Absa Group pre-close call transcript

13 December 2023

Arrie Rautenbach

Morning everybody. I think we can start the meeting. Let me start by thanking everybody for joining us as we cover our 2023 trading update. I'm joined by Chris Snyman, who stepped in as the Interim FD. Chris has been with the organization for 15 years, and then we've also got Alan on Teams.

I'm going to start by just reflecting on the macro environment, the operating environment and I think it's safe to say, that remains a very tough, very challenging macro environment.

If I focus on South Africa in particular, which is our biggest market, we have to say that the macros have stayed very tough, specifically also into the second half of this year, particularly as a consequence of the rapidly rising interest rates and the fact that it stayed high, which continuously impacted our SA consumer franchise amidst continued low confidence as well as low growth. And we've seen a particularly disappointing 3Q GDP print.

It’s safe to say that we continue to see better growth potential in ARO, but some sovereign risk in key markets remained, so this stays a key focus for us.I have to call out at this point Ghana that is dealing with very high inflation.

If I just for a second reflect internally where we are as a group, I have to start off by just saying that every division is very focused on the execution of their strategies and continue to show good momentum against that execution. At a group level, we've got key specific focus areas and key organisational health metrics that we are tracking.

I'm very happy to say that if we look at our organisation, our colleague engagement scores and participation with the recent survey that we've done, we're seeing the highest engagement scores across the organisation in the recent history and in particular, very strong engagement across our most senior colleagues, higher than the average across the full organisation.

Secondly, we've had a strong emphasis on our customer experience and we're seeing very good customer experience outcomes across all the segments. And lastly, we measure active customer numbers in SA and ARO and we are seeing very good growth on customer active customer numbers going into the second half as well. This gives us particular confidence as we look at our performance expectations, in our medium-term plan.

In SA, what is very clear is that our consumers remain under pressure, as significantly higher interest rates have increased credit impairments while we've also seen a slowdown in consumer activity.

A big focus area for us has been on managing credit risk in two very specific areas.
Firstly, as we look at our collection strategies and our focus here is very much working with our customers to help them through this rapidly increasing interest rate cycle.
And secondly, as we think about acquisition with our maintained focus on growth in specific segments within the risk appetite adjustments that we've made. We have seen early delinquencies improve during the second half, although the flow through into late arrears and NPLs caused our impairments to be stickier than our expectations.
Particularly pleasing is to see the benefit of diversification with strong revenue and earnings growth from both ARO as well as CIB.

Before I just reflect on our key focus areas going forward, we have to say that we have strong performance momentum across the medium-term and as we look at 2024 and beyond, a couple of key focus areas that I want to highlight before I hand over to Chris to go into some more detail on the trading update.

Firstly, we maintain a very strong focus on growth, particularly outside SA, but still with a very keen focus on key segments in SA.

Secondly, it’s very important to say that all the pricing actions that we've taken in retail SA is now behind us, and is in the base, and this should assist our non-interest revenue momentum as we go into 2024.

Strong focus on risk quality and continued improvement in delinquencies as we go into 2024, aided by a stable or lower rate outlook, very strong focus on our organisational efficiencies and productivity and lastly continued momentum in our organisational health metrics, some of the areas that I've highlighted before, which gives us the confidence in our medium-term plan that we've that we took through our board recently.

At this point, I'm going to ask Chris to go into a bit more detail and then we'll open up for questions at the end of these comments.

Chris, over to you.

Chris Snyman

Thanks Arrie and good morning everyone.

Firstly, I want to talk about our full year guidance. I wanted to flag that there are mainly two drivers behind the slightly softer guidance that we provided and I will unpack both of those drivers.

The first being, the SA consumer pressure that Arrie spoke about and secondly the impact of applying hyperinflationary accounting in Ghana.

So firstly, if I talk about the SA consumer position, the pressure is evident in a slightly weaker revenue position and we're seeing that on net interest income from slower loan origination and from lower transactional volumes, as well as on credit impairments.

On our credit impairments, it's only our SA secured portfolios that are worse than we expected with the other books broadly in line, including unsecured retail in South Africa.

Consumer delinquencies started increasing in the third quarter of 2022 and rose as rates increased rapidly over the period.

We expected delinquencies to improve in the second half of 2023. What we've seen is that early delinquencies have improved, although migration of the 2022 and first half of 2023 delinquencies into higher coverage buckets was a bit worse than expected.

Importantly though, all the consumer books improved noticeably from the elevated first half charge, and our group credit loss ratio is noticeably better than the first half charge.

