Absa 1H20 presentation speaker notes

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Introduction

Good morning everyone and thank you for joining us for Absa's interim results presentation.

First of all, I hope that you and your loved ones are safe and well in these extraordinary times, as Covid-19 continues to weigh heavily on us all.

I will cover the substantial impact of Covid-19 on the economies in which we operate and our response to the pandemic so far, following which I will update you on the completion of our separation from Barclays PLC, before commenting on our performance during the first half of 2020.

Thereafter Jason will dissect our numbers for the period, particularly details on our credit impairments, following which I will provide some concluding remarks, before Jason and I respond to any questions you may have.

A crisis like no other, an uncertain recovery

Covid-19 is generating health and economic challenges almost without modern precedent across the global, regional and domestic economy. Across the globe, policymakers have moved quickly with emergency economic support and critical public health initiatives of vast scope. These measures have provided some mitigation of the supply, demand and health shocks hitting economies, but it is clear that the impact of 2020's crisis will reverberate for many years to come. Notwithstanding the unprecedented policy response, as at mid-June the International Monetary Fund was forecasting the global economy to shrink by 4.9% this year, more than 8 percentage points weaker than the outlook at the time of their January forecast, and for Advanced Economies to shrink by 8% this year, a swing in forecast of nearly 10 percentage points compared to their forecast in January 2020. Volatility, uncertainty, and risk are all likely to remain at levels that make medium-term planning difficult until such time as effective vaccines are developed, comprehensively tested, and distributed across the globe. In itself this presents a scientific, economic and logistic challenge without easy historic comparison.

South Africa's own experience of the pandemic and the associated economic challenges are perhaps even more stark, particularly as the country entered this crisis already in a mild recession following several years of disappointing growth, with extremely high unemployment, a very weak fiscal position and already fragile business and consumer confidence. Covid-19 laid bare the economic vulnerabilities arising from failures to implement necessary structural reforms, and shore up confidence through policy certainty, focused implementation, and appropriate accountability frameworks. Fortunately, the SA Reserve Bank, the government, South African business organisations and broader civil society have all focused their recent efforts on mitigating the impacts of the pandemic on the country.

However, it also needs to be noted that the country-wide lockdown was among the most far-reaching globally and whilst this is likely to have helped insure against a more aggressive spread of Covid-19 amongst the population, the direct impact on the economy is likely to have been severe. Just how long-lasting the economic damage is likely to be remains highly uncertain.

Our research team expects South Africa's real GDP to contract 8.3% this year, a somewhat larger contraction than that currently forecast by the SA Reserve Bank or by the market consensus. Positively, the figure reflects a modest upgrade of our forecast made in May. In context, however, the downturn is without modern precedent for the country. By example, the economy shrunk "just" 1.5% in 2009 during the global financial crisis, and one needs to go back to the early 1930s to find a contraction as large as 6%. For 2021, the bank's current forecast is for the economy to rebound by 2.4%. As further evidence of just how significant the current economic challenge is, our research team projects that South Africa could take four years or longer to regain the level of real economic activity witnessed in 2019.

The impact of the health and economic crisis precipitated by the Covid-19 pandemic is not isolated only to South Africa. Across our African Regional Operations environment, economies have been impacted even if the direct prevalence of the pandemic so far appears much less severe than in SA. Commodity market gyrations, a sudden-stop to global tourism, and supply chain interruptions, together with the impact of domestic lockdowns, where they have been implemented, have disrupted normal business activity to varying degrees across the region. Against a pre-Covid real GDP growth forecast for 2020 of 5.7%, our research team now believes that our ARO countries could now grow just 0.9% this year on a GDP-weighted average.

Within the mix, Botswana, Mauritius, Zambia and the Seychelles are expected to come under the most pressure, whilst Ghana, Kenya, Tanzania, Mozambique and Uganda are still expected to grow this year, although well below our previous expectations.

Given the unprecedented nature of the current health and economic crisis, forecasting with confidence is particularly difficult currently and scenarios play an even greater than normal role in ensuring appropriate risk management. We show a number of scenarios that we have considered in our results booklet.

Absa's response to Covid-19

Since I covered our operational response to Covid-19 in our presentation in May, I won't go into a lot of detail on it again, besides updating you on some key numbers and recent developments.

From the onset of this crisis, colleague safety and wellbeing was our immediate priority, and we quickly switched to a predominantly remote working model, that enabled our colleagues to continue to work safely from home while essential frontline colleagues worked under strict hygiene protocols that are still in place despite the decline in infections and gradual opening of the economy.

Our technology capabilities enabled this change, including rapidly increasing our VPN accessibility, deploying remote working protocols and rolling out mobile versions of our HR and learning systems.

Currently two-thirds of our staff are working remotely or are on stand-by at home. In addition, we provided relief to commission-based staff who could not operate during the lockdown.

Supporting our customers through this difficult time has been a priority, from providing advisory and transactional services to offering payment and other relief programs. Even during South Africa's hard lockdown, over 40% of our branches stayed open to provide essential banking services, including paying out social grants. At the moment, 83% of our branches are operating, and our frontline staff continue to observe stringent health and social distancing protocols.

We have 11 thousand staff onsite, across branches, call centres and corporate offices. Our frontline staff have been phenomenal during the lockdown and have really lived our purpose in helping our clients to manage during difficult and uncertain times. As you know, we have the largest ATM network in the country, and despite operational challenges, we maintained high availability across it to meet the cash needs of Absa customers and the broader public. Moreover, our systems stability has been excellent during this period.

We have offered customers substantial payment relief; Retail and Business Banking in South Africa launched what we believe is the sector's most comprehensive relief programme. Customers in good standing could opt-in for three months of payment relief across all our lending products. Take up has been substantial: As at 30 June, we had provided R8.7bn of relief on R154bn worth of loans to 538 thousand customers, including 20 thousand businesses. That equates to 29% of RBB SA's customer loans. In addition, we approved R0.5bn in business loans as part of the government loan guarantee scheme, which we expect to increase as the reopening of the economy accelerates following the introduction of Level 2 regulations. We also distributed R132m to SMEs on behalf of the Oppenheimer South African Future Trust. CIB South Africa assisted clients on a one-to-one basis and granted payment relief on R37bn of loans, 12% of their book. Lastly, Absa Regional Operations afforded customers payment relief on loans totalling R25bn, or 19% of their overall customer loans.

