Absa Group FY24 pre-close call

Charles Russon – Interim Chief Executive

Good evening and thank you for joining us for Absa Group's 2024 pre-close call.

Key messages

I have been interim CEO for 3 months now and have spent significant time listening to our key stakeholders over this period while initiating actions to ensure delivery of our near-term performance. We have also spent time as an Exco to review our strategy and to agree a set of medium-term action plans.

We recognise that we have disappointed the market, with three profit warnings in 16 months undermining confidence in Absa.

We have made some execution missteps in recent years. For instance, we were too slow to adjust and pull back our risk appetite in retail lending in response to the changing macros and to reduce costs in the second half of 2023.

We are also only too aware that certain significant events have had a substantial impact on our performance in recent years. Ghana's sovereign debt default reduced our earnings by R1.8bn in 2022, and Naira losses were R800m in late 2023 and early 2024. Applying hyperinflation accounting in Ghana has also reduced our earnings by approximately R1bn over the past 15 months. These are not and cannot be excuses: if they occur, we must understand them, but they are part of running a diversified Pan-African universal bank.

Without dwelling on the past, I assure you that we are taking the learnings from our recent performance into account in the way we operate going forward.

Having been on Absa's Exco for a decade, it is very clear to me that we have a significant franchise. We have scale in all our businesses, with a substantial franchise in South Africa, plus a diversified African footprint that represents a real opportunity. Our job is to deliver the required returns through focused and precise execution of priorities in a pragmatic and considered manner.

The scale that we have across our businesses means that we do not need to seek out market share. Rather, we need to be precise about where we deploy our resources in pursuit of the right franchise-enhancing opportunities. This may mean that we reduce our appetite for certain products or segments, which are not franchise-enhancing in terms of long-term profitability and hence we are introducing increased precision and accountability across the group.

In addition to greater precision, we also need to ensure that we execute on our priorities, to deliver in the immediate, the short-term and the medium-term. This starts with delivering on our 2024 priorities and market expectations, and then ensuring we take that into 2025, to improve our returns. Our ambitions are realistic and grounded, leaving no room for excuses on delivery. All business performance cells will be closely tracked at our Finance Committee to ensure we deliver on our plans.

As you will hear from Deon, our second half 2024 performance is better than our first half and we are on track versus our full year guidance. I truly believe that the first half of 2024 was our low point in terms of performance, and you should expect steady improvement from here.

While our broader strategy is unchanged, certain refinements will drive better profitability in the short to medium-term. We have agreed on four strategic execution priorities that we are actively pursuing.

Firstly, shifting away from a focus on market share growth to pursuing sustainable growth that delivers profitability at the right returns. Having scale in our businesses, we must ensure that we price correctly for the risk and stop or pull back on unprofitable parts of the franchise where we see no opportunity for sustainable returns through-the-cycle. This we will cascade across all our businesses and deep into our performance metrics.

Secondly, to enable the delivery of the right returns, we must change the emphasis from a product profitability and returns focus to both product and customer franchise profitability, so that we make precise decisions and can track the resulting franchise outcomes. Let me give an example to bring this to life. From my previous role in CIB, we made the decision in 2019 to measure profitability and returns of the client franchise - and not just revenues - down to a sector and individual client level. This was cascaded down through scorecards to an individual banker level and meant that all decisions were looked at against these lenses in addition to product profitability and returns. I believe that this clear focus has been a key enabler of our improved performance in CIB.

Thirdly, the outcome of focusing on product and franchise is that we will become more precise in allocating capital. This is not a bottom-up, demand-driven exercise. Instead, we will look at those products, segments and sectors where we are below hurdle or delivering returns below market and agree actions to drive an improvement in returns. And where we are doing well, we will assess what else can be done to further enhance returns and profitability.

Finally, since we want to grow sustainably, we are driving a productivity and efficiency program across the group to leverage technology and remove unwanted costs. These productivity and efficiency gains will generate the capacity for us to reinvest for the future and drive those opportunities that will advance the franchise as previously mentioned.

We believe that these changes will enable us to execute better, in a more precise manner, holding each business and performance cell owner accountable for their profitability and delivery, which we will closely track across the group.

Before closing, I want to briefly comment on our respective business divisions at the moment.

We continue to see good momentum in CIB, particularly across Transactional banking and Markets in Africa regions.