Moving on to the second aspect, on hyperinflationary accounting, it's now an industry wide requirement to apply hyperinflationary accounting to entities in Ghana. This was only confirmed in October.

The impact is material to our second half 2023 headline earnings position, given that Ghana is one of our largest subsidiaries outside of South Africa. We expect this impact to be a roughly 2% drag on our group headline earnings.

A couple of other key elements that I wanted to highlight.

Firstly, we flagged that our second half revenue growth would slow when we provided our outlook in March, with base effects a key driver including from the disposal of our asset management business, which is in revenue and pre-provision profit but a non-headline item. We also had a litigation recovery and an insurance payout from SASRIA due to the 2021 KwaZulu Natal unrest.

Excluding these base effects, momentum was better, although it's still slightly lower than our first half growth.

We guided that our NII growth will be a lot stronger than our NIR growth in 2023 partially reflected by those base effects that mainly impacts on our NIR position.

Moving on to cost growth, it is broadly in line with our previous guidance and reflects investments made in key areas which includes frontline staff, marketing and technology.

We are looking strategically at our cost base opportunities as we move forward and, as we've discussed with you in the past, we see opportunities in our retail network as well as in our corporate real estate.

Moving on to RoE, our RoE for the full year is somewhat below last year's 16.4%, but above our internal group cost of equity of 14.5%. Within that, the second half returns are lower and it's impacted by hyperinflationary accounting.

We've also had further debt restructures in Ghana during the period and as we flagged, our BEE deal is in from September 2023 and is approximately a 1% drag on our 2023 earnings position.

Also, remember that our second half cost-to-income ratio is usually higher than our first half ratio, which also means that our return on equity in the second half is typically lower than our first half.

We will provide 2024 guidance with our results when we publish the 2023 results on 11 March next year, but maybe just in closing, I want to highlight that we remain committed to delivering an RoE which is sustainably above 17% and a cost-to-income ratio that is sustainably in the low 50s over the medium-term. Improving our credit loss ratio is a key driver in improving our RoE in the near-term and the sensitivity there is that every 15 basis points reduction in our credit loss ratio equates to about a 1% RoE uplift.

With that, I'll hand back to Arrie.

Arrie Rautenbach
Chris thanks for taking us through that detail. I think those are our comments on our trading update, I'm very comfortable for us to spend some time answering some questions.

So if you just raise your hand, will cover those questions.

Q&A

Harry Botha – I'd just like to get a sense of some of the challenges you're facing in the secured lending markets, if you could possibly highlight where you've been growing ahead of peers, or where you faced collection challenges and the headwinds you've had in those products in South Africa. And then, if you could maybe speak to the likelihood of returning capital to shareholders via share buybacks, particularly with a share price below price to book at the moment.

Charles Russell – Can you comment on the second half performance in rest of Africa, excluding the Ghana hyperinflation, which you've separated out? And then, also if you could just unpack your internal CoE calculation resulting in a CoE of 14.5%?

Ross Krige – For me, within non-interest revenue in the retail bank in SA, it sounds like that was a key driver of the lower-than-expected revenue growth. You've given us some indication on the weak consumer, but please unpack it more relative to peers, it was an area that wasn't necessarily called out, so it sounds like it's gotten worse over a three month period. So any more detail you can give there. And just to clarify, it sounds like you are expecting an improving run rate into 1H24?

Chris Snyman – Harry, on the secured portfolio, this is a portfolio we have grown steadily for a number of years. In Home Loans, we have maintained broadly flat market share over the medium-term. And VAF we have gained slightly. It's a business we have grown to try and build scale. As you look at the performance from a credit perspective, very much what we highlighted earlier. When rates increased in 2022, we saw early delinquencies come through strongly. We thought delinquencies would stabilise, and on early delinquencies, we've seen that. But it's the flow into later buckets that has had an adverse impact on the charge. We rolled out interventions to help customers through the period of stress. You'll know that with longer duration products the impact is higher than for shorter dated products.

Arrie Rautenbach – I met with both those business again yesterday. Importantly, the one business that has grown a big higher is VAF. That is off a specific strategy, our bank of dealer strategy. Our effort is on collections and optimising those strategies.The last rate increase in May only came through in the third quarter, as we saw the delinquencies increase as a consequence of that last hike. What we have seen since then is the situation stabilizing very nicely for us, with a particularly strong performance as we closed out November, so it's very clear that those strategies are giving us the benefit we are looking for. As you mentioned earlier into next year, with a flat rate environment, we expect momentum to continue.