We also waived various fees, ranging from SASwitch fees, when customers of other banks use our ATMs in South Africa, to certain digital transactions in ARO. And we supported distressed bancassurance customers in South Africa by providing payment holidays on life premiums, while extending our credit cover to temporarily include a wider definition for 'loss of income' events.

Over and above this, in line with our commitment to be a force for good in the communities that we operate in, we mobilized our Citizenship programme as Covid-19 quickly evolved into a humanitarian crisis. Absa and its employees contributed over R71m in support across the continent, including R7m of donations from colleagues. To date, across our presence countries we have contributed to the expansion of screening and testing, the provision of Personal Protective Equipment for thousands of health workers and humanitarian support to vulnerable communities.

Working together with clients in various key sectors, we have not only delivered over 2m meals to vulnerable households, we have also begun to focus our attention to supporting economic recovery and the rapid development of employment opportunities.

Our efforts have garnered international attention, and we are very proud to have been recently recognized with Euromoney's Excellence in Leadership Award in Africa for our integrated response to Covid-19. We were one of six banks globally recognized for our outstanding performance during this crisis. Moreover, we won four separate awards for corporate social responsibility in Zambia, Ghana and

Seychelles. The manner in which colleagues have turned up over the past few months is remarkable, and we have remained resilient because of their determination and the quality of our crisis management.

As our initial response to the crisis became more settled, we then began to establish concrete steps to recalibrate the business for the near term and future. During the second quarter, we began to pivot from a growth focus, to prioritizing protecting our balance sheet, by preserving capital and ensuring we have sufficient liquidity buffers.

Separation from Barclays substantially completed

Separating from Barclays successfully was one of our priorities this year, and I am pleased to report that it is now substantially complete. This is a great achievement for Absa, since the project's size and complexity were unparalleled in Africa. In fact, we understand that our three-year separation is the largest of its kind globally. At its peak, nearly 1300 colleagues and contractors were working on the 273 projects.

As you would expect, Covid-19 delayed a few projects, in particular those requiring onsite work. However, we completed 99% of the projects by 5 June, including the technical build for three outstanding platinum projects. Of the three, the ARO Card Issuing project was delivered early last month. CIB's new valuation systems went live this month, while its FX products have also gone live, although client migration will extend into the fourth quarter this year, which CIB mentioned at their investor day last November.

It is important to highlight that during separation many systems were enhanced, rather than just replaced. The programme has fundamentally improved Absa's resilience, systems and capabilities, to the benefit of staff and customers alike. For example, we improved customer experience through greater stability and upgraded user interfaces in several countries across the continent. Separation also gave us the opportunity to refresh our Absa brand, which we had not invested in for many years.

Moreover, we not only completed the separation on time and on budget, but with over R1bn of centrally-held contingency remaining, which will supplement our capital position.

Critically important, and an outcome that will serve us very well going into the future, is that during the process of separating, we have built business resilience and technical competence in managing complex projects, which were valuable as we planned and executed our response to Covid-19. For example, we quickly reprioritized our book of work to focus on stability, digital and in-year benefit projects. We are able to deploy these change and project management skills elsewhere across the group.

Key 1H20 messages

Moving onto our results. As I indicated earlier, the severity of the Covid-19 crisis during this reporting period, particularly during the second quarter, is without precedent, certainly in our lifetime. Let me convey what I think are the six key messages for our interims, beyond the substantial decline in our normalised headline earnings.

First, our revenue showed resilience. Despite slowing significantly in the second quarter, it grew 3% year-on-year to over R40bn, a respectable performance considering the significant revenue pressure banks faced during this period. Large policy rate cuts reduced our net interest income by R1.3bn after our structural hedge. Moreover, Covid-19 lockdowns and the weak economy reduced our loan production and transaction volumes materially, and sizeable negative fair value adjustments dampened our non-interest income further.

Second, operating expenses continue to be well-managed, declining 2% year-on-year to R22bn. Some of this was due to benefits from restructuring undertaken previously, and far lower provisions for incentives given the performance. This outcome also reflects appropriate management actions in response to Covid-19, such as implementing a hiring freeze and enforcing higher discipline when it comes to cost management.

Third, given positive operating JAWS of 5%, our cost-to-income ratio improved materially to 54% and our pre-provision profits grew by 9%.

Fourth, the most prominent feature of our first half was the significant increase in our credit impairments, which were four times higher year-on-year. Worsening delinquency trends and provisions for single name exposures produced half of the increase, while management judgmental provisions, due to the unprecedented deterioration in macroeconomic variables, drove the rest. I am comfortable that we have been disciplined and prudent in exercising that judgement. Jason will unpack this charge in detail later, since we have front-loaded our provisioning into this half.

Fifth, we continue to benefit from having a diverse group, both across geographies and activity. I will highlight certain areas that showed great resilience.

Lastly, we have focused on protecting our balance sheet over this period. This is evident in our solid core equity tier 1 ratio of 11%, which remains within our board target range and well above regulatory requirements. Our liquidity in both ZAR and foreign currency also remains solid. Our LCR and NSFR ratios are well above regulatory hurdles.

Salient features

As I mentioned, our pre-provision profit grew 9% to over R18bn, our strongest growth since the first half of 2016, when we benefitted from a substantial currency tailwind.

However, our credit loss ratio rose sharply to 2.77%, almost treble the top end of our through-the-cycle range. Much of the increase was judgmental overlays to build coverage. Absorbing these substantial provisions meant our diluted normalised headline EPS decreased by 82% to 173 cents.

Consequently, our RoE fell materially from 16.4% to 2.6% for the period, well below our cost of equity. Thus, our profit after regulatory capital charge, or PARCC, decreased to a negative R6.1bn from positive R1.3bn in the first half of 2019.

Nonetheless, our net asset value grew 6% to R131 per share, largely due to growth in our cash flow hedging and foreign currency translation reserves. As we guided in May, we felt it prudent not to declare an interim dividend. This is also in line with the Prudential Authority's guidance note.

Divisional performances

Before handing over to Jason, I will briefly comment on each of our divisions. Their earnings all fell materially year-on-year due to the significantly higher credit charges. However, all three generated both positive balance sheet and operating JAWS for the period. And you can see they all posted solid pre-provision profit growth. Plus, there are developments in each worth highlighting.

