Standard Bank

Conference Call transcript

15 June 2018

MANAGEMENT CALL

Operator
Good day ladies and gentlemen welcome to the Standard Bank management conference call. All participants will be 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 conference, 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, for introducing the call. And also thank you everyone on the call for your interest on our pre-close call today. We also have on the call - Luvuyo Masinda who as you would know is the CIB CFO, as well as Cedric Miller, who is the PBB CFO, and Sarah Rivett-Carnac, who is the Head of Investor Relations.

I wish to make clear upfront that today we will comment on the operating environment to date and our expectations for the full year. We will not specifically be talking for the six months to 30 June 2018.

In South Africa despite improvement in consumer and business confidence levels earlier in the year, the prolonged low-growth environment continues to weigh on consumers and businesses. Tax bracket creeps, VAT hikes and, more recently, petrol price increases have added to this pressure. The outlook remains difficult.

In our Africa Regions, the portfolio as a whole has enjoyed a supportive macro environment and inflation pressures have continued to subside. Interest rates are generally down year-on-year and exchange rates have been less volatile.

In the West Africa region, a higher oil price is providing support. In Nigeria the introduction of the NAFEX mechanism continues to assist FX liquidity. In Angola, inflation continues to decline, the Kwanza has devalued 25% year to date and rates have been relatively stable.

In East Africa, the interest rate caps and floors remain in place in Kenya, impacting asset growth.

In South and Central Africa, Mozambique's currency has remained relatively stable period-on-period. Zimbabwe is due to hold elections at the end of July, which we hope will further stabilise the economy.

As you would have seen in the BA900 regulatory returns to March 2018, our retail lending portfolios in South Africa continue to grow slowly, driven by a combination of low client demand for credit and business caution in a fragile environment. In CIB asset growth is inherently lumpier and we have seen a small decline in the portfolio year-on-year as loans roll off and are not renewed and corporates continue to delay investment decisions.

In South Africa our retail deposit funding has continued to grow steadily over the period. In Africa Regions we continue to grow our customer base and our retail deposit franchise. This will remain a focus area across the group in the months to come.

Now turning to the full year outlook for 2018.

We expect asset growth to pick up in the second half of this year. Loan growth in the Africa Regions should be slightly quicker than in South Africa, but this is expected to continue to be diluted by currency movements.

In respect to net interest income, in SA we have seen 2x 25 basis point cuts since this time last year. May I remind you that the annualised impact of each 25 basis point rate cut is approximately R300 million in NII. And in Africa Regions, rates are also down year-on-year. The businesses have also seen some more aggressive pricing in the market. Against a backdrop of tighter margins, NII growth will be under pressure unless we see a strong pick-up in asset growth in the second half of this year. The transition to IFRS 9 will impact NIM, net interest margin, negatively by about five basis points due to the IFRS 9 requirement which restricts the recognition of interest in suspense on balances past 90 days in the income statement.

The pressure on fees and commissions in South Africa continues, in particular as our customers increasingly transact on our digital platforms. In Africa regions, increased customer numbers are translating to higher transactional volumes and are supportive of fees. These trends are both expected to continue.

The trading revenue performance has been stronger, in particular in Africa Regions, relative to a weaker comparative period. Again this is a trend we expect to continue.

So from a revenue perspective, we expect NIR to grow faster than NII.

The portfolio continues to perform well overall from a credit perspective. We are monitoring pockets of stress in particular portfolios and industries. Despite risks to the credit impairment charge, we expect the group credit loss ratio for 2018 to remain at the lower end of the 80 to 100 basis point guidance range.

Turning to costs. While we continue to focus on managing our headcount and costs, we will not do so at the expense of the franchise. The IT amortisation charge is expected to increase to approximately R2.7 billion for the year. While positive JAWS remain a key metric which we target, our focus remains on headline earnings growth and ROE. We will not necessarily achieve positive jaws every reporting period. At this stage, we expect jaws to be flat to marginally negative for the full year.

The direct taxation rate for 2017 was low at 22%. This should increase to around 23% for 2018.

The banking activities income statement will continue to be impacted by African currency movements, however less so than in the first half of 2017.

In May we increased our stake in Stanbic IBTC in Nigeria from 53% to 64% through an off-market block purchase of shares. And in Kenya, we have an offer open to acquire up to an additional 15% of the shares in issue, which if fully tendered will increase our stake from 60% to 75%. The offer closes on the 2nd July and the number of shares tendered will be announced shortly thereafter. Although these transactions will have a limited impact in the first half of 2018, going forward we will pay away less of the earnings related to these entities to minorities.

Looking at other banking interests, ICBCS has had a difficult first few months, however we expect it to deliver a profit for 2018 in line with their business plan. The business is still in the process of being integrated into ICBC and connected with the ICBC client base. Based on the business plan, the business is expected to require additional capital in late 2018 or early 2019; our 40% share thereof would equate to approximately US$80 million.

The Argentine Peso has depreciated significantly year to date, down approximately 30% compared to the ZAR. It is still to be seen whether the new IMF deal will calm the markets and provide some support to the currency in the second half. The operating conditions in Argentina are expected to continue to be difficult for the rest of the year. ICBC Argentina has fared well under the circumstances and although on track to deliver growth in Peso, earnings will be diluted when translated into Rands.

Liberty had a pre-close call on the 24th May. In it they noted that operating conditions are expected to remain challenging during the year. Liberty management's immediate priorities remain:

- the restoration of the financial performance of the South African retail insurance business to improve sales and margins;
- improved investment performance of STANLIB;
- simplification of the group's overall operations to better support advisors and customers; and
- better leveraging the relationship with the Standard Bank group.

The Liberty earnings attributable to the group will continue to be impacted by the Liberty Two Degrees Real Estate Investment Trust (REIT) accounting mismatch as well as a number of treasury shares outstanding and SBK share price movement throughout the year. As at the 31st December 2017, the REIT was trading at R8.35 per share and the Standard Bank share price was R195.66. To the extent that the REIT price and the Standard Bank share price increase, this will result in a drag on IFRS earnings attributable to the group.

Putting all this together, the banking activities' earnings are likely to grow faster than the group's earnings. Year to date our capital levels have declined as a result of the implementation of IFRS 9, circa 70 basis points, and the buyout of some of the minorities in Nigeria, circa 20 basis points. Our capital position remains strong and will support a dividend cover at the lower end of our 1.8 to 2.2 times cover range. The group's revised medium term return on equity target range remains 18% to 20%.

Lastly, as you are aware, IFRS 9 was implemented on 1 January 2018. We issued a transitional report in April detailing the day one impact which is available to download from our website. I don't propose to go over that on this call other than to say that the day 1 impact on ROE was positive 70 basis points and on the common equity tier one ratio was negative 70 basis points. If you have any queries on the report, please contact Sarah.

In closing, the outlook in South Africa is expected to improve, however it may be a bumpy ride. The Africa Regions economies are expected to continue to grow at attractive rates supporting banking operations in those countries and enhancing the diversification of group earnings. We remain committed to delivering continued earnings growth and an improving return on equity.

We will report our first half 2018 results on Thursday 16th August. 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 are welcome to press star and then one on your touchtone phone and that will place you in the question queue.
If you however decide to withdraw the 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.

The first question comes from Harry Botha of Avior Capital Markets.

Harry Botha
Hi. Good afternoon, Arno and team. Thanks very much for the pre-close guidance. I just want to get some feedback on how the SAP implementation is going. Have you been able to transition over your current accounts in H1? And can you give us some guidance in terms of net interest margins in terms of mix? Should we expect some positive mix benefits to come through on the assets and liabilities side? Thanks.

Arno Daehnke
Thanks Harry. On SAP I think the last time we met we were about to conclude the final migration of our client base. We now have 95% of our clients on the SAP platform. And as such we have actually formally closed the programme. The residual 5% will be migrated over the longer term. So we are very pleased with that outcome and it is great to have that milestone behind us.

Harry Botha
Great. Thank you.

Arno Daehnke
So that's on SAP. On margin we will continue to have some tailwinds from our mix. Particularly our liabilities are growing faster than our assets, and particularly our retail liabilities. But you must also bear in mind some of the headwinds, Harry. I mentioned IFRS 9. I also mentioned some of the endowment headwinds we're facing. And we have previously, when we met with you in March, guided to an overall decline in NIM. And we maintain that stance.

Harry Botha
Okay. Thank you.

Operator
Ladies and gentlemen, just a reminder, should you wish to ask a question you are welcome to press star and then one. The next question comes from Charles Russell of Citi.

Charles Russell
Hi Arno. Just a quick question just to clarify that ROE guidance. Did you mention that you would be improving ROE from the 17.1% reported last year in 2018?

Arno Daehnke
Charles, you were fading out there. 17.1% to 20% range. What is your specific question around that?

Charles Russell
The question is in 2018 is your guidance that ROE will improve from the 17.1% last year?

Arno Daehnke
Charles, over the medium term we expect our ROE range to go to 18% to 20%. For 2018 we do think that ROE could well migrate upwards from the point we did last year.

Charles Russell
Okay, great. Thank you.

Operator
Sir, we have a question from Jacques Conradie of Peregrine Capital.

Jacques Conradie
Hi Arno. Thanks for the update. I'm just interested to see if you've seen any real positive signs in the SA business that are telling you maybe confidence is improving or things could get better. Are there any signs in either the retail or corporate business that you could almost say are early indications that the second half could be better, or is it actually fairly tough and fairly unchanged over the last six months?

Arno Daehnke
Great question. Thanks Jacques. I'm going to hand over to Cedric and then Luvuyo for retail and wholesale respectively.

Cedric Miller
Thanks Jacques. It's Cedric here from the retail side. If we look at our business, we still see that affordability still remains an issue. The weak GDP numbers that we've seen for the first quarter certainly don't help. I think the impact of the increased VAT rate as well as other inflationary pressures such as fuel price increases and possible electricity hike increases etc. will continue to weigh on the consumer. As Arno has said, we had still not seen a significant uptick in our asset growth. That continues to remain soft. But there are other issues that we are quite encouraged by from a retail perspective. If we look at the health of the franchise and we start to look at things like customer numbers, which we will publish in June, if we look at deposit growth, all of these things that we measure quite carefully because they tend to have a long-term impact on our P&L, many of those things do trend in the right direction.

And as I said we are certainly encouraged by that especially if we look at our big market segment, being our middle market segment. That is growing quite nicely compared to reductions that we've seen in the last couple of years. So I think that there will be a lag effect from when these organisational or franchise health indicators start to translate into really strong P&L. I would like then to conclude and mention that as with most other banks the transition from customer behaviour from physical infrastructure to digital is still continuing at pace, which then means that like other banks we have to look at our cost base in terms of how we respond, and secondly new products and the pace of new products that we introduce on our platforms.

Luvuyo Masinda
Hi Jacques. It's Luvuyo here from CIB. I think the first half of the year from a corporate side should be taken in the context of the lack of investment we've seen over the last few years. So whilst we have seen especially the start of the year a positive sentiment it hasn't necessarily translated into investment decisions. And so we have seen outside the renewable energy space. We are seeing some pressure in a couple of sectors and outside the renewable, which was a welcome injection to our business, and I suppose in the wider economy we haven't seen that really translate into big investment in other sectors. Arno touched on the headwinds from margin. You then find the combination of the lack of investment together with the surplus liquidity and capital that each of the banks have quite a robust competition especially from lending in the investment grade corporates.

And we have really seen pressure on margins, lending margins in that space. Having said that the pipeline is quite rich. We think there are big opportunities subject to some finality in some policy in some of the sectors like mining. We are very encouraged by the pipeline. But it is on condition I suppose of some decisions around policy certainty in some of the sectors. So the pipeline is there but there is really cautious optimism all around. I suppose you also see it translated if you look at the loans and advances growth across corporate banks in South Africa.

Jacques Conradie
Great. Thanks a lot for the detailed answers, guys. Luvuyo, maybe just one follow-up. You mentioned there are a few sectors under pressure, and I guess the one sector we can see from the equity markets is the construction

sector that is just going through a horrible time. Do you expect to navigate through that while maintaining the impairment guidance that Arno mentioned earlier at the lower end of your range?

Luvuyo Masinda
We are comfortable that we will still maintain for CIB within the 30 to 40 basis points credit loss ratio. But yes, we are in the middle of the sectors under stress as well. But on the positive side we have some sectors that are performing well. We have also had positive outcomes from provisions we have taken in the prior year. So the combination of those we are still confident of being in the lower end of that credit loss ratio guidance.

Jacques Conradie
Thank you.

Operator
The next question comes from Stephan Potgieter of UBS.

Stephan Potgieter
Hi Arno. Thanks very much for the call. Just a question on the current impact in the rest of Africa. You mentioned some pressure in Angola and some of the countries. Overall for the portfolio where would you say you are sitting so far this year, just to get a feel for what the currency impact would be on the balance sheet and income statement?

Arno Daehnke
Thanks Stephan. Overall the currency impact of the stronger Rand is adverse for earnings and obviously for our income statement line items. Maybe I can leave it at that sort of level.

Stephan Potgieter
I was just wondering. You obviously know where the currencies are for the portfolio so far this year relative to where it was at year end. So how much is the Rand stronger essentially across your portfolio?

Arno Daehnke
That is quite a broad question. We would have to unpack every single individual currency.

Stephan Potgieter
I understand.

Arno Daehnke
But overall the way it translates into our earnings streams there is a few percentage points difference between a Rand reported number and the constant currency basis number.

Stephan Potgieter
That’s helpful. Thanks very much.

Arno Daehnke
A few percentage points.

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

Elan Levy
Thanks for the call. You mentioned that the ICBCS business is going to require another capital injection. I think you said around $80 million which equates to roughly a little over R1 billion. Could you just unpack that a little further and when that is likely to need to flow?

Arno Daehnke
Elan, it is likely to come either end of this year or possibly next year. And we are supporting the business to grow faster with that capital to be able to book additional risk weighted assets as they build their franchise. We do see the opportunity to being there and obviously putting in the $80 million pro rata share with ICBC.

Elan Levy
I know this has obviously come up before, but is this seen as a final capital injection? I understand your need and your willingness to support the business.

Arno Daehnke
Good question. We do see this as the final requirement for the next medium term, medium term being the next two to three years. So we do see this as the last injection and the last ask.

Elan Levy
Are you prepared to guide what the capital adequacy is within that business? Is it currently strained or is it healthy enough that the pipeline is surplus to capacity?

Arno Daehnke
The capital adequacy is not strained. The entity is currently surplus capital. So it is really catering for the pipeline we see looking out two to three years.

Elan Levy
Okay. Thank you.

Operator
Ladies and gentlemen, one final reminder, should you wish to ask a question you're welcome to press star and then one.
Sir, we don't seem to have any further questions from the lines. Do you have any closing comments?

Arno Daehnke
Thanks very much everyone for dialling in, and we're looking forward to meeting with you in August on our half-year numbers.

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

END OF TRANSCRIPT