Chris Snyman – on buybacks, as Arrie has flagged, we remain very focused on growth and capital is a strategic asset that will support that strategy. With capital above the top end of our target range, we have adequate capital to support our growth ambition. If we see that our growth ambition does not materialise in the medium-term, for whatever reason, that will cause us to reflect on our distributions to shareholders, whether as higher dividends, special dividends or buybacks. We will continue to evaluate that position. We spoke about a dividend payout for the full year of at least 52%.

Arrie Rautenbach – The momentum in Absa Regional Operations (ARO) is still very encouraging. You've asked us ex-Ghana, we've seen very strong customer franchise expansion. We aren't seeing that momentum slow down. We continue to flag that as the key area that will grow faster than SA. And you've obviously seen our recent acquisition of part of HSBC in Mauritius, which gives you an indication that we expect growth to come from ARO, although that's only a 2H24 implementation. You get a sense of where we expect the growth to come from as we continue to flag.

Chris Snyman – On our CoE, we use a standard CAPM model to build our internal CoE. We use a 3-year average long bond as the risk free rate to build that up. There's certainly an expectation that as we move forward, the CoE will increase, given how the long bond has moved recently. But due to the decisions – typically medium-term – we make on the back of the CoE, it's important that we use something more stable than you would use for valuation purposes. Certainly, the approach we use is similar to what the other banks in SA use. When we conclude on our CoE, we certainly look at it relative to other banks and we critically challenge it through our Treasury Committee to ensure it is balanced.

Arrie Rautenbach – Let me touch on retail consumers, it's very important that as we saw a slowdown in activity. If I think of the recent Black Friday outcome, that activity was flat on last year, which is again just an indication of where the SA consumer finds themselves. The important thing here, is the last of the pricing decisions that we took as we came into 2023, which is both ito making Rewards free, which is an important part of our consumer value proposition and some pricing adjustments for entry-level customers to ensure those are aligned with the market. Again, those choices are aa behind us as we go into next year, and as a consequence of that we expect our NIR growth to show strong momentum as we go into next year. Plus, as I flagged earlier, we see strong customer acquisitions in SA and ARO. That should give you an idea of our momentum expectations as we go into next year. So we certainly expect that to move in the right direction. And strong confidence about that outcome.

Chris Snyman – And I think Ross had a question about improving run rates into next year. I just want to clarify that question. Was that run rates into second half of 2023 or into 2024?

Ross Krige – Thanks Chris, Arrie's already answered that.

Keamo – On the credit loss ratio, which products came in line with the through-the-cycle range in 2H and which were above that. And on costs, can you expand on the opportunity for better costs on retail network and corporate?

Ross Krige – When one of your peers provided an uupdate a week ago they commented on energy deals being delayed and the impact there financially, what you seeing there on timing? And on the loan growth side, you've given us some colour. But again your guidance went from double digit in August to single digit now. How do you see 1Q and 2Q24 playing out with what you see on the ground?

Khumbelo Nevhorwa – you provided us limited commentary on CIB business. Ross alluded to the energy deals. Can you tell us how that business is doing on the trading side and on renewables. And can you elaborate on origination into 2024?

Chris Snyman – Where we stand relative to through-the-cycle. It's fair to say that outside of SA consumer we are broadly in line with our through-the-cycle expectations. It's the SA consumer books we are still slightly above where we expect to be through-the-cycle, but closer than it was now due to the improvements we've seen there.

The question on cost opportunities, where we see that. Firstly just to remind you that we ran a big efficiency programme since 2018 and we were very successful in that. But certainly coming out of Covid we are seeing new opportunities emerge on the back of big investments in IT we have made and change in consumer behaviour. If you look at branches, we've seen rapid declines and cash volumes reducing, and therefore the type of infrastructure must be revisited. There's also new technologies that are emerging, that will drive the agenda. The mindset in the next phase is not a cost focus, but a productivity one. We talk about growth with productivity, not to take away from growth, which is a key focus area.

I wouldn't want to talk about growth into 2024 for the moment. The environment is still very uncertain. The internal expectation is we still have good opportunity for growth in the segments we operate in, both in SA and ARO. But you see in some consumer segments that are down. Home Loan production at an industry level is 20-30% lower than last year. It's certainly an opportunity to originate good quality growth at this point in the cycle.