Starting with Retail and Business Banking South Africa, normalised headline earnings fell 91% year-on-year to R0.4bn due to far higher credit impairments. Within this, all of our lending businesses made losses, but the transactional franchises were resilient. Both Relationship Banking and Retail's Transactional and Deposits made over R1bn for the half, despite reduced fee income due to Covid-19 and the weak economy. The Insurance Cluster's earnings grew 21% to over R0.7bn, demonstrating the benefits of repositioning it within RBB and exiting from the volatile agricultural crop and commercial lines of business.

RBB SA's operating expenses fell 8%, in part due to reduced variable costs on lower volumes, although this also reflects the benefits of restructuring that started in the second half of 2018. The operational benefits such as reduced bureaucracy, improved customer primacy and market share gains were less evident from the second quarter, given the disruption from Covid-19. Nonetheless, as I mentioned earlier, RBB SA's good business continuity plans allowed us to support customers during this difficult time.

The cost initiatives leverage digital to improve operating efficiencies and customer experience. RBB SA has made progress on its digital journey, starting with refreshing its platform architecture and building resilience while substantially improving the quality and speed to market of new functionalities. We are seeing benefits across our digital estate, including consistently being the highest rated banking app on both the app store and Google Play store. Our digitally active customers grew 12% from December to over 1.7m. Our new end-to-end digital onboarding system in vehicle finance has reduced turnaround times from hours to minutes. And we recently launched Activate, a digital-only short-term insurance offering, while in life insurance we have partnered with a fintech to provide a digital SME group life offering.

It is worth mentioning that RBB SA completed the sale of its Edcon store card book in the first quarter, which freed up over R8bn of risk-weighted assets.

Lastly, RBB SA's credit charge was four times higher year-on-year, as we took substantial provisions against future expected credit impairments.

Corporate and Investment Banking's total normalised headline earnings dropped 43% year-on-year to R1.6bn, although it was our largest division by earnings.

Importantly, CIB has completed the separation from Barclays, which has freed up some management resources which had been tied up for the past three years. CIB's revenue increased 15% to over R10bn and, importantly, this growth was broad-based. Markets revenue in South Africa rebounded off a low base, while ARO continued its strong growth and has doubled since the first half of 2016. Commercial property finance also grew strongly. Corporate Banking maintained its double-digit revenue growth,

largely due to ARO, as South African activity slowed, given the more severe lockdown and macro backdrop, plus low business confidence. CIB's deposit growth was strong, an area where it had disappointed in the past. Its deposits rose 19% year-to-date, with core deposits up more. During the first half, CIB completed our acquisition of SocGen's local custody business with R113bn of assets under custody and trustee, which will help CIB to grow deposits.

CIB's credit impairments were seven times higher year-on-year, off a relatively low base, particularly in ARO. The large increase reflects single name charges and macroeconomic variable charges.

Lastly, Absa Regional Operations' earnings fell 67% year-on-year to R0.6bn. Completing its separation from Barclays was a major milestone for this business, the bulk of which we acquired from Barclays in 2013. ARO's separation involved the largest single data and systems migration in Africa, as customers in nine countries were switched to a new, enhanced online banking system. Moreover, our rebranding outside South Africa has been very successful and has improved staff morale while providing an opportunity to engage with customers. We rebranded over 340 branches and corporate offices, over 860 ATMs, over 17 thousand point of sale terminals, over 1.2 million customer cards and thousands of staff uniforms and stationery.

ARO's strong digital growth is worth highlighting, with increased adoption across intelligent ATMs, mobile and internet banking. The number of digitally active customers grew by 28%, resulting in digital transactional volumes rising 77% and transaction values 43%. Growth in mobile lending also increased strongly. For instance, it was extended to Ghana, where 210 thousand loans were disbursed in just four months. We also launched NovoFX in Zambia and Botswana, allowing customers to send money across boarders for immediate payments into recipients' accounts. Automation and digitization have allowed us to optimize ARO's branch network.

ARO continues to benefit from its well-diversified portfolio, both by activity and geography. For example, although RBB made a small loss, the Investment Bank grew earnings 14% year-on-year off a relatively high base; a very creditable performance. Similarly, certain countries performed strongly to offset some that were weaker.

While ARO's operating expenses grew 17%, this included restructuring costs to right size the business, higher incremental runs costs after separating from Barclays, IT investments and the weaker Rand. Excluding these, cost growth in constant currency was sub-inflation, reflecting various initiatives.

As with the other divisions, however, credit impairments dominated ARO's first half performance, as its credit charge was five times higher compared to the same period a year ago.

Those are the points I wanted to pull out for our divisions, some of which were masked by their significantly lower earnings because of higher credit impairments.

I will now hand you to Jason, who will take you through our first half financial performance in more detail.

Jason Quinn

Thanks Daniel and good morning everybody.

I am going to cover the main features of our first half performance and will provide guidance for the rest of 2020.

Income statement reflects impact of Covid-19

As usual, throughout the presentation I talk to our normalised financials, which adjust for the consequences of separating from Barclays and better reflects our underlying performance. We reconcile these with the reported IFRS results in our booklet.

Daniel highlighted the unprecedented operating environment, which is evident across our financials.

Our first half was a story of two quarters. Although our first quarter was somewhat impacted by Covid-19 towards the end of March, revenue growth was high single digit with mid-teen growth in customer loans and deposits. Combined with continued cost management, this produced strong pre-provision profit growth. Our RoE was only slightly lower YoY, given increased credit impairments, as we started to see the impact of Covid-19 towards the end of the quarter.

However, in the second quarter, as the pandemic deepened, our presence countries went into lockdown and their economies stalled, loan production and transaction volumes slowed materially. This was particularly evident in April, given South Africa's hard lockdown. Significant policy rate cuts also reduced our net interest margin, despite protection from our structural hedge. Later I'll show how volumes recovered from April to June and into July.

As a result, revenue growth for the half slowed to 3%. Net interest income was more resilient, up 6% to R24bn, despite noticeable margin compression. Non-interest revenue declined 2% to R16bn, as 8% lower fee and commission income outweighed solid insurance premium growth and a strong rebound in Global Markets revenue.