We are seeing a recovery of our Product Solutions Cluster and Everyday Banking performance and will combine these units into a single Retail SA business, to accelerate the turnaround and drive value through a single customer lens.

After substantial investment in front-line staff, Relationship Banking is starting to deliver on its improvement plan.

ARO RBB has maintained positive underlying momentum, in what has been a tough operating environment.

And finally, we will take a close look at our Group Centre, reallocating costs where possible and ensuring that only Group Treasury and shareholder costs are retained.

I will pause there and hand you over to Deon to take you through our performance expectations to 2026.

Thank you for your attention.

Deon Raju – Financial Director

Thank you Charles and good evening everyone.

Since you may not have gone through the detail of our trading update, I will cover it now.

2024 outlook

Starting with our 2024 guidance, my commentary refers to the percent YoY change in our IFRS financial results versus the equivalent 2023 period.

In summary, our overall 2024 guidance is unchanged from when we delivered half-year results in August. Within that, we expect a slightly better credit loss ratio now than we did previously. Conversely, the stronger Rand is expected to be approximately a 3% drag on group revenue and earnings in 2024.

Based on our macroeconomic expectations, and excluding major unforeseen political, economic, or regulatory developments, our guidance for 2024 is as follows:

In line with previous guidance, we expect materially stronger earnings growth in the second half of 2024, off a relatively low base.

We continue to expect mid-single digit revenue growth, with broadly similar growth in net interest income and non-interest income.

Hence, we expect net interest income growth to slow in the second half, due to lower growth in South African retail lending, deposit insurance in South Africa and the impact of higher cash reserving requirements in some Africa regions countries.

We expect mid- to high single digit customer loan and deposit growth for the year.

Non-interest income growth should improve noticeably in the second half of 2024, in part reflecting non-recurrence of the Naira losses in the second half of 2023, but also due to better growth in fee and commission income and insurance revenue.

We expect mid-single digit growth in operating expenses, improving from 8% in our interims, given cost actions that we took in the first half and base effects of lower separation costs

As a result, we expect low to mid-single digit growth in pre-provision profit and a similar cost-to-income ratio to the 53.2% in 2023.

Our credit loss ratio is expected to improve to midway between 2023’s 118bps and the top end of our through-the-cycle target range of 75 to 100bps. We expect our second half credit loss ratio to improve noticeably to within the upper half of our through-the-cycle range.

As previously guided, credit trends across the retail books in South Africa are positive, particularly in Vehicle and Asset Finance and Personal Loans reflecting actions taken in collections and new business origination. Like in the first half, CIB’s credit loss ratio is expected to exceed its through-the-cycle range slightly. Africa regions’ charge is expected to increase off a low 2023 base.

For modeling purposes, four items have impacted our 2024 results, namely first half losses on the Naira, applying hyperinflation accounting in Ghana, costs related to our BEE transaction, and the costs of separating from Barclays PLC. We expect these items to reduce our second half 2024 earnings by approximately R700m. The impact of hyperinflation accounting is slightly more than we previously expected.

Consequently, we continue to expect an RoE of 14% to 15% for the year, versus 14.4% in 2023.

We expect our Group CET 1 ratio to end 2024 in the upper half of our Board target range of 11.0% to 12.5%, and we plan to maintain a dividend payout ratio of 55% for 2024.

Lastly, from a geographic perspective, South Africa is expected to drive earnings growth, mostly on lower credit impairments in retail and Relationship Banking. Africa regions earnings are likely to decrease slightly, due to the stronger Rand, increased cash reserve requirements in certain countries, higher credit impairments off a low base, plus a challenging operating environment in several countries. However, we expect strong revenue and pre-provision profit growth from the region in constant currency.

Pathway to our 2026 target

Lastly, we promised to update you on our RoE expectations over the medium-term.

Since it's December, I'll make some very high-level comments on the shape we expect in 2025. As usual, we'll provide more detailed guidance when we report on 11 March.

Revenue growth is expected to be relatively moderate in 2025, which means our JAWS is likely to be slightly negative. We expect the stronger Rand to remain a drag on revenue next year.

We expect our credit loss ratio to improve further to within the top end of our through-the-cycle target range of 75 to 100bps next year, largely reflecting continued improvement in our retail charge in South Africa. The normal seasonality is likely to be evident in our 2025 credit loss ratio, with our first half credit loss ratio above the second half.

We also expect less of a drag from substantial items next year, with Ghana hyperinflation accounting currently expected to end in the middle of 2025.