Arrie Rautenbach – As mentioned, I met with those businesses yesterday. Our medium-term posture is to grow revenue slightly stronger than the market. But our big secured portfolios, those markets have slowed down. Vehicle finance in particular has slowed into the last quarter, but again our risk appetite and value propositions are all in the right place and will maintain our market share. Unsecured we continue to look for growth, but we're very sensitive to the risk. We made the point that we have invested significantly in our Business Bank and Wealth, a very strong operational performance since we've made those adjustments and key to growing our NIR into next year. CIB is well positioned around renewables in SA market, and again we have very strong CIB momentum in our ARO markets. Hopefully the message you're getting is that that our business is focused on where we are seeing opportunity.

Chris Snyman – On CIB trading, ARO business is still growing well and we continue to see opportunity with them. I flagged that we had some additional restructures in Ghana during the half, particularly on the cocoa bills. There was a position the CIB trading book held that will reflect in results. ARO is still stronger, SA is relatively low, linked to overall confidence in the market. If you think of FX and fixed income trading, that's closely tied to the macro story and confidence. Therefore, while we still see growth in that area, it's not as nearly as high as what we have seen in ARO. We have seen good traction in client franchise, with good traction in the corporate business that we see as the centre of the CIB business.

Arrie Rautenbach – We will flag this in March, customer primacy growth and the ARO business. Alan Hartdegen – I just want to flag some colour on the trading comments. I want to flag that CIB SA had a weak base in the second half of 2022, so it has grown strongly in the second half this year, they didn't have a great first half. And as Chris said, Africa's trading has slowed of the very high base in the first half. I wanted to mention there are a number of questions on the chat.

Harry Botha – Just on net interest margin, how should we think about the second half given strong momentum in CIB and obviously comments about pressure in stage 3 balances in secured lending. Should we think of a lower NIM in the second half and how that changes into 2024.

James Starke – To return to asset quality, it feels like Absa is experiencing a bit more pressure than peers, particularly on consumer lending in SA. Perhaps can you give us some colour on that, as everyone should be facing the same macro and rate environment. And is it possibly around how you are approaching restructuring? Is that perhaps impacting your provisioning strategy relative to peers?

Bankole Ubogu – following on the asset quality question, you mentioned there's a 15bp to 1% higher RoE. What is your expectation for the continued momentum improvement into next year? Are you relying on continued improvement there. And secondly, is there any impact of Ghana on the equity part of your calculation. And you mentioned the cocoa bill impairment, is that outside your credit loss ratio?

Chris Snyman – We have certainly seen a broadly stable NIM into the half. What I would flag is while we have a lower exposure to NIM than some of our peers, we are still positively leveraged, particularly in ARO. So our performance was certainly assisted by the rate upticks in the continent in the prior 18 months. Those are all now in the base so expect to be stable. So from here, those are linked to the interest rate cycle. Our house view is that rates remain higher for longer, so it starts reducing in the second half of 2024. Some think it may be quicker, but that's not how we built our plans into 2024. What I wanted to flag was that while from an unhedged perspective there should be some downward pressure if rates pull back, our hedge should give us some improvement over time. It's just the dynamics of the hedge. Some of those instruments roll off. That should give us some NII resilience going forward.

Arrie Rautenbach – On asset quality, James, I think what's important here is if you look at the shape of our balance sheet, we started coming back into those in 2018, so you sit with a younger base in your mix, and therefore how they deal with the rapidly rising rates is critical, and therefore we stay very close to those customers. You do know what we have a very conservative posture when it comes to our provisioning methodology, our definition of default, which is a key part of our strategy at this point, so hopefully that gives you a sense that it's more in the mix and how we restructure.

Chris Snyman – one other point is the composition of our retail portfolio on our overall balance sheet. The composition is slightly higher than some of the peers. You had a question about restructuring, and it's hard to say what our peers are doing, but what we're doing is actively working with customers to work their way through the stress, and that includes short-term and long-term restructures, depending on the quality of the customer. In the short-term, restructures stay in the bucket they were in before the restructure.

Arrie Rautenbach – on the chat, there are a couple of questions around Ghana. I'll just read them.
You indicate that Ghana will impact HEPS by c.2%, or c.R400m. Can you indicate where in the P&L this impact will be felt, in impairments or NIR or a combination of the two?
Alan, you said there'll be a new line in the P&L.

Chris Snyman – yes, the majority will be in a new line. It's not in pre-provision profit.

Arrie Rautenbach – There was a question on RoE, Al can you guide us?

Alan Hartdegen – Ja, we can't be that specific. Our guidance is our FY23 RoE will be "somewhat" below last year's 16.4%, but above our 14.5% internal CoE.