Our total revenue grew 3% to R40bn for the half. Currency translation effects of a 12% weaker Rand during the period increased both our reported revenue and costs by 3%.

As you would expect of us in the current environment, operating expenses were again very well controlled and responded to the crisis. Costs declined 2% YoY, or 5% in constant currency, to almost R22bn.

Credit impairments increased significantly and were four times higher YoY at almost R15bn, which I will cover later in considerable detail.

The 38% increase in 'Other' reflects higher VAT and a large decline in income from associates and JVs.

The effective tax rate decreased slightly to 26%, which I have previously indicated is a sustainable level.

Non-controlling interest fell 29%, as far lower minorities offset higher AT1 coupons.

Normalised headline earnings decreased 82% to just below R1.5bn for the half.

The normalisation items are shown on the right. Separation-related operating expenses of R1.4bn was the largest item, which was higher than a low base in the first half of 2019, due to ARO rebranding costs, and higher amortization and technology build costs this year. We also deducted almost R300m of revenue. At a headline earnings level, we added back R900m. Our IFRS reported headline earnings fell 93% YoY to R559m.

Customer loan growth slowed …

Balance sheet momentum continued in the first quarter, as gross loans were up 16% YoY. However, moving into the second quarter, in April and May our gross loans declined during national lockdowns, while June increased marginally.

So at the end of the half total gross loans grew 7% YoY to R975bn, or 9% excluding reverse repurchase agreements, and annualized first half growth was 6%, all from the first quarter.

RBB SA, our largest book, grew 4% YoY, or 5% adjusting for the disposal of the Edcon storecard portfolio in the first quarter, as our market share increased slightly to 21.5%.

CIB SA's gross loans rose 6% YoY to R308bn, with reasonable growth in commercial property finance and foreign currency loans, while overdrafts, overnight finance and reverse repurchase agreements declined.

ARO's gross loans increased 25%, with almost two-thirds of this due to the weaker Rand, as RBB grew 26% and CIB 25%.

Looking at RBB's loan growth in South Africa on the right hand side, all the books grew despite considerably weaker second quarter production.

Home Loans rose 4% to R245bn, as its share of new business increased to 22% from 21%.

Vehicle and Asset Finance grew 7% to R88bn, as our market share improved slightly to 20%.

Personal Loans grew 10% and credit cards 9% excluding the Edcon storecard disposal, given strong growth in the second half of 2019 and in the first quarter this year.

Lastly, Relationship Banking rose 3%, with 13% growth in Agri and term loans, while commercial asset finance was flat due to the tough economic environment.

Given the substantial impact of Covid-19, RBB SA's annualised first half loan growth came in at just 1%, even as run-off on the back book slowed due to the substantial payment relief granted.

… as lockdown reduced second quarter production

This slide illustrates the substantial impact of South Africa's Covid-19 lockdown on our new loan production in our two largest retail books.

On the left, Home Loans production was up 20% YoY in the first quarter. However, production dried up during the hard lockdown in April. Production rebounded in May and June, although the second quarter was still down 72% YoY. Total industry registrations fell 39% during the first half and we declined 31%. July's production improved, but was still 27% lower YoY. While volumes have picked up, perhaps due to low interest rates, there are still operational challenges with the Deeds Office processing transactions when their offices close for precautionary safety measures related to Covid-19.

The trends were similar for vehicle finance, although the recovery was stronger. First half production fell 19% YoY, compared to the 42% decline in the market of total new and used vehicles financed during the period. Personal loans production dropped by more than three-quarters in the second quarter. Despite improving, it remained about two-thirds down YoY in July, as we tightened risk appetite with a large reduction in approval rates.

Robust deposit growth across the board

Growing core deposits is a key focus and it's an important sign of the health of our franchise.

Total deposits growth improved to 15% YoY, or 17% excluding reverse repos, with average first half deposits up a similar amount. Adding R122bn in deposits, produced strong positive balance sheet JAWS, with gross customer loans up R64bn YoY.

Customer deposits increased to 76% of our total funding mix from 74%.

RBB SA grew 12% to R392bn, or 43% of our total deposits excluding reverse repos, given strong growth in notice deposits and savings and transmission deposits. Deposit margins declined reflecting competitive pricing and a shift to low-margin deposits.

Within RBB SA, retail deposits rose 12% to R240bn, improving our market share slightly to 22%. Growth in investment products was strong, although transactional deposits also grew 11%, as customers preserved liquidity.

Relationship Banking, rose 13% to R150bn, with strong growth in savings and investments due to new products, while transactional deposits declined slightly, largely in the public sector.

Deposits are also a priority for CIB SA and grew 17% to R243bn, or 25% excluding reverse repos, with the Absa Access Deposit Note launched last year performing very well.

ARO's deposits increased 26%, or 11% in constant currency. Within that, RBB's deposits rose 26%, or 13% in constant currency, largely driven by current account growth. CIB's grew 24%, or 8% in constant currency, due to improved products and greater focus on key clients in target sectors.

Significant policy rate cuts reduced net interest margin

Moving to our net interest margin, benchmark rates were reduced in most of our presence countries in the half, with large cuts in several countries. South Africa's repo rate dropped 275 basis points during the period.

Lower policy rates were the reason our net interest margin narrowed to 4.23% from 4.52%, as average interest bearing assets rose 13% to over R1.1tn and net interest income grew 6%. Lower rates reduced our net interest income by R1.3bn in the half.

Our lending margin widened by 7 basis points. Pricing improved in Home Loans and Investment Banking in South Africa, while slower growth in Home Loans versus overall group loans had a positive mix effect that was partially offset by disposing of the high-margin Edcon store card portfolio.

Our deposit margin declined by 5 basis points due to competitive pricing in RBB SA, while stronger growth in low-margin deposits had a negative composition effect of 2 basis points.

Lower policy rates reduced the endowment income on lazy deposits and equity in South Africa, lowering our group margin by 18 basis points.

We continue to hedge structural balances of 13% of our South African capital and liabilities. Our structural hedge released just over R900m, to the income statement, which was 11 basis points more than the comparative period. The programme's cash flow hedging reserve increased materially to R4.5bn after tax at 30 June 2020, which is indicative of the current extent of protection available in future periods as the hedges amortise, should all other factors remain the same

Endowment on equity and liabilities after hedging had a net negative contribution of 7 basis points, due to slower growth in endowment balances relative to the Group's overall interest-bearing assets.