These factors should improve our RoE in 2025.

We expect a broadly supportive macro backdrop through 2026. In South Africa, we expect GDP growth to improve from 1% this year to over 2% for the following three years, with inflation remaining benign and policy rates cut by another 75bps cumulatively at the next three MPC meetings.

We forecast improving GDP growth across most Africa regions countries, with rate cuts in Ghana, Kenya and Zambia, although some countries such as Mozambique, Kenya and Zambia continue to face fiscal challenges.

Against this backdrop, we expect to improve our RoE to 16% in 2026, with several key drivers.

Firstly, looking at the next 18 months, we expect credit impairments to improve further, particularly in our South African retail books.

Second, we have launched a productivity programme that will finance investment through to 2026 and should help us to improve our cost-to-income ratio medium-term.

The benefits stem predominantly from cost efficiency, with the rest coming from revenue uplift, such as generating the full benefits of investments already made in Salesforce and Absa Access.

Around half of the total productivity benefit comes from IT and Retail SA. Key initiatives include renegotiating 3rd party contracts and decommissioning legacy systems in IT, as well as optimising properties, cost of cash and branch processes in Retail SA.

We expect the efficiency gains realised in these areas to fund continued investment in our digital and data capability, further cloud adoption, and cyber security investments. The efficiency gains will also help us to absorb increased amortisation medium-term.

Third, a key challenge and opportunity is improving non-interest income growth. Retail SA needs to deliver better non-interest income medium-term, in a very competitive environment. Combining Product Solutions Cluster and Everyday Banking into Retail SA will improve the ability to deliver client value, particularly distribution of value-added services and insurance product across a large customer base. CIB has grown well, particularly Corporate, leveraging a strong transactional platform. Africa regions is also doing well with strong customer and NIR growth in constant currency. We need to improve our NIR growth in the medium term given a franchise of our scale, diversification and geographical presence.

Lastly, while Africa regions will be a drag on our earnings growth in 2024, we expect better growth and improving returns from these businesses medium-term.

The above four drivers of our ROE recovery will be underpinned by the key execution changes that Charles highlighted in his comments.

Thank you for your attention, we will now take your questions.

Questions and answers

Ross Krige – Investec

Two parts, the precision and capital allocation, is that mostly in the Retail Banking side and secondly, what impact would that have on growth? There was a suggestion that there is potential for market share losses in Retail. Also, on the Retail segments that you combining, is there a leadership announcement for that? Finally, on asset quality and better than expected performance, can you elaborate as it sounds like it's mostly within SA Retail? What is driving the better-than-expected performance?

Charles Russon

Thanks Ross. I'll deal with the first. In terms of capital, precision and allocation, I think you are right, the organisation is at different levels of precision around this, but no particular area has got to a point of perfection around it and it's going to be an acute focus across the broader organisation. Does it mean that growth is off the cards? No. We are saying here is we want to grow, but with the right returns and profitability. We've got scale and we need to be applying our capital more to areas where there are opportunities and pulling back where we can't see returns, a line of sight to returns in the right space above the cost of equity on a sustainable basis.

In terms of retail leadership, the project to bring the respective businesses together has to run through a process and our current leaders of those businesses, both Geoff and Christine will be driving that project and that's where we'll leave it.

Deon Raju

Ja, Ross, Asset quality much better. Yes, retail we called out, very positive. We call out VAF and Personal Loans (in particular), but generally the trends have been positive across retail.

Ross Krige

Just a follow-up question Charles, are there any areas in retail banking that you think the business can improve on quickly in terms of generating the right product and client returns or are we still in the process of working that out and recalibrating?

Charles Russon

Ja, look, we are going through that process at the moment. We clearly understand the product profitability and returns across the broader organization. But it is now creating that linkage into the customer and client franchise and making sure where we've got businesses with returns below market competitive levels or cost of equity that we understand the full franchise. So, yes we understand those areas where we've got a challenge. But to understand what are the opportunities to increase cross sell and can we action those and do those lead to the right outcomes. I think it tells you the level of precision we're at across the areas of business and the focus we got to ensure that we do track to the right outcomes, otherwise different decisions will ultimately be made around scarcity of capital around those businesses.