Arrie Rautenbach – there's a question whether excluding the Ghana hyperinflation impact, would operational RoE still have deteriorated in 2H23?

Alan Hartdegen – Yes, it would have.

Chris Snyman – we have given you enough data points that you can triangulate that.

Arrie Rautenbach – Another question: What is the likelihood that the improvement in the Retail credit cycle in FY24 is offset by a deterioration in the Corporate and/or Commercial/Business credit cycle, given some of the much-publicised infrastructural difficulties locally, as well as some high-profile distressed credits currently?

And what is the extent of the troubled exposure to Ghana cocoa bonds?

Those are the questions in the chat.

Chris Snyman – The question around cost-to-income in 2024, we haven't given our guidance, so I won't be specific. What I would say is some of the drivers, we've made big investments this year. Some of the investments will continue to flow into our P&L next year, some of the hires, the tech build. However, costs will be a focus. We will start on the big opportunities I mentioned. Some of those come with a cost to achieve. We'll be very specific on the investment case as those come though. We gave the medium-term view that cost-to-income ratio should remain in the low 50s. That should give you an idea of where our headspace is.

On the cocoa bond exposures, we've restructured what we held previously, similar to the restructures we did in late 2022 on the sovereign bond exposures that we held. The view is that these cocoa instruments are key to the economy, so that gives us a level of comfort. But our focus remains on managing the risk that we see in Ghana.

Arrie Rautenbach – I think we're comfortable with the position we have there now Chris.

Chris Snyman – Bankie had a question about our expectation on the continued improvement of our credit loss ratio into 2024? We are not giving guidance yet. We've seen a better loan loss rate in the second half that we had in the first. Some of that is tied to having a stable rate environment into the second half. And we remain exceptionally focused on the levers that will help us to manage that into 2024.

The other question around hyperinflation accounting. As a team we've spent a lot of time on that and bringing it into our processes. The dynamic that stands out for me is that the 2% drag on earnings if offset by a 2% increase in our opening equity in retained earnings, so there's a bit of an offset. Broadly the impact is NAV neutral. It will have a small impact on RoE ito of how those impacts flow through.

Just on cocoa bonds, you had a question whether that's in our credit loss ratio guidance we gave. The biggest part of that is in non-interest revenue, there's a small amount in credit impairments. The big impact was on non-interest revenue.

Ross Krige – On Ghana, and impairment side and coco bonds, it seems like the situation is still quite volatile, how comfortable are you, could there be more adjustments? Presumably this 2% adjustment is for full year 2023 and should be in the base, with no further adjustments into 2024?

Chris Snyman – The question on the restructures, whether there are more instruments. Maybe at a country level we have seen recent good news flow on the restructure with the IMF. That process is not fully closed, but seems to be moving in the right direction. There are some instruments that may be subject to conversations with the sovereign, but we certainly expect the impact to substantially less that what we have experienced to this point. The expectation is that the big instruments were we are likely to suffer a restructure through P&L have been delt with. But this is subject to conversations with government.

Then on hyperinflationary accounting, whether that is in the base. Our current expectation is that it will be in effect for two years, given the inflation expectations for the country. There are qualitative and quantitative drivers. The quantitative is if cumulative inflation is over 100%, so we'll probably have to apply it again. It's an annual impact. So the adjustment you see for 2023 is likely to be required again in 2024. It's NAV neutral broadly. The closing NAV remains the broadly the same.

Arrie Rautenbach – Just another question on coverage and how we see that going forward?

Chris Snyman – We are having many internal conversations at the moment around where we close the year. Those conversations are almost closed out. As we make those decisions we look at our coverage and the progression, and then also relative to the peers. All of that comes into play as we finalise the position. Our posture is that we want a strong coverage position.

Arrie Rautenbach – There's a final question on sustainable finance and whether there are any delays.

Alan Hartdegen – As you know there have been some delays. We've closed quite a few deals in the second half of this year, and we expect to close some in the first quarter of next year. We did in our UBS presentation in October highlight that currently our pipeline is we have 26 projects totalling 3.1GW. Also to emphasize, we originate and distribute, so we hold onto only a quarter or a third of what we originate. Our guidance is that as a percent of our total book, we expect that to double by 2026 from about 2%. It doesn't have a huge impact, but you get trading revenues on the back of that.

Arrie Rautenbach – Ladies and gentlemen, I think we have covered your questions. Thank you for joining us. Again, just to give you confirmation that management are focused on closing this year in the right position and starting 2024 with the right momentum.