Pre-close call with investors and analysts
Monday 4 December 2017, 15h00

Call led by Arno Daehnke, supported by Luvuyo Masinda, Sayuri Govender and Investor Relations

Operator

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

Arno Daehnke

Good afternoon ladies and gentlemen, and thank you Judith, and thank you to everyone on the call for your interest. I have with me Sarah Rivett-Carnac who is our Head of Investor Relations. Also with me is Luvuyo Masinda who is the CIB CFO, and Sayuri Govender who is joining us from PBB Finance. Thank you for your interest and I look forward to spending the next few minutes with you to talk about our pre-close call for Standard Bank.

The operating environment in South Africa has quite clearly remained uncertain over the last few months in the run up to the ANC conference, which is now just over a week away. The low consumer and business confidence continue to weigh on investment decisions and credit growth.

In our Africa Regions, the dynamics continue to be diverse. Since the half year, we have seen inflation pressures starting to ease and interest and exchange rates have largely stabilised.

In the West Africa region, higher oil prices have been supportive of a recovery in these economies. Economic activity has increased across the region, with higher production volumes and positive business, consumer and investor confidence. Foreign currency liquidity constraints in Nigeria have eased, following the introduction of the NAFEX rate in the second quarter this year.

In East Africa, the electoral impasse in Kenya has ended following the rerun of elections in October 2017, and the Supreme Court ruling upholding Uhuru Kenyatta as the winner. The effects of the drought have subsided, and food price inflation is declining. The regulatory caps and floors introduced in Kenya in September 2016 remain in place and have resulted in a slow-down in credit growth.

In South & Central Africa, Mozambique's currency remains stable, although on average weaker than in 2016. Zimbabwe has recently experienced a change in leadership for the first time in almost 40 years in a peaceful transition and there is hope that this will be positive for the economy.

The BA900 regulatory returns have recently been released for September 2017. In these, you will have seen that in South Africa, both our retail and wholesale lending portfolios continue to grow slowly, as the effect of protracted low consumer and business confidence weighs on the investment decisions of our clients. We would see this trend continuing in South Africa to the end of the year. Loan growth in the Africa Regions should be slightly quicker.

Also in the BA900 returns, you will have noticed that our retail deposit funding has grown steadily over the year. Our retail funding market share has stabilised and our NPS scores have shown an improvement.

For context, in 1H17, profit attributable to ordinary shareholders was up 14%, with headline earnings up 12%. Profit attributable to ordinary shareholders for the nine months to 30 September 2017 grew 16% period on period, and headline earnings adjustments were not significant. Although many of the trends experienced during the year remained consistent to the end of October, we remain cautious on credit performance in the last two months of the year as well as potential market movements closer to year-end.

Now turning to the full year outlook for 2017.

Starting with net interest income, in the first half of 2017, net interest margin expanded strongly, in part due to positive endowment, with most of this coming from our Africa Regions. Subsequent to the half year, in South Africa we had a 25bps cut in the repo rate in July 2017 and in the Africa Regions, interest rates have largely stabilised, so the positive endowment impact should be more muted for the full year. We expect our margin for 2017 to expand slightly from the full year 2016 NIM of 383bps.

The pressure on fees and commissions in South Africa continues. We expect the usual acceleration in fees in PBB SA in the second half of the year, as customers transact more in the lead up to the holiday season. The strong performance delivered in the Africa Regions in local currency for 1H17 has continued in the second half. Overall, fees and commissions for the group are expected to be flattish on last year, slightly weaker than we expected earlier in the year.

The trading revenue performance in the second half has been stronger both in SA and Africa Regions, where there has been a return of portfolio flows in Nigeria following the introduction of the NAFEX rate. We still expect that trading revenue is likely to end the year lower than 2016 but should not be down as much as at the half year, where the 1H16 comparative was particularly strong.

