
Sizwe Nxasana
OUTGOING CEO
Johan Burger
CEO DESIGNATE

CEO'S REPORT

The group continued its track record of producing earnings growth (+14%) and returns (24.7%) above its targets, which is pleasing given its strong capital position and high earnings base.

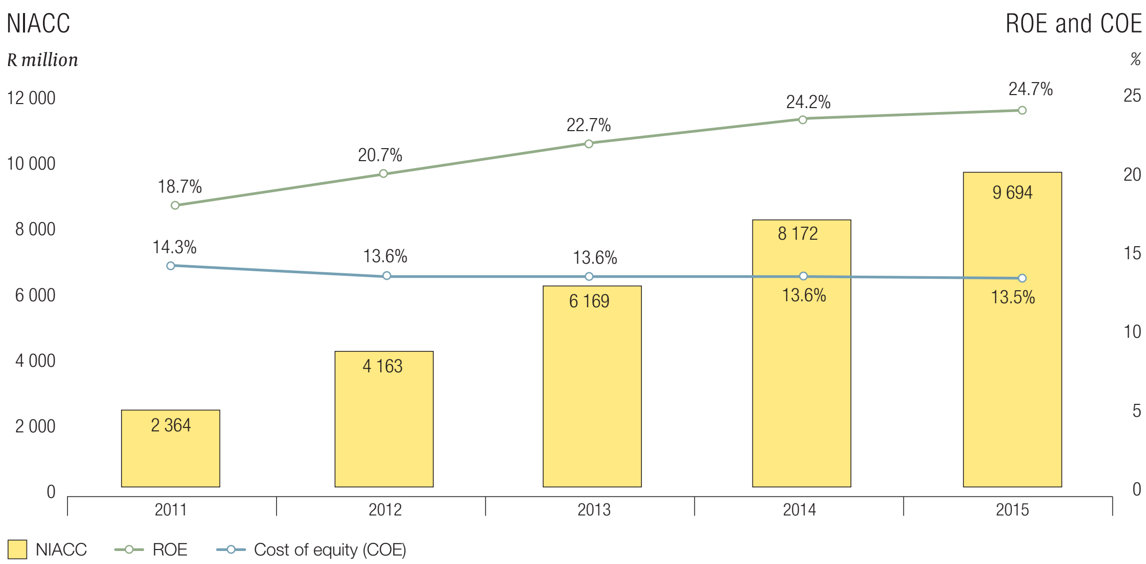
Ordinary dividend per share ↑	Diluted normalised earnings per share ↑
21%	14%

INTRODUCTION

The year under review was characterised by a challenging operating environment:

- **Macros –** South Africa's economy was characterised by subpar growth, consumers remained under pressure and business confidence was low. Globally commodity prices were depressed.
- **Regulatory demands –** the regulatory environment also became more demanding with increasing prudential, conduct and credit regulations, higher capital and liquidity costs and increasing cost of compliance.
- **Scarcity and cost of financial resources –** the year saw an increase in the market cost of funding and liquidity.

Against this backdrop, as outlined in the CFO's report and shown in the following chart, the group continued to deliver returns in excess of the cost of equity and produced 19% growth in economic profit (net income after capital charge), which is higher than the group's earnings growth, reflecting disciplined capital allocation and a focus on a capital-light business mix. The group has always viewed economic profit, i.e. the excess return over the cost of equity, as the true measure of shareholder value creation.



GROUP STRATEGIC OBJECTIVES

FirstRand's vision is to be the African financial services group of choice, create long-term franchise value, deliver superior and sustainable economic returns to shareholders within acceptable levels of volatility and maintain balance sheet strength. The group seeks to achieve this through specific growth strategies in both its domestic market and the rest of Africa, supported by the effective allocation of capital, funding and risk appetite:

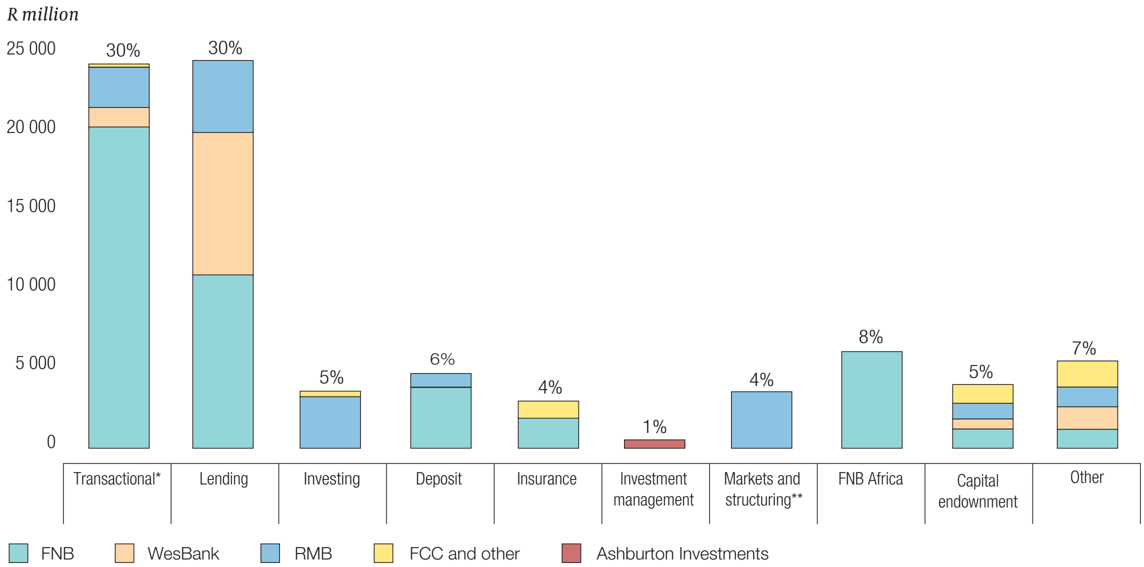
- In its domestic market, the group will continue to protect and grow its lending and transactional franchises through innovation, disruption and specific cross-sell initiatives across group customer bases. In addition, FirstRand believes it can capture a larger share of profits from the broader financial services markets, through leveraging its platforms, skills and proven culture of innovation to deliver highly differentiated channels, products and solutions which enable customers to transact, borrow, save, invest and insure.
- In the rest of Africa, FirstRand is actively seeking to establish meaningful banking franchises in those countries that the group has prioritised as markets expected to show above average economic growth, and which are well positioned to benefit from the trade and investment flows between Africa, India and China. These markets are mainly in the SADC region and the west and east African hubs.

STRATEGIES TO ENSURE SUSTAINABILITY OF GROWTH AND RETURNS

As previously stated, the group seeks to create long-term franchise value, deliver superior and sustainable economic returns to shareholders within acceptable levels of volatility and maintain balance sheet strength.

FirstRand believes it has the necessary strategies and operating platforms to continue to generate growth and earnings above its hurdle rates, although the level of outperformance that can be achieved becomes more difficult given the high earnings base created in the past and the challenging operating environment going forward.

The chart below shows that the group's portfolio of businesses already represents a diversified earnings stream, although mainly concentrated in traditional banking activities, namely retail and wholesale lending, and transactional and related endowment (representing 60% of revenues). The high quality of the lending and transactional franchises that reside in FNB, RMB and WesBank are a direct result of the group's strategy over the past five years to achieve significant market share of profits in those activities.



* *Includes deposit endowment. For RMB includes fees related to investment banking and advisory, and corporate and transactional banking.*
** *Includes only M&S NIR (M&S NII shown in lending/deposits/capital endowment as appropriate).*
Excludes consolidation entries.

As outlined in more detail in the franchise operating reviews, all of the group's operating franchises have built strong transactional value propositions:

- FNB has focused on acquiring main bank customers through offering a highly differentiated and innovative value proposition and efficient channels for transacting;
- RMB has maintained its quality advice, structuring and underwriting franchise and improved its corporate transactional offering; and
- WesBank's quality transactional franchise is delivered on the back of new business generation.

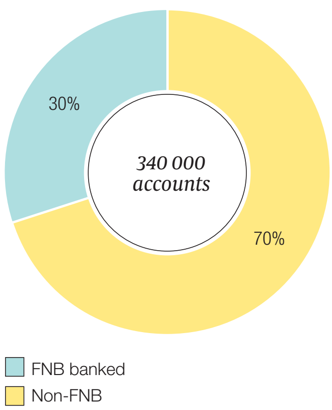
The lending franchise reflects the strength of the origination businesses:

- FNB's strategy to grant credit to existing customers with FNB main transactional accounts has resulted in an improved risk/return profile;
- the success of WesBank's JV model in the domestic retail VAF and MotoNovo businesses and the use of other distribution channels such as Direct Axis; and
- the group's strategy to increase the balance between wholesale and retail led to growth in RMB's lending business – RMB has been the lead arranger in most acquisition, leverage finance and infrastructure deals in South Africa and continues to see good opportunities in the rest of Africa.

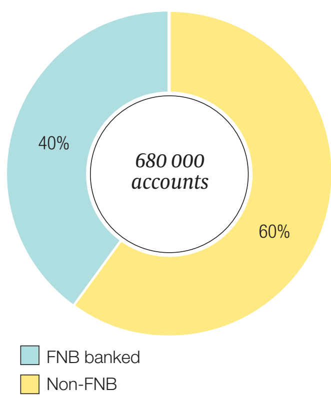
This market positioning will stand the group in good stead moving into what is expected to be a more difficult operating environment. FirstRand, however, recognises the imperative to continue to protect and grow its domestic franchises and believes this can be achieved through executing on disruptive and innovative strategies to deliver differentiated offerings to customers. In addition, the appropriate level of cross-sell available through collaboration across all of the franchises is still not fully realised.