The negative reset impact following the falling prime rate in South Africa during the half was a 16 basis point drag on the margin.

ARO reduced the group margin by 4 basis points, as lower policy rates in these markets and competitive pricing offset a positive mix impact from its strong loan growth.

Non-interest income decreases slightly …

Balance sheet growth and a focus on growing our customer base and improving primacy was starting to translate into better non-interest income, with 8% YoY growth in the first quarter.

However, non-interest income slowed materially in the second quarter due to Covid-19 lockdowns and an unprecedented reduction in economic activity. Thus for the first half non-interest income declined 2% YoY to R16bn or 40% of total revenue.

At a divisional level, RBB South Africa’s non-interest income was most impacted, falling 7% YoY, although it remains the largest contributor by far. Within this, however, the Insurance Cluster was very resilient increasing 9% YoY, while Transactional and Deposit declined 6% and Relationship Banking fell 13%. Card decreased 15% or 7% excluding Edcon.

CIB SA’s non-interest income rose 1%, as strong Global Markets and solid Corporate growth were dampened by R570m of negative fair value adjustments mainly on the non-core private equity portfolio, which are one-off in nature.

ARO grew 14%, or 4% in constant currency, as RBB increased 3% and CIB 25% on strong Global Markets growth.

… due to substantial impact of lockdown

The graph on the left shows RBB South Africa’s fee and commission income, which grew 2% YoY in the first quarter. However, it declined sharply in April during the hard lockdown and although it recovered in May and June, it remained below pre-Covid-19 levels and the second quarter was down 20% YoY.

On the right, our debit and credit card turnover halved in April and despite improving into July it remains below first half 2019 levels, particularly credit cards.

While our card acquiring volumes fell almost 40% in April, they recovered relatively quickly and by June they exceeded first quarter levels and were 15% higher YoY.

Strong rebound in Markets revenue

Global Markets revenue increased 42% to R3.2bn, our strongest performance in 5 years. ARO grew 34%, or 21% in constant currency, off a high base due to continued product and geographic diversification, and now accounts for 43% of our total Global Markets revenue.

SA Markets revenue rebounded, growing 49% YoY off a low base to R1.8bn, given significant growth in fixed income and foreign exchange revenues in part due to increased volatility, while equities declined. The SA franchise revenues are almost back to the levels we printed before Barclays exited, which disrupted our Global Markets business materially.

The split by type on the right shows the resilience of the Corporate franchise and strong growth in Institutional client flows, plus a significant turnaround in the revenues generated from client facilitation risk compared to last year.

Underlying cost growth well contained

Moving on to costs, our operating expenses declined 2% YoY, or 5% in constant currency, to R22bn. The reduction reflects the benefits from our restructuring efforts over the past two years, particularly in RBB SA, plus management actions in response to Covid-19 and lower variable costs on the back of lower activity due to national lockdowns.

Staff costs decreased 5% YoY, or 8% in constant currency, to R12bn, but remain the largest component at 55% of the total. Salaries increased 1% YoY, mostly due to the sustainable benefits in this period of restructuring costs in the base, which together with a hiring freeze reduced headcount by 2000 YoY. The provision for bonuses fell 87% in line with group results, while deferred cash and share-based payment provisions decreased by 29%.

Non-staff costs increased 1% YoY, although these were down 1% in constant currency. Incremental run costs after separating from Barclays were R830m, up from R650m in the base.

Property-related costs grew 11%, largely due to spending R75m on protecting colleagues and customers from Covid-19, with no increase in the underlying cost base and in line with previous periods. Technology costs rose 7%, reflecting continued investment and post separation incremental run costs. Our total IT

spend, including staff, amortization and depreciation, grew 7% to almost R5bn, or 22% of group expenses. Amortisation of intangible assets grew 22% due to a 14% increase in software assets to R5.7bn. Depreciation rose 3%, or 1% in constant currency. Professional fees grew 25%, given higher investments to improve digitization across our estate.

The 13% decline in cash transportation costs is a good example of lower variable costs due to the Covid-19 lockdowns and reduced economic activity.

Management actions include reducing marketing spend and communication costs, plus a substantial decline in travel and entertainment spend within 'other'. Other also includes lower fraud losses and 51% lower administration fees after disposing of the Edcon store card portfolio.

In this tough operating environment, you would expect us to continue to manage costs very tightly, especially during the crisis. We see further structural cost saving opportunities in operations and technology, and through digitalization, while continuing to reduce discretionary costs.

Despite moderate revenue growth, lower costs produced positive JAWS, resulting in a 54% cost-to-income ratio, our lowest in many years.

Significant increase in credit impairments ...

Given the significant build in first half credit impairments, I'll spend much more time than usual on credit today.

Credit impairments of almost R15bn were four times higher YoY, reflecting the impact of IFRS 9 accounting in particular incorporating estimations regarding forward looking assumptions around macroeconomic variables and the cliff effect of stage migrations, all caused by the substantial strain Covid-19 placed on our customers and the weak economic outlook.

While the bulk of the increase came from RBB SA, it grew by less than both CIB SA and ARO. Our credit loss ratio increased from 79 basis points to 277, almost three times the top of our expected through-the-cycle range of 75 to 100 basis points.

RBB South Africa's credit loss ratio rose to 377 basis points from 112, which was at the bottom of its through-the-cycle range of 110 to 155 basis points. Although Home Loans' credit charge was 12 times higher YoY, off a very low base, its 143 basis point credit loss ratio was well below first half 2012 levels, when we experienced a significant impairment build in that portfolio. Within Everyday Banking's R5.1bn credit impairment, Card and Personal Loans' credit loss ratios increased to 13% and 15% respectively. Relationship Banking's charge also increased materially off a low base.

CIB South Africa's credit loss ratio rose from a low 18 basis points to 93, over three times the top end of its through-the-cycle range. ARO's credit loss ratio increased materially YoY, off a low base, particularly in CIB.