The credit environment in South Africa remains manageable. Customers have cautiously taken on credit and we have continued to ensure our credit collections capabilities are strong. The trends to date are similar to the first half for PBB, with home loans and VAF improving on better quality books, and a slight increase in charges from credit card and business lending, evidencing some strain but still well within appetite. PBB Africa Regions was impacted by elevated charges in Nigeria. CIB has delivered lower credit impairment charges, particularly from reduced portfolio impairments in Nigeria and Ghana. Despite risks to the credit impairment charge, we expect the group credit loss ratio for 2017 to be at the lower end of the 80-100bps guidance range.

IFRS 9 will be implemented on 1 January 2018. We have been running parallel since January this year and are busy with a hard close audit process, so we are well advanced in the lead up to the go-live. There will be a day-one reduction in retained earnings. Based on September inputs, we expect an increase in the stock of balance sheet provisions of 25-35% and a 40-70bps impact on CET 1, which is slightly higher than we expected six months ago. The impact will obviously be subject to circumstances and inputs as at 1 January 2018. A directive issued by SARB proposes a phase-in allowance to spread the transitional adjustment over 3 years, which will dampen the immediate impact on capital.

We continue to focus on carefully managing our costs against a low revenue growth outlook. Amortisation of the IT intangible asset should increase to approximately R2.7bn for the year. We expect to deliver positive jaws for 2017, though slightly moderated from the 1% at the half year.

The direct taxation rate for 1H17 was low at 21.1%. This should increase to around 23% for FY17.

The group's income statement will continue to be impacted by African currency movements, however it is expected be less so in 2H17 than in 1H17.

Our African subsidiaries with large non-controlling interests are Nigeria, Kenya and Angola. Good performances from Nigeria and Angola are expected to more than offset a more muted performance from Kenya. We expect profit attributable to non-controlling interests to increase compared to 2016.

Looking at other banking interests, we still expect ICBCS to break even for FY17, in line with their business plan. The Argentine Peso has appreciated slightly against the ZAR in the second half of the year, though on average still remains weaker than a year ago, and the operating conditions in Argentina continue to be difficult. However, we expect that ICBC Argentina will have a better second half, similar in ZAR to the second half of 2016.

Liberty released their operational update for the nine months ended 30 September just over a week ago. In it, they noted that operating conditions are expected to remain challenging in light of the poor outlook for economic growth. Management's immediate priority remains the strategic execution of initiatives to restore the value of new business and margin, reduce costs and complexity in the business and improve the customer experience.

The Liberty earnings attributable to the group will be impacted by the REIT accounting mismatch as well as the number of treasury shares outstanding and SBK share price at the end of the year. Currently the REIT is trading below its NAV, which results in a reported profit in Liberty's accounts, whereas at the end of 2016 the REIT was trading above its NAV with a reported loss in Liberty's accounts. If the 2017 SBK share price on 31 December is higher than the 2016 closing SBK share price of R152, this will be reported as a loss. You will recall that we included a very small profit from Liberty in the second half of 2016. We expect Liberty to deliver a better second half in 2017 than last year.

Putting all of this together, the group's earnings are likely to grow faster than banking activities' earnings.

Our capital position remains strong and will support a dividend cover at the lower end of our 1.8 -2.2 times cover. In 1H17 the group delivered an ROE of 16.1% and banking activities ROE of 16.8%. The group ROE target range remains 15-18% with a strategic focus on moving higher into the target range for the full year.

Lastly, the three rating agencies recently announced their decisions on the rating of the SA sovereign, and subsequently on the banks.

- Fitch affirmed their ratings at BB+, one notch below investment grade
- S&P downgraded their ratings by one notch to BB for the foreign currency rating and BB+ for the local currency rating, now both sub-investment grade; and
- Moody's retained its investment grade rating but placed the ratings on review for downgrade.

