation proposal a few weeks ago. I mean what's your view on whether rationality will prevail there and do you have a back-up plan I guess in case the worst case scenario plays out?

Arno Daehnke
Yes, Jacques we have a strong conviction that rationality will prevail and that that ruling will be reversed.

Operator
Ladies and gentlemen just a 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. Please go ahead.

Asanda Nortje
Afternoon gents. I'd just like to find out on the costs, are we starting to see the benefits of the cost program or the implementation of the new system, obviously branch closures and so on, or is there anything specific that leads you to potentially coming out with positive jaws for the year?

Arno Daehnke
Hi Asanda. Certainly we've worked on structural cost initiatives for many years now, those are related to both the technology platforms which was deployed in the past as well as activities we have done in 2019 such as branch closures. The benefits of branch closures will only be fully felt next year because obviously we bore the costs up front in 2019 and as I said the benefits will be felt later on. The Group continues to see opportunities to reduce costs further and we continue to affect those and try and monetise across all dimensions.

Operator
We have a question from James Starke of SBG Securities. Please go ahead.

James Starke
Hi Arno. Sorry I should have asked this earlier. Pertaining to the branches, can you comment perhaps on the impact it has had, if any, on your client experience and perhaps how you've seen it play out in regard to customer attrition or retention?

Arno Daehnke
James I'll hand you over to Barbara Bell from PBB.

Barbara Bell
Okay. James, I think obviously any big large closure in this regard will certainly have some impact on customer satisfaction. I think for the most part we've seen a lot of that recover subsequently. We've seen reasonably good

outcomes from that perspective. We obviously have also seen some increased activity in our call centres and we are obviously responding to that. I think attrition is a mixed bag, I think you've got a combination of competitive environments at the best of time and not necessarily directly related to the branch closures per se. As we mentioned we have slowed down attrition in the last quarter.

Operators
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 Charles Russell of Citi. Please go ahead.

Charles Russell
Hi Arno and team, thanks for the call. Just a question to clarify a statement made earlier. Arno you mentioned that customer attrition has slowed, does that mean that customer numbers are still reducing or does that mean that you just losing less than what you lost in comparative years and you know relative to the normal goings that you have in a year, customer numbers are now starting to increase?

Arno Daehnke
Okay I will hand over to Barbara as this is specifically PBB South Africa.

Barbara Bell
Hi Charles. What we spoke about at half year was a moderate reduction in the customer numbers for SA. That reduction is largely the same into the second half… into this last quarter but what we are seeing now is that we slowed down the attrition and the base is starting to stabilise. So, moderate attrition still in the last couple of months, but we've now seen that starting to turn. And really the benefits of the more recent management strategies are starting to take hold. So, the year-on-year attrition is at a very similar level as we would have spoken about as of June.

Charles Russell
Barbara could I follow up with a question regarding those management strategies that you are talking about to slow the attrition?

Barbara Bell
Sure, that's a combination of the ecosystem work that we're doing, the introduction of what we refer to as enterprise and prestige direct, as well as new product offerings. So, for example the new MyMo launch that you would be familiar with. All of those are part of the overall management response to the attrition.

Operator
Ladies and gentlemen if you would like to ask a question please press star and then one. We have a question from Chris Turner of Investec. Please go ahead.

Chris Turner
Hi Arno thanks for the call. A quick one, your ROE guidance that you've spoken to a little earlier where you've said it will be below the target range for FY19, what does this look like on a normalised basis excluding the R2.4 billion in payment out of ICBCS?

Arno Daehnke
The impairment was only taken in the third quarter – impact from the fourth quarter in fact - so the impact on average equity would not be material Chris.

Chris Turner
And on an earning basis?

Arno Daehnke
In other words, if we take out the cost of the ICBCS operational losses and PES starters?

Chris Turner
Yes

Arno Daehnke
The ROE would be quite a bit higher Chris. I'm reluctant to give you the exact number and whether it's within the target range or not but it would be markedly higher. In other words the ROE of the banking activities, if that's what you asking roughly, excluding other banking interests, is quite a bit higher than the Group ROE.

Operator
Ladies and gentlemen, just a final reminder if you would like to ask a question please press star and then one. If you would like to ask a question please press start and then one. Arno, we have no further questions. Do you have any closing comments before we conclude?

Arno Daehnke
Yes, thank you Claudia and thank you for all the people who have dialled into the call, we appreciate that and we looking forwards to speaking to you at our March year-end result presentation and discussions.

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

END OF TRANSCRIPT