… reflecting three drivers

Unpacking the substantial increase in our credit impairments, there were basically three drivers. Half the increase, or R5.5bn, came from management judgmental provisions based on an unprecedented deterioration in macroeconomic variables. Worsening delinquency trends added R3.7bn to our charge, while the period also included R1.8bn of provisions for single name exposures.

The single name provisions were for numerous clients across our CIB and Business Banking books in SA and ARO. There was not one particularly large exposure and the industries they operate in vary, although some are in cement.

Relatively low exposure to Covid-19 impacted industries

Our direct exposure to industries that have been significantly impacted by Covid-19 is relatively low. However, these are big in absolute terms and clearly the specific names within each is crucial. The graph shows the aggregate exposure to each sector across RBB and CIB in South Africa and ARO. CIB SA constitutes the bulk of the lending, although RBB SA has quite large exposures to commercial property finance, manufacturing and construction, while ARO has more lending to non-food retail, manufacturing and hospitality, in particular.

Commercial property, predominantly in South Africa, is the biggest exposure while still relatively modest in the context of our overall lending book. Although parts of the property sector are under pressure, our CPF portfolio is well-diversified, we have improved its risk profile in recent years, and its LTV is low at around 50%. Manufacturing and non-food retailers are the next largest, and these books are well diversified. Our loans to the hospitality industry and construction sector are relatively small in a group context. As I said in our May update, the construction sector in SA has been distressed for some time, which Covid-19 has exacerbated, whereas hospitality and hotels were in reasonable shape before the pandemic. Oil and gas is small for us at less than 1% of our group loans, plus clients in that sector have responded to the crisis and are shoring up their balance sheets and have hedged their oil and currency positons. Our exposure to automotive dealers, healthcare and aviation are all small, and our total exposure to South African Airways is backed by a government guarantee.

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 R720m now, which has good levels of collateralisation and has stood up well to price volatility.

Finally, our SME portfolio is relatively small at R12bn.

Noticeable 1H20 delinquency stage migration

Despite substantial payment relief measures, the delinquency profile and non-performing loans deteriorated noticeably during the half. Thus, excluding single names and before incorporating the change in macro-economic variables, our credit impairments would have doubled YoY.

As you can see, our level of stage 2 and 3 loans increased materially, after having improved consistently for the previous two years since we adopted IFRS 9.

Stage 2 increased as a result of higher early stage delinquencies and SICR adjustments.

Stage 3 growth included specific names in the wholesale portfolios that were impaired. Delays in the sale in execution process in Home Loans, which Covid-19 exacerbated, and changing Personal Loans' write off period to 12 months from 6 also increased the stage 3 ratio.

Our stage 3 loans are higher than peers, due largely to our more conservative Basel-based definitions, which we are updating as we re-develop these models in the medium-term.

Provided extensive Covid-19 payment relief

As Daniel mentioned, we granted significant payment relief to customers in good standing at the end of February, who required short-term financial relief due to the Covid-19 pandemic.

RBB South Africa's relief covers R154bn of loans or 29% of its overall book and 71% of the total relief we granted. Within this, Home Loans is the largest by value and Cards the largest by the number of customers. A third of our Home Loans and VAF books were granted relief, while Card was the lowest at 18%.

CIB SA granted payment relief on R37bn of loans, or 12% of its book. These ranged from providing bridging finance to deferring capital or interest, or relaxing covenants on a temporary basis. It received 310 requests. The property sector represented a high proportion of the requests by number, rather than by value.

ARO has granted payment relief on R25bn of loans, or 19% of its book. Within CIB ARO, the largest sector under relief by value was hotels and tourism.

All these portfolios have been ring-fenced in order to ensure heightened monitoring post the expiry of the relief measures. The first tranche of RBB South Africa's payment relief lapsed this month, particularly mortgages and vehicle finance. Of these customers, a large majority paid their instalment, while a portion chose to extend their payment relief, although a partial instalment payment is required. We will have a better idea of how these books perform by the end of this quarter.

Macroeconomic variables management adjustments

Given the unprecedented impact of Covid-19 on the global economy, we updated the macroeconomic scenarios used in our credit models. While there is considerable uncertainty, you saw earlier how expectations for economic growth in our markets has decreased materially. In December, our baseline

scenario for South Africa's real GDP was 1.5% growth this year and 1.7% next, which swung to a 9.7% fall this year followed by 3.1% growth next year. We used the latter assumptions in our first half expected credit loss calculations. Our latest expectation is that of a slightly smaller decline of 8.3% this year, with a modest recovery of 2.4% in 2021. As the graph shows, we don't expect South Africa's real GDP to recover to 2019 levels by 2024. Given the significant forecast risk, we retained the 9.7% GDP fall scenario in our modeling for the half year macroeconomic variable estimation. We provide details of our various macro scenarios for SA and our four largest ARO countries in our booklet.

Given the unprecedented operating environment, we made two further adjustments to our expected credit losses. We applied a scalar to RBB's probability of default and loss given defaults for each product, based on qualitative factors such as exposure to impacted industries and applied appropriate sense checks or qualitative assessments to the outcomes. PDs and LGDs for wholesale exposures were determined on a case-by-case basis and stressed per industry.

These PD and LGD scaling factors will be reassessed as the Covid-19 pandemic's effects become known and the level of customer distress becomes evident within the models and at each reporting period.

Lastly, we considered whether a significant increase in credit risk event had occurred, resulting in migration from stage 1 using 12-month expected losses, to stage 2 with lifetime expected losses. Since our substantial payment relief measures mask arrears, making it harder to determine whether a SICR had taken place, we considered whether customers were experiencing short-term liquidity problems, the particular industry and expected arrears in a Covid-19 environment.

On the right, the R5.5bn of MEV management adjustment is spread across several areas, with RBB SA two-thirds of the total. The adjustment is more than half of our Home Loans credit impairments, given the large payment relief on that product. It was also a relatively large proportion of CIB SA's charge.

Excluding the management adjustment, our first half credit loss ratio would have been 173 basis points, in line with our charge during the global financial crisis.

Material 1H20 increase in loan coverage

Our balance sheet credit provisions have almost doubled over the past 5 years. There was a large increase in 2018 as we implemented IFRS 9 based on expected losses. The first half charge improved our total loan cover to 4.5%, almost three times the level we entered the global financial crisis with 11 years ago. The rise in RBB SA's cover was even larger YoY than its increase when we adopted IFRS 9.