While Standard Bank remains well positioned to manage the impacts of ratings downgrades, with strong capital and liquidity buffers, it will undoubtedly make doing business in South Africa more difficult in 2018. We expect the downgrades to negatively impact economic growth and employment. Retail consumers and businesses are likely to remain constrained and demand for credit low. Government and bank funding costs are likely to rise, particularly in foreign currency, and credit impairment charges may also increase. Foreign outflows following index exclusions may be negative for the exchange rate. Sustained currency weakness could translate into upward pressure on inflation and higher domestic interest rates in 2018.

Whilst the outlook in South Africa is expected to remain constrained, we expect our Africa Regions economies to continue to grow at attractive rates, providing diversification to group earnings. We remain committed to delivering continued earnings growth and an improving ROE.

I will now take questions. Operator, thank you.

Operator

Thank you very much sir. Ladies and gentlemen, at this time if you would like to ask a question you're welcome to press star then one to place yourself in the question queue. If you however decide to withdraw your question you're welcome to press star, then two on your touchtone phone to remove yourself from the question queue. Just a reminder, should you wish to ask a question you're welcome to press star and then one. We have a question from Jacques Conradie of Peregrine Capital.

Jacques Conradie

Hi Arno. Thanks a lot for the update. Just a question on the SA business. Are you seeing any signs in the last two or three months that could make you optimistic on things trending into next year, or do you think it really comes down to how December plays out and whether that gives consumers a confidence boost or a further confidence hit?

Arno Daehnke

Sure. Thanks for the question. We have not yet seen signs trending into a more positive environment. As per your suggestion it does depend on December and obviously what the rating agencies are going to do early next year, Moody's in particular.

Jacques Conradie

Okay great. Thank you.

Operator

The next question comes from Prince Mopai of Benguela Global Fund Managers.

Prince Mopai

Hi Arno. My question is on the SA sovereign credit rating downgrade. I want to know, how has the bank put measures in place to prevent any significant rise in the cost of funding? And also I want to know will you be able to pass the increased cost of funding on to your clients or rather customers?

Arno Daehnke

Thanks Prince. We expect the biggest impact to be on the cost of funding for foreign currency funding and less so for Rand cost of funding. In terms of foreign cost of funding we have pre-emptively raised additional funding this year as we did last year which will hopefully allow us to weather the increased cost of funding. In terms of passing it on to clients a portion of the increased cost of funding will be passed on to clients, but it will also adversely impact our net interest margin as some of this cost we will have to bear.

Prince Mopai

All right. And then another question is on the loans and deposits, rather on the loans side. Obviously given the low economic growth environment do you see any opportunities for growth? And if so which loan types do you believe are going to offer that growth, short term and long term to be specific?

Arno Daehnke

Sure. Let's split it into the retail and the wholesale business. In PBB we continue to see our credit growing mid-single digits. Most of the opportunity is in vehicle and asset finance where we are under our market share. In CIB we have seen some improved pipeline coming through and possibly we see slightly accelerated loan growth going into the end of the year and early next year.

Prince Mopai

Okay. That's all from me. Thank you.

Arno Daehnke

Okay. Thanks Prince.

Operator

Ladies and gentlemen, just a reminder, if you wish to ask a question you're welcome to press star and then one. The next question comes from Harry Botha of Avior Capital Markets.

Harry Botha

Hi Arno. Thanks for the update. I just wanted to ask about SAP implementation. How is it going? Are you still on track to implement in the next couple of months? Thank you.

Arno Daehnke

Harry, we continue to make good progress on our SAP implementation. Our last big implementation is scheduled for the first quarter of next year.

Harry Botha

Okay. Thank you.

Operator

Ladies and gentlemen, just a reminder, if you wish to ask a question you're welcome to press star and then one. The next question comes from Elan Levy of RMB Morgan Stanley.

Elan Levy

Thanks Arno. Thanks for the call and for the update. A question for you perhaps, Luvuyo, on the corporate credit loss ratio which from your guidance has continued to track very well. Obviously at interim stage you were quite comfortably below your guided range of 40 to 60 bps and it sounds like that hasn't changed much in H2. Under your base case do you see that starting to inflect into next year? Or perhaps more philosophically do you see it as giving you some sort of risk appetite to perhaps originate more aggressively next year?