James Starke – RMB Morgan Stanley

Hi, good afternoon Charles and Deon, thanks for the opportunity. Three questions from me. The first, you mentioned initiatives around efficiency, perhaps can you give us some colour on any initiatives to improve client primacy and digital penetration in your retail franchise? The second question, again on credit losses, can you confirm your guidance and how it is interplaying with your revised GDP outlook vis-à-vis 2% over the outlook? Is that already in your IFRS 9 overlays or is it something that may still come in future? And the last question regards your Markets business, can you give some colour on what you are experiencing following the taking on of HSBC's market activities and perhaps how that might run rate into 2025?

Charles Russon

Thanks James. Deon will deal with the second question. In terms of the Markets business, we're not going to get into that level of detail this point in time. We have integrated the business, and we now have got to make sure we deliver on the opportunity and the reason that we ultimately brought it into the organisation. In terms of primacy and efficiency around our broader Retail business, what you seeing is an uptick in the NIR and the transactional activity that we've seen, which Deon alluded to in his earlier commentary. The specifics around that, this is early days and part of it is we have to remove the obstacles and why we do want to bring the business together such that there are no artificial obstacles getting in the way of driving the broader franchise for the profitability of the broader organisation.

Deon Raju

James, certainly as we run our forward-looking macro models, it will pick up some level of positivity through the positive GDP as well as the lower inflation, lower interest rates and better outlooks. So, some of that will feature this year as part of the CLR, but I have to say we are seeing much better constructs as well emerging. Much better performance emerging. I would say that is a greater driver, but you will have some element of your macro models also playing a role in that.

Cornette van Zyl – Sanlam Investments

I have got four questions. My first three questions are related. I just want to understand, you said that NII growth is slowing into the second half of the year, so 2024, and then you specifically mentioned lower growth in RBB SA, you spoke about deposit insurance and cash reserving in the rest of Africa. My first question is, which of those three factors is the one causing the biggest slowdown in NII? Secondly, if there is slow loan growth in RBB SA, in which products specifically are you pulling back? And then my third question, when you talk about NIR growth noticeably improving the 2H24, I'm trying to get a sense of the underlying operational performance and momentum in the second half, because there were the non-recurring losses etc. You specifically flag better growth in fee and commission and insurance, but could you possibly give us a sense of what the NIR growth for RBB SA is specifically and the underlying momentum of that operationally looks like versus the first half of the year?

Deon Raju

So, yes Cornette, we did call out NII growth slowing into the second half. Retail growth is a factor. We also called out cash reserving that is a large factor in the slowdown. But I would say your retail growth slowing, particularly unsecured, which is related to your second question, and I call out personal loans, in particular. And I think we mentioned that at the first half as well as we spoke about it. It's part of the reason why, our second half performance on credit impairments is also, as you commented, slightly better than expected. And then the third one, operationally NIR. Look, generally across the franchise, there's been good underlying performance. I would call out retail and Business Bank specifically to your question, better performance in the second half than the first half of underlying operational.

Cornette van Zyl – Sanlam Investments

Thanks Deon, that's clear. My fourth question, and this is why I wanted to ask this separately, relates to the outlook for 2025. I'm trying to understand this point of revenue growth being moderate or moderating into 2025. I mean it's already muted, but I presume that plays into the strategic sort of shift in terms of focusing on profitability. Because I'm trying to sort of think and shape a bit of an income statement 12 months ahead, and that's why I think you put that guidance out. It's almost that you would think that you would have revenue growth slowing, loan growth slowing or at least be muted, not necessarily slowing, but be muted because of the strategy change and focus on profitability. But to then get the RoE up and to get the profitability up, I'm assuming that has got to be offset by better credit losses on these particular products. So is it a play between growth and revenue versus what's been given away in credit risk. Is that where that comes together? If you could just clarify that for me that would be great. Thank you. Those are all my questions.

Deon Raju

Yes Cornette, I think you kind of summarised it. I think as you've seen what's happened in the second half, you know clearly as you exit this year, some of that momentum goes into next year and that's why we call out moderate. It's certainly the first big play for earnings for us is impairment and we can see that. We're coming from a high point, so the fall off is certainly something that is very important for next year. If we talk about loan growth, we still see reasonable loan growth. But in terms of Retail, I think the underlying consumer environment, just at the moment and going into the first quarter, is still not quite there. We do think it will be better in the second half, but as you do things in the second half, it impacts the following year. So, if you think about the shape, you know then as you go into the following year, you then have more on the revenue line. That starts to come back. So, broadly that's how we think about the shape.

Alan Hartdegen

Cornette, also just to clarify, we we're thinking more moderate growth rather than moderating for next year.

Harry Botha – Bank of America

Thanks very much, just two questions from me please. Apologies if I missed it at the beginning, but the strategic areas that you outline in terms of improving product franchise and efficiency, do you have a timeframe of how that plays out and I guess given the three-year target for 2026 target of 16%, do you see it materially higher on RoE if everything comes together? And then, in terms of revenue headwinds in this financial year, you noted the 3%. It doesn't sound like it would materially change your guidance. So, are there other areas possibly answered already I guess, but that have outperformed to maintain guidance? Thank you.

Deon Raju

I can answer the second one quickly, it's credit losses Harry, to answer your question specifically.

Charles Russon

In terms of your first question, those four priorities, how much is built into this? I mean, at the end of the day, we're focused on executing this, you would have heard me say that, that this isn't something we're about to kick off. So it is something that's in action already across all four of them. Some of it has been included and is part of this in terms of the 2026 guidance of 16%. But we certainly see that as this gathers momentum, it continues out into the medium-term as well. So yes, hopefully that gives you a feel for it.

Harry Botha – Bank of America

Great thank you. Maybe just coming back to the revenue point, so for 2024, are you lowering guidance slightly, though you've maintained mid-single digit guidance growth?

Deon Raju

Ja, we've maintained mid-single digit guidance on revenue. And we called out a 3% currency drag on revenue and headline earnings.

Ross Krige - Investec

Thanks. Just on the productivity program, it doesn't sound like that's going to incur a whole lot of extra costs, but I just wanted to check if that's the case. And if so, would that be included in your FY25 guidance?

Deon Raju

Yes, it is included in our FY25 shape. And it is no big cost to achieve, I think is your underlying question. Whatever cost to achieve we've got is incorporated in our guidance and it's really to fund the investments and then manage underlying costs to moderate levels.

James Starke – RMB Morgan Stanley

Can you perhaps give us a flavour for how you're finding pricing in the various loan categories you're active in? Thank you.

Deon Raju

James, there is there is quite a lot of competition on the retail secured market, in particular. So, we are seeing some pricing pressure. I wouldn't say that's noticeable. In our VAF business we've been far more selective around the business that we originate, so we've been able to manage the margin better in our vehicle and asset finance business, as that business shows its focus to improving RoE and generating value, particularly the cross-sell elements and the client view, as Charles mentioned. So that has more scale now, so it can be a bit more selective and it needs to improve ROE and value. But Home Loans, in particular, we are seeing pricing pressure. The other area I would call out is in our CIB business, particularly things like renewable finance. The pricing is getting very rich there from that perspective. So those are the two areas we have seen.

Khumbelo Nevhorwa – Melville Douglas

Thanks a lot. I just wanted to ask, you provide us with the targeted RoE of 16% by 2026, but it doesn't give us detail as to how the strategic initiatives will materially improve your risk-adjusted return. Do you have a targeted range of RoE beyond that point? Cause I'm assuming that 2026 is when you're starting the initial phase of these four strategic initiatives?

Deon Raju

Ja, happy to take that. As you point out Khums, 16% is an intermediate target for us. We have clear line of sight of that. We are focused on delivering. We will deliver this year. We want to deliver next year. We want to hit our 16%. Like you said, 16% is not necessarily our terminal rate. The initiatives that Charles called out, the key priorities to move the revenue that I called out in my slides, all of those should be the things that build momentum, into 2026 and beyond. And I think that's what we have conviction on as we sit here.

Alan Hartdegen

There's a question from Nick Krige in the chat.

You have stated that you will not chase market share and will focus on profitability. This should translate into muted growth in the book. Will this muted growth require right sizing and significant cost cutting?

Charles Russon

Thanks for that question Nic. I think those will be decisions that ultimately we come to as we understand the franchise in more detail at a precise level at a performance cell level and what ability have we got to deliver returns at a different level to where they are at the moment. If it is a problematic area. But I would also say, this is not saying that it is no growth. What we want is sustainable growth that delivers the right profitability. So, where we see those opportunities, we will be going after them and we will be deploying capital to deliver that. In terms of any decisions that get made. Ja. If there are decisions where we are pulling back, in all likelihood you would then deal with the cost base around it as appropriate. But that's a decision we'll get to in due course.

Alan Hartdegen

It looks like there are no more questions. Thanks everyone for joining us this evening.

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