We believe that our level of coverage is appropriate for the current operating environment, as we provided early for the expected losses due to the Covid-19 pandemic, based on current expectations.

Going forward we will utilize these provisions if and when delinquencies crystallize.

Significant decline in divisional earnings and returns

Moving to our divisional performance, normalised headline earnings declined materially across the board due to these substantial credit impairments. However, it was encouraging to see that all the divisions posted growth in pre-provision profits.

RBB SA, which usually generates about 60% of our earnings, fell 91% YoY to R415m, as losses in lending products on the back of large credit impairments outweighed more resilient performances in the transactional franchises and insurance.

CIB SA dropped 47% YoY to R817m, despite strong pre-provision profit growth.

Absa Regional Operations earnings decreased 67% to R569m, given significantly higher credit impairments off a low base.

Our first half divisional returns dropped sharply and were all well below cost of equity.

RBB SA earnings fall with losses in lending products

Starting with RBB South Africa, the Covid-19 pandemic had a substantial impact on our largest business. In the first quarter, its multi-year strategy to regain leadership was on track, with strong pre-provision

profit growth and new business production. However, in the second quarter RBB SA shifted from strategy execution to preservation of capital and supporting customers. As mentioned, the pandemic reduced its loan production and fee income materially in the second quarter, while increasing its credit charge significantly. These were partly offset by 8% lower operating expenses that benefited from the successful execution of the restructuring in 2019 and reduced variable costs. Looking at its franchises, all grew pre-provision profits YoY, which was outweighed by higher credit impairments.

Home Loans revenue was resilient, growing 8% YoY, well above 3% cost growth. Despite 12% higher pre-provision profits, Home Loans lost R320m, given significantly higher credit impairments.

Vehicle and Asset Finance revenue also held up, increasing 6%, while costs decreased 11%, producing 27% higher pre-provision profits. However, VAF's credit impairments were almost 4 times higher, resulting in a R1bn loss for the period.

Our Insurance Cluster continues to benefit from integration into RBB. Although also impacted by Covid-19 in the second quarter, it performed extremely well, with earnings growing 21% to R709m. SA Life earnings grew 20%, due to 9% higher net premiums, partly offset by 10% higher claims, as increased retrenchment claims outweighed lower mortality claims. Given the impact of Covid-19 on retrenchment claims and loan production, the embedded value of new business declined 18% YoY. SA Short-term insurance earnings grew 8%, as its underwriting margin improved to 13%, given lower motor claims during the lockdowns and no catastrophic weather claims in the half.

We are comfortable that the conservative approach we adopted over many years with regard to the actuarial valuation of insurance liabilities results in us not having to create a substantial Covid-19 related provision, based on current assumptions.

We had also disposed of our commercial lines business and the group has not offered business interruption type insurance products for some years.

Relationship Banking earnings decreased 38% to R1bn, as significantly higher credit impairments again outweighed solid pre-provision profit growth. Revenue was resilient, declining slightly due to lower non-interest income as transaction volumes fell during the second quarter. Operating expenses reduced 8%, given restructuring costs in the base and volume-related savings in its cash operations. While its RoE fell materially, it remained in line with our cost of equity.

I cover Everyday Banking on the next slide.

Transactional and Deposits held up relatively well

Everyday Banking incorporates Transactional and Deposits, Card issuing and Personal Loans. While its earnings fell 93%, this reflects divergent performances across its businesses.

Transactional and Deposits earnings decreased 5% to R1.2bn, a resilient showing considering the 6% decline in its non-interest revenue due to the second quarter lockdown. Reduced operating costs produced positive JAWS and higher pre-provision profits, while credit impairments on its small overdraft book grew 52%. Our primary customers declined to 2.9m, due to the decline in customer activity levels and income during the lockdown. Transactional accounts grew 1% to 6.2m and our overall customer base was stable at 9.7m.

The two lending businesses made losses due to significantly higher credit impairments. Card's pre-provision profits grew 2%, due to lower variable costs. However, its credit charge more than doubled to almost R3bn, producing a R505m loss for the half. Given solid 11% revenue growth, Personal Loans pre-provision profits increased 16%. However, its credit impairments almost trebled to R1.9bn, pushing it to a slightly larger loss than Card. We would expect these two businesses to return to profitability in the second half.

CIB earnings down despite strong pre-provision profits

Moving onto CIB, I show all of its components, in line with how it is run on a Pan-African basis.

CIB's first half earnings fell 43%, or 46% in constant currency, to R1.6bn due to significantly higher credit impairments. Credit impairments were 7 times higher, increasing its credit loss ratio to 130 basis points from a low of 22 basis points last year. Revenue grew 15%, or 10% in constant currency, with strong 42% growth in Global Markets and 47% in Commercial Property Finance, plus 12% higher Corporate revenue, while negative fair value adjustments weighed on Banking and Private Equity Revenue. Non-interest revenue decreased to 35% of total revenue. While well below our 40% target for next year, when excluding the R570m of negative fair value adjustments that we believe are one-off in nature, the

proportion was 40%, given the strong rebound in Global Markets. Costs rose 5%, or 2% in constant currency, with South Africa down 4% largely due to lower provisions for incentives. ARO's costs increased 27%, or 17% in constant currency, mostly due to incremental run costs after separating from Barclays that are now largely in the base. Given strong positive JAWS, CIB's total pre-provision profits grew 24% YoY.

In South Africa, CIB's earnings declined 47% to R817m, as far higher credit impairments outweighed strong 28% growth in pre-provision profits.

Within this, SA Corporate earnings fell 35% to R288m. Revenue growth slowed to 4%, as transactional volumes and deposit margins came under pressure, while credit impairments more than doubled.

SA Investment Banking earnings dropped 52% to R529m, despite strong pre-provision profit growth. As I mentioned, Global Markets revenue rebounded, with strong growth in institutional flows and improved client facilitation risk revenue. Banking revenue was flat, given negative fair value adjustments, otherwise it would have increased 15%. Commercial property finance continues to grow strongly off a low base.

We still see growth potential in target areas and aim to win primary relationships to increase our transactional revenue and deposits.