Luvuyo Masinda

Thanks Elan. I think you're right. The credit loss ratio that we're seeing is still within the range and in fact slightly below, a similar trend to what you saw at interims. I think when we look forward I think the most important thing that we've learnt is being disciplined around our client acquisition and operating within the regions that we've chosen. And outside of South Africa where we typically do have higher credit impairment it does mean focussing a lot on multinationals and starting to now focus a little bit more on the large corporates within the countries. We think because of the way we are focusing our client strategy we don't foresee that our credit loss ratio will necessarily worsen. We still think focussing on international multinationals or even South African multinationals on the continent there is still massive opportunity for growth using the balance sheet. So we don't see that as an inhibitor for growing our balance sheet. We don't think that necessarily has to come at the expense of higher impairment. I think the credit loss ratio will naturally go up slightly as a result of the Africa region becoming a bigger component overall rather than us originating more aggressively from a credit risk point of view.

Elan Levy

Okay. That's clear. Thank you.

Operator

The next question comes from Chris Steward of Investec.

Chris Steward

Good afternoon all and thanks very much for a very comprehensive review of how things are going. Maybe you can help me understand a little bit what has resulted in the IFRS 9 slightly bigger adjustment expected on the common equity tier one. Is this an industry-wide phenomenon or is it something idiosyncratic to Standard Bank?

Arno Daehnke

Chris, the industry-wide phenomenon would have been the doubtful debt allowance which you probably have been following. The doubtful debt allowance when it came out was slightly higher than what we had originally modelled in terms of the percentages allocated in phase one, two and three. So that had a slightly wider impact. And, Chris, our models are obviously forward looking in terms of expected credit loss charge. They are factoring in a worsening credit environment, downgrade etc. That is all priced into those models. So that obviously would have also increased the balance sheet provision and the transitioning amount.

Chris Steward

Okay. It will be interesting to see how these numbers compare across credit providers in the market to see who is expecting what I guess. All right. Okay, thanks.

Arno Daehnke

Thanks Chris.

Operator

The next question comes from Charles Russell of Citi.

Charles Russell

Hi. Sorry, I had myself on mute. Thanks Arno for the update. One quick question from my side. You mentioned that your net promoter score is improving. If you could perhaps elaborate a little on that. To what extent is it improving? I think the last number I saw was seven. Could you perhaps talk about how much improvement you are seeing there? And then also the impact on retail customer numbers, perhaps your active current accounts or other transactional and savings accounts. Those numbers have been trending backwards for the last couple of reporting periods. What is happening with those today?

Arno Daehnke

Thanks Charles. This is a metric obviously very important for us, especially in South Africa where we've lagged the market in terms of our PBB SA net promoter scores. We have seen improvement since May 2017. And this particular metric has increased from 49% to 66% as at the end of September, so there has been a good improvement there. Charles, you will remember when we had our discussion we put in specific management actions to boost our NPS and to make sure that we deliver to our clients' expectations. So that has improved that net promoter score and we're very pleased with that trend. But clearly we still have lots of work to do in this space and it is ongoing. We are by no means where we would like to be finally. The second question was on…

Charles Russell

Just the impact on customer numbers.

Arno Daehnke

Oh the impact on customer numbers.

Charles Russell

Did the higher net promoter score result in customer numbers increasing or are you still seeing that decreasing?

Arno Daehnke

In our targeted client segments we continue to grow our clients as per our expectations in those segments. So we are on track to deliver on where we want to grow our clients too.

Charles Russell

Great. Thanks very much.

Operator

Ladies and gentlemen, just a reminder, if you wish to ask a question you're welcome to press star and then one. Mr Daehnke, we don't seem to have any questions in the queue at this stage.

Arno Daehnke

Great. Thanks very much everyone and we look forward to engaging with you in the new year.

Operator

Thank you. On behalf of Standard Bank that concludes this afternoon's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT