Absa market update

Daniel Mminele

Good afternoon and thank you for joining us on our call this afternoon.

Given the significant uncertainty created by the covid-19 pandemic and economic downturn, we felt it important to update the market on how we have been responding to these challenges and their impact on our performance to date.

I will cover our response, and then Jason will unpack the substantial impact on our performance.

After that we will take your questions.

The covid-19 pandemic started as a devastating public health crisis, but has triggered an unprecedented series of events that have disrupted markets and economies worldwide. For example, the IMF expects global GDP to decline at least 3% this year. For South Africa, there is a large divergence in forecasts given the high level of uncertainty. Absa's Economic Research Team has recently revised its forecast lower and now expects that real GDP will contract by 10% this year, taking us back to 2011 levels and 2004 on a per capita basis. It could take several years for South Africa's real GDP to recover to 2019 levels. You may have seen that the Absa Purchasing Managers' Index fell to an all-time low in April during the national lockdown, significantly below global financial crisis levels. Of course, entering this crisis, South Africa had already been facing serious economic challenges of a technical recession, an extremely high level of unemployment at 29%, looming sovereign rating downgrades, and this against the background of a very weak fiscal position, weighed down by increasing government debt, ongoing challenges with State Owned Companies and insufficient progress with implementing structural reforms.

We expect average real GDP in our Absa Regional Operations to decline slightly this year, particularly in countries that rely on tourism, while the global downturn will weaken raw material and oil exports. Growth is expected to hold up reasonably well in Ghana, Kenya and Tanzania, whereas expectations are for more pronounced slowdowns in Botswana, Mauritius, Zambia and the Seychelles. Central banks in seven of our presence countries reduced interest rates by 100bp or more recently, including Zambia's 200bp cut last week.

Covid-19 has impacted the tail end of our separation from Barclays, delaying a few projects. However, by next Friday, the 5th of June, we will have substantially completed this large program on time and within budget. Jason will share more details a little later. Having joined the race at the final stretch, I have been extremely impressed with how diligently and disciplined the colleagues have carried this mammoth project, unparalleled on the continent in terms of size and complexity. These days it is more the norm for projects of this nature to go beyond time lines and budgets, so this is very commendable indeed. In the process, we have built resilience and skills to manage complex projects, which became a strategic advantage as we planned and executed our response to covid-19. For example, we quickly reprioritized our book of work focusing on stability, digital and in-year benefit projects.

The actions we have taken in response to covid-19, led at group executive committee level, have been guided by the principles of, first and foremost, wanting to ensure the health and safety of our staff; to support and stay close to our customers and clients; and to ensure the resilience of our franchise from both an operational and financial perspective. We have also been involved in humanitarian efforts to support vulnerable communities in which we operate across all our markets.

We have implemented social distancing protocols, splitting our staff into those that can work from home and those that would be required to be in the office. Of our 5 500 call centre staff in South Africa, 82% are currently working, spread across numerous buildings, in addition to our three main call centres.

We dynamically managed the number of branches that remained open to serve customers, while observing stringent health protocols. During South Africa's level 5 lockdown, we kept 259 of our branches open to ensure essential banking services were available, including supporting social grant payments. We have almost all of our 571 branches operating this week, some with reduced hours.

We have also split CIB's Markets trading teams, to operate from two different locations with some front office support staff working from home, so that we remain available to our clients to execute for them at all times.

We have encouraged staff to work from home where possible and have technologically enabled them to do so. We transitioned to a predominantly remote working model within a very short space of time, and 65% of colleagues are either working remotely or on stand-by at home.

For example, over the past week, we had an average of almost 25 thousand staff working remotely. We increased our VPN capacity to 60 thousand concurrent users. Prior to the lockdown, 1 800 colleagues was the most that had ever logged in from home concurrently. In the past month, 22 thousand staff have had virtual meetings on a day basis. During the first two weeks of lockdown we deployed 500 desktops, 700 laptops and 2 100 data cards to enable more staff to work from home in SA.

Naturally, given the large number of colleagues working remotely, we have also enhanced our cyber security systems.

Ensuring systems stability has been a priority, and we had excellent stability in the first quarter. April was one of our most stable months in the past two years, admittedly with considerably lower volumes, but we are using this opportunity to drive a number of initiatives to further enhance stability.

Supporting our customers through this difficult time has been another priority, ranging from providing core transactional services, to offering payment and other relief programs, allowing them peace of mind to concentrate on staying healthy.

For example, as the bank with South Africa's largest ATM network, as part of an industry effort, we agreed to waive Saswitch fees for other banks' customers using our ATMs during the national lockdown.

To assist customers who experienced challenges as a result of covid-19, Retail and Business Banking in South Africa launched what we believe is the sector's most comprehensive payment relief plan on 30 March. It provides three months of payment relief across all our credit products for wealth, business bank, private bank and retail customers.

Take up has been substantial. To date, we have provided R8bn in payment relief to 398 thousand customers on 584 thousand accounts, representing R146bn of loans, over a quarter of RBB SA's total book. Credit cards saw the highest take up by number, followed by vehicle finance, mortgages and personal loans. Mortgages were the largest by value, at over half of the total relief.

In ARO, we also introduced relief programs on payments and fees. Payment relief is in the early stages of implementation in most countries. We also reduced fees in line with in-country regulatory directives and reduced certain fees to assist customers. Transactions on digital channels, including Mobile Money and ATMs are free or capped. Consequently, we expect a R70m reduction in fees across Kenya, Ghana, Zambia, Mozambique, Uganda and the Seychelles.

We assist our CIB customers requiring support on a one-to-one basis, on requests for short-term deferrals of interest or capital repayments, changes to covenants, or additional funding. We approve increases of general facilities where we are comfortable with the risk, and all drawdowns of committed facilities go through our usual credit process. Many clients have placed funds drawn down on these facilities back on deposit with us. Jason will cover our CIB book later, including our exposure to sectors that are under pressure.

We have experienced good collaboration with the Financial Markets Department of the SARB and our regulators in the Prudential Authority. The SARB issued Directive 3, providing temporary relief for banks offering up-to-date customers payment relief as a result of covid-19 without triggering punitive capital and accounting consequences.

The PA and the SARB have been very supportive during the crisis, reducing sector capital and liquidity requirements, and adjusting financial market operations, including buying bonds in the secondary market when liquidity dried up. Interest rates were also reduced by 275bp this year cumulatively, providing an estimated R100bn of relief to consumers and businesses on an annualized basis.

As you know, together with the SARB and National Treasury, banks recently launched a guaranteed loan scheme to support small and medium-sized enterprises with turnovers less than R300m. Initial take-up by our customers has been relatively low. While still too early to tell, we believe that in part this may be due to our existing payment relief program for this segment, where we restructured R16bn in facilities, over 10% of Relationship Banking's loan book.

We have also provided relief to our bancassurance customers. For example, we have offered customers premium payment relief on their life cover. We also extended our credit life to temporarily cover a wider definition of loss of income events. Claims volumes have doubled from before lockdown to 500 - 600 per day this month, driven by higher retrenchment claims.

As covid-19 and its dire economic consequences became a significant humanitarian challenge, we have mobilized our citizenship programme in all our countries to provide humanitarian and community support.

In trying to maximize our impact, we have focused on three areas:

- supporting testing and screening for covid-19;
- providing personal protective equipment for the heroes of this pandemic, the medical personnel; and
- providing food to vulnerable families and communities.

We have contributed to a number of initiatives, either directly through NGOs working with communities, or via national funds established by governments and supported by business.

I am proud that] Absa and its employees have contributed approximately R55m to these efforts across the continent, with R7m coming from colleagues via salary or leave donations.

So far I have spoken about our initial operational response to covid-19 and the socio-economic crisis it has precipitated. While it is very uncertain how and when we will finally emerge from this crisis, there is a growing consensus that it will have a lasting impact. It is likely to fundamentally transform how we live, work and interact. It will accelerate some trends that were already occurring, and to which we had been responding, such as increased digitalization. Others were less evident in Africa, such as the global shift towards remote working arrangements.

In our March results presentation, I spoke about reviewing our strategy implementation process and making some adjustments where necessary. The covid-19 crisis requires us to reassess our current growth strategy, our pace at which we are transforming our business, and our structure, to ensure that we have a relevant, competitive business model.

We have initiated a number of work streams that are looking at opportunities for more digital innovation, entrenching remote working models, touchless payments and digital wallet solutions, new digital servicing models, innovative products that address emerging client needs, strategic partnerships, and how we shift and nurture our culture so that our organisation thrives once we emerge from this pandemic.

Before I handover to Jason, let me just say that we are dealing with an unprecedented situation generating both demand and supply shocks across all our markets. At this stage the severity and duration, and the full impact on economic activity, remain uncertain. This requires us to constantly revise our assumptions as more data becomes available. Our current focus is on preserving capital and ensuring we have sufficient liquidity buffers, rather than focusing on growth.

I will now hand you over to Jason, who has been coordinating our financial risk management response, and also to update you on performance as I indicated earlier.

Jason Quinn

Thanks Daniel and good afternoon everybody.

I will cover the following topics – the status of our separation from Barclays, the areas we are focusing on most in the crisis, and our recent performance followed by some revisions to our guidance, where possible. After that we'll take your questions.

Firstly, with just ten days to go to our committed completion date, it is opportune to update you on our separation from Barclays, and it's almost a year since the detailed separation presentation that Paul O'Flaherty and I provided.

As of last week, we had completed 259 of the 276 projects and we are on track to deliver 270 by next Friday, the 5th of June. Of the 6 remaining projects, 3 relate to minor "mop up" activities, for example turning all users off Barclays systems. We generally let Barclays services go on for a month after project completion to ensure that they are embedded.

I am very pleased to confirm that all solutions will have been built by next Friday. However, as you may expect, covid-19 has impacted the final step of implementation on some of our projects, so the final closure of only three platinum projects will stretch beyond the 5th June.

The project most impacted is ARO card issuing, which should be completed in July, however, it's a small portfolio of 155 thousand cards and all it means in practice is that we will remain on the existing platform a little longer.

And two CIB projects, FX products and replacing valuation systems, need onsite migration work with clients, in particular FX products, to enable them to access and integrate with the platforms. We mentioned at our CIB investor day last November that client migration would continue after June, and covid-19 has exacerbated this.

The existing services have been extended with Barclays, at an additional temporary cost that is well within the allocation of contingency for those projects. As previously communicated, and now with a few days left, I am comfortable that we will be capital and cashflow neutral with regards to our separation program.

I should highlight that the conclusion of our rebranding outside South Africa has been a great success and it has increased staff morale and provided an opportunity for significant customer engagement. We had contingency plans in place, but haven't seen any client attrition or liquidity issues.

So, as regards separation, we are on the brink of putting an important chapter in the Group's history behind us, in a safe and successful manner.

Next, I want to cover three key areas that we are focusing on at the moment – liquidity, capital and credit quality. As Daniel said, in the near-term we have responded to the crisis at hand and are preserving our capital and liquidity and protecting our balance sheet and client franchise, rather than focusing on growth.

Starting with liquidity, in our Q1 pillar 3 disclosure today, we disclosed a LCR of 121% and NSFR of 112%, both strong and well above regulatory minimums.

The LCR declined slightly from December due to clients reducing the term structure of their deposits given market conditions in March.

However, deposit growth increased materially in April, well ahead of our asset growth and our LCR is over 130% at present.

The SARB reducing the sector's minimum LCR requirement to 80% from 100% frees up capacity for about R20bn in additional lending.

On capital, our ratios remain strong and within board target ranges.

The Group normalised CET1 ratio was 11.1% at 31 March, down 70bp during the quarter. The main reason was our final 2019 dividend of R5.2bn, which was 55bp of the decline.

The weaker Rand increased RWA demand, but with limited impact to CET1 given offsetting movements in capital supply. Constant currency RWA growth of R29bn was mostly in CIB due to asset growth, PD migration and FX volatility. Counterparty credit risk and market risk also increased, given the extreme market dislocations we experienced in March. Financial markets, particularly bonds, normalized to some extent in April on the back of significant actions by the SARB.

Moody's SA sovereign downgrade in late March had a negligible impact on our CET1.

The sale of the Edcon storecard book concluded in February 2020 reduced our RWAs by R9bn.

At 11.1%, our CET1 represents a surplus to the new regulatory minimums of well over R30bn of equity.

Our total capital ratio was 14.8%. I was pleased that we issued R2.7bn of tier 2 capital in February ahead of the crisis and have minimal calls for the rest of the year.

In response to covid-19, the Prudential Authority issued a directive temporarily reducing the Pillar 2A minimum CET1 by 50bp, tier 1 by 75bp and total capital by 100bp. They have also made the capital conservation buffer of 250bps available for banks to utilize during the stress.

Our ARO subsidiaries all have capital ratios well in excess of regulatory requirements and are expected to remain above these in a severe stress scenario.

You might be interested to hear that we ran a "IMF bailout" stress scenario at the beginning of the year, with credit impairments increasing to double our experience in the global financial crisis. Under this stress scenario, which was then extended for a number of years, our Group CET1 remained above regulatory requirements.

The outlook for credit quality is the biggest variable for us at the moment and our main battleground, given uncertainty on the duration of the covid-19 pandemic and its impact on our economy, and low visibility on the shape and duration of the economic recovery.

I will discuss our YTD credit impairments and expectations shortly, but want to put the current stressed environment into context and provide color on our exposure to particular sectors that are under the most pressure.

Looking back into history for some data points, over the past two decades the Group had three years of very elevated credit impairments, well above our current through-the-cycle range of 75 to 100bp.

Firstly, in 2012 substantial mortgage and commercial property impairments increased the credit loss ratio to 1.6%.

Before that, in 2009 the charge was 1.7% during the height of the global financial crisis. The current environment is very different to the GFC. Our loan growth was considerably higher heading into that, given the strong economic growth and a retail lending boom. Our three-year cagr in loans prior to the GFC was 21%, compared to just 8% over the past three years, and even less excluding reverse repos, which are short-term arrangements with generally low credit risk. Back then, balance sheet provisions were just 1.6% of our customer loans, compared to 3.1% at 31 December 2019 after implementing IFRS 9 and increasing coverage. Today we have a higher proportion of CIB lending, whereas in 2009 retail mortgages were almost half our total loans and these had far higher LTVs than today. Our capital levels were similar, albeit on a Basel II basis. We are also more geographically diversified now, as ARO makes up 22% of earnings, from 4% in 2008. Of course, in 2009 SA's real GDP fell 1.5%, considerably less than the decline we now expect this year. So the current stress appears to be far greater, although we enter the crisis with better provisions.

Lastly, the Group's all-time high charge was 2.4% in 2002, due to significant credit impairments for UniFer, a struggling microlender we owned a majority stake in at the time.

Since Daniel discussed the substantial payment relief we have provided to our RBB SA clients, I'll cover CIB's direct exposure to stressed industries.

Oil and gas is about 1% of our group loans, and many of our clients have responded to the crisis and are shoring up their balance sheets and have hedged oil and currencies.

Looking at distressed sectors, hospitality and hotels are 3% and construction 1% respectively of CIB's total exposures, so both are small in a group context. As I mentioned in our March results presentation, the construction sector has been distressed for some time, which is exacerbated by the covid-19 crisis, whereas hospitality and hotels were in reasonable shape before that.

Transport is 4% of CIB's credit exposure and within this, airlines are a very small, collateralized component. Our exposure to SAA is backed by a government guarantee.

SOEs account for 4% of CIB's exposure, although this overall figure isn't particularly meaningful, because we have government guarantees in many instances.

We discussed commercial property finance at our CIB investor day in December. At the end of last year our SA portfolio was R70bn including Relationship Banking, and ARO's was R6bn, together 8% of group loans. The portfolio is well-diversified and we have focused on improving its risk profile over the years, and its LTV is around 50%.

As of last week, since March, CIB has received 270 requests for new funding, covenant concessions, extension of maturity dates, or moratoriums on capital or interest. All are considered carefully on a case-by-case basis.

Although our exposure to some of these more distressed sectors is relatively small, I don't want to create the impression that we expect benign credit impairments in CIB. In fact, we expect a material increase in its charge this year, particularly in ARO, off a low base given the systemic nature of this crisis

Given weak and volatile equity markets, I should add that within RBB SA, Wealth's share-backed lending has declined materially in recent years to just R750m in total now, and is currently well-collateralised.

Lastly, our SME portfolio is relatively small at R12bn.

Finally, I'll update you on our recent performance and provide you some guidance for 2020 where possible, which was included in a SENS announcement that we released just before this call.

Starting with our performance, although our first quarter earnings were somewhat impacted by covid-19 towards the end of March, our RoE was slightly lower YoY and our capital generation was strong. We were on track to achieve the guidance we had issued and the strategy was being well executed.

However, the national lockdown in South Africa had a substantial impact on our April and year to date performance. We saw the following trends for the first four months:

We had some benefit from a weaker Rand versus ARO currencies. On average, the Rand was 8% weaker than our ARO currencies from the comparative 2019 period.

Despite slowing materially in April, our YoY customer loans growth was low double digit. I was pleased that deposit growth was stronger than that, in the high teens. Group customer loans declined slightly in April MoM, across RBB SA, CIB and ARO.

RBB SA's loans declined in April, as new business production in mortgages and vehicle finance combined dropped from an average of R5bn a month in the first quarter to negligible levels, on the back of the closure of deed offices, estate agents and mortgage originators and licensing offices and motor dealers. Personal loans production fell from an average of over R1bn a month in the first quarter to only R100m.

Our net interest margin declined YoY, due to the rate cuts in South Africa and most of our ARO markets. YoY net interest income growth was high single digits, but is expected to slow.

Non-interest revenue growth was mid-single digit YoY, despite RBB SA declining due to substantially reduced transaction volumes during lock-down.

There was a material reduction in RBB SA's fee income in April. For example, April ATM volumes dropped about 40% from March and slightly more YoY. Debit card and credit card turnover fell over 40%

and 50% YoY respectively, while April's point of sale volumes decreased over 40% month on month. April bancassurance sales dropped over 80% month on month due to lower credit life and branch sales.

There are signs of some recovery in transactional volumes in May, as parts of the economy gradually re-open.

CIB's non-interest income for the period increased, with strong Markets revenue growth off a low base. Markets corporate client flows reduced noticeably in April while institutional flows remained intact.

Operating expenses were well contained, producing positive JAWS for the first four months and strong pre-provision profit growth.

However, credit impairments doubled, with large increases in personal loans and credit cards. The credit loss ratio was similar to 2009 levels of 1.7%, well above our through-the-cycle target range. This growth mostly came through in April and was impacted by the growth in the IFRS 9 SICR charge and "cliff effect", where judgements were required. The lockdown also had a substantial operational impact on our collections and recoveries processes, for instance where some customers were unable to make payments due to physical branch closures.

Consequently, our RoE for the first four months fell materially YoY.

It is difficult to provide guidance for the rest of the year, given the significant uncertainty about the impact of covid-19, national lockdowns and the economic outlook. These have a material impact on loan and transaction volumes and credit impairments, in particular.

Our latest estimate is for SA's real GDP to fall 10% and our ARO portfolio to decline slightly on average. We expect lower average policy rates for 2020 across the board. Based on these current assumptions, and excluding further major unforeseen political, macroeconomic or regulatory developments, our guidance is as follows:

We see limited loan growth and deposits are likely to increase by more than loans.

The 275bp lower interest rates in SA is expected to reduce our net interest income by approximately R1.6bn in 2020, after factoring in the meaningful benefit of our structural hedge. We believe there could be another 50bp rate cut in South Africa this year. Our annual sensitivity to further rate cuts in South Africa is a R250m reduction per 50bp.

Revenue growth is expected to slow, reflecting reduced loan production and transactional activity on the back of the impact of the lockdowns and negative GDP.

Operating expenses are expected to decline slightly YoY, reflecting a hiring freeze, lower short-term incentives, significant project reprioritization and material reductions in marketing and travel and entertainment spend.

On credit impairments, IFRS 9 requires the use of forward looking assumptions when determining the level of provisions required. These assumptions have a basis in historical information but in this unprecedented stressed environment will require additional levels of management judgement.

Coverage is expected to significantly increase as the macroeconomic base case has deteriorated resulting in lower realizable collateral values, higher likelihood of default and a greater proportion of defaults impacting SICR. Judgement regarding the financial health of clients will need to be based on a multitude of factors.

We expect a significant increase in credit impairments, to well above our through-the-cycle target range of 75 to 100bp. Given the substantial uncertainty, we will provide additional disclosures on the judgements we have made and more guidance on the expected credit charge in 2020 when we report our first half results on 24 August.

Our RoE in 2020 is likely to decline materially from last year's 15.8%.

We expect our CET1 ratio to remain resilient. It may decrease to below our board target range as a consequence of the crisis, however, stress testing confirms that it should remain well above regulatory requirements. Given our focus on preserving capital, we currently do not envisage declaring an ordinary dividend for 2020.

We are reviewing our medium-term financial targets and will update the market when there is greater certainty in the macroeconomic outlook.

Lastly, we expect first half normalised headline earning per share to decline more than 20% YoY. We will provide more specific guidance once there is reasonable certainty on the extent of the decline.

Thank you for your attention, Daniel and I will now take your questions.