CIB ARO's earnings fell 37%, or 49% in constant currency, to R773m. Credit impairments rose almost tenfold, resulting in a credit loss ratio of 3.1%. Pre-provision profits grew 21%, although much of this was due to the weaker Rand.

ARO's Corporate earnings decreased 62% to R317m, due to significantly higher credit impairments and incremental run costs. Revenue grew 19%, reflecting strong net interest income growth driven by the weaker rand and solid constant currency loan and deposit growth.

ARO's Investment Banking franchise was one of our best performers, as earnings grew 14% YoY, or 1% in constant currency, off a relatively high base. Revenue grew 34%, or 21% in constant currency, given strong client hedging as we continue to build momentum in our franchise. Moreover, Investment Banking benefits from not having a loan book, so credit impairments are not a factor.

Given this strong performance, Investment Banking increased to almost two-thirds of our overall CIB earnings, with ARO now just under half the total.

Absa Regional Operations enhance revenue growth

Despite the difficult operating environment, ARO's overall revenue grew nicely at 16% YoY off a relatively strong base. Admittedly, it did benefit again from a weaker Rand, as constant currency growth was closer to 4% YoY.

ARO's revenue growth in past two years has enhanced our group growth, particularly since revenue in South Africa declined 1% YoY this period, following 3% in the first half 2019. Thus, ARO has increased its share from 21% to 26% of our group revenues.

Absa Regional Operations

Despite this revenue growth, ARO's earnings decreased 67%, or 77% in constant currency, to R569m. Before Covid-19, I flagged that we were cautious on ARO's earnings this year, given its low 2019 credit charge and higher incremental run costs after separating from Barclays. Clearly Covid-19 exacerbated this by increasing credit impairments and dampening revenue. ARO's pre-provision profits still grew 14% YoY, despite slightly negative JAWS, predominantly due to Rand weakness. However, its credit impairments were almost 5 times higher.

I covered CIB ARO earlier. Despite strong pre-provision profit growth, RBB ARO made a small loss for the period, as its credit impairments trebled. While RBB's cost-to-income ratio improved slightly, we see considerable potential to reduce this from 69% medium-term, as we reshape the franchise now that we have separated from Barclays. We also see scope to grow our CIB franchise across the continent.

Focus on preserving capital and liquidity

As I said in our May update, we have focused on preserving capital and liquidity and protecting our balance sheet and client franchise, rather than on growth during this period.

With the separation from Barclays complete a permanent difference between normalized and IFRS capital has arisen and thus I show our Group IFRS capital adequacy ratio, which remains within our board target range and comfortably above regulatory requirements. Our core equity tier 1 ratio of 11% is at the bottom of the board target range. It declined during the period, largely due to paying our final 2019 dividend of R5.2bn and risk-weighted asset growth, which outweighed low internal capital generation. The impact of phasing in IFRS 9 that will be complete next year was offset by the well-timed disposal of the Edcon store card portfolio.

The main RWA growth came in CIB, due to book growth, higher credit risk, increased market risk due to market volatility and currency weakening. ARO grew as strong deposit growth was invested in sovereign debt. RBB's growth was offset by impairments that took the risk to their P&L and released RWA.

Prior to Covid-19, we ran an "IMF bailout" stress scenario at the beginning of the year, where credit impairments increased 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.

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.

Our total capital adequacy ratio of 14.9% is in the middle of our board target range. We redeemed R2.5bn and issued R2.7bn of tier 2 capital in February. We have minimal redemptions for the rest of the year.

In response to covid-19, the SA 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 liquidity position is strong. As I highlighted earlier, our deposits grew 15% YoY and 23% annualized year-to-date. As you can see, our sources of liquidity grew 46% YoY to R317bn, and our LCR of 127% and NSFR of 117% are both strong and well above regulatory requirements.

The SARB reduced the sector's minimum LCR requirement to 80% from 100% during the period, which in our case frees up capacity for about R20bn in additional lending.

2020 outlook

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

As mentioned, our latest estimate is for SA's real GDP to fall 8% and our ARO portfolio to grow 0.9%. 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:

Our net interest margin is still expected to decline noticeably this year, although we expect a slight improvement in the second half. We believe there could still be another 25 basis point rate cut in South Africa this year. Our annual sensitivity to further rate cuts in South Africa is a R250m reduction per 50 basis points.

Loan and deposit growth should slow in the second half, with deposits expected to grow faster than loans.

Operating expenses are expected to decline YoY, resulting in pre-provision profit growth.

Our credit loss ratio is expected to be well above global financial crisis levels for the full year. The second half credit loss ratio is expected to improve significantly, but remain well above the through-the-cycle range of 75 to 100 basis points. This is based on our current estimates that a further build of macroeconomic variable reserves, in particular, will not be required and that the reserve will be utilized if and when delinquencies crystallize.

Our core equity tier one ratio is expected to remain resilient as capital generation improves in the second half and should remain broadly at first half levels.

Our return on equity is expected to remain well below cost of equity this year, although it is likely to improve in the second half.

Finally, given our focus on preserving capital, we do not envisage declaring an ordinary dividend for 2020.

Thanks very much for your attention, I'll hand you back to Daniel.

Daniel Mminele

Thank you, Jason.

Please allow me to make a few closing remarks before we take your questions.

The Group has experienced significant challenges as a result of Covid-19 which has had a material impact on our operating environment, business activity levels, and financial performance, as we have just discussed. There is a growing consensus that when we emerge from this crisis, economic life, the business environment and indeed, social interactions and customer needs and preferences will have undergone a fundamental structural change.

We need to make sure that we are correctly positioned for this with regard to ensuring that we have a relevant and competitive business model that will see us emerge from this crisis as a strong and resilient business for our colleagues, customers, clients and shareholders.

In this regard we have already instituted initiatives which will culminate in proposals being presented to the board by year-end. They are around making strategic choices for the markets we operate in that include accelerating and refining our digital strategies, agility of our organisation, how we attract and retain leaders that will drive a more entrepreneurial culture, what skills and capabilities we invest in, and our approach to strategic partnerships.

We will also continue to deepen our ESG activities, which have already seen Absa become a founding signatory of the UN Principles for Responsible Banking, publishing our sustainability policy and standard on coal financing, and being the first South African listed company to voluntarily include a climate change resolution at our AGM in June, with the resolution being supported by almost 100% of our shareholders.

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