As can be seen in the picture below, there are still meaningful opportunities in the WesBank customer base for FNB to introduce its market-leading transactional offering, particularly given that 60% of WesBank motor customers remain unbanked by FNB. The recent acquisition of the non-controlling interests in Direct Axis, which has a customer base that is also significantly under-penetrated by FNB, provides new, high-quality customers to introduce transactional products. The group believes transactional offerings are the appropriate mechanisms to drive growth in new customers, particularly given the negative credit cycle. It is in line with FNB's stated objective to increase volumes on its electronic platforms and grow fee and commission income, with the concomitant positive impact this will have on NIR, ROA and ROE. Credit extension should increase on the back of these new transactional relationships, particularly where FNB generates behavioural data on the transactional accounts.

DIRECT AXIS

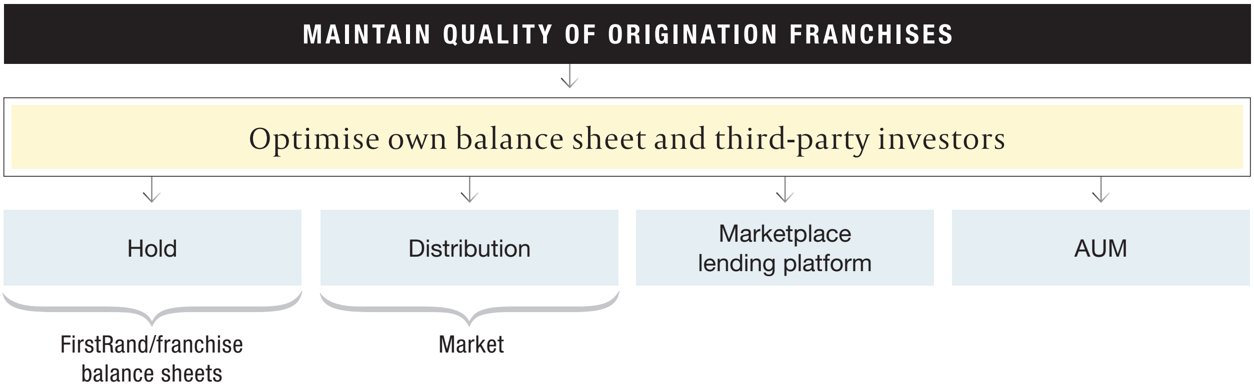


WESBANK MOTOR



In addition to the cross-sell focus, the group also believes it will be necessary to rethink its business model, specifically for some of the asset origination businesses. It is critical that the group maintains the quality of its origination franchises by not restricting origination to balance sheet capacity. The following chart explains how the group can maintain the quality of its origination franchises by optimising its own balance sheet and through the establishment of other platforms with access to the group's origination capacity, e.g. third-party investors.

> The group believes transactional offerings are the appropriate mechanisms to drive growth in new customers



The group believes growth of its domestic franchise also lies in its ability to capture a larger share of profits from the broader financial services markets including savings, insurance and investment products, currently the domain of asset managers and insurance companies. These activities currently represent only 11% of gross revenue and many of them have become more attractive following changes in regulations. The group can offer significantly differentiated, but more cost-effective offerings to both existing and new customers currently saving and investing with competitors. It can, in particular, leverage off its strong actuarial skills base, flexible electronic distribution platforms and track record of innovation and this will further enhance customer entrenchment and be integrated into the main bank relationship.

FirstRand is currently investing in a number of initiatives in the insurance space and, in March 2015, acquired its own life insurance license. FNB is driving the long-term insurance strategy on behalf of the group and is building an appropriate platform to launch risk products. It is envisaged that the current activities of FNB Life will move onto this platform.

Post year end, FirstRand's WesBank franchise formalised its longstanding relationship with Hollard Insurance Company through the formation of a new holding company. This entity will consolidate the existing insurance products provided through WesBank and Hollard and includes the acquisition of two other entities, Motorite and SMART. WesBank will own 81% and Hollard will hold the remaining 19% of the new entity. The objective of this initiative will be to offer the best value-added motor products in the market. Motorite offers a variety of vehicle warranty and maintenance products, while SMART specialises in body repair cover and offers paint-and-dent protection products. By combining resources it is envisaged that going forward WesBank will be in a strong position to provide innovative and competitively priced solutions for vehicle buyers. This initiative is conditional upon receiving approval from the applicable regulatory bodies.

Investment management is another market where FirstRand believes it can build a differentiated offering, capture a large share of the profit pools available and over time, generate a new and potentially significant revenue stream for the group. The creation of Ashburton Investments in 2013 brought together the group's asset origination, asset management, liability gathering and distribution platforms under one operating pillar. The objective is to build an investment management franchise that offers both traditional and alternative investment products, with greater emphasis on the alternative space which is currently unique in the domestic market and plays to the group's track record in originating high-quality asset classes such as private equity, infrastructure and corporate credit.

Prior to the consolidation of these activities within the investment management pillar, Ashburton as a standalone asset manager, previously part of FNB, had over many years established an excellent track record in the traditional space. Utilising these proven investment skills, augmented by specialist skills in alternative products, the broader Ashburton Investments business is now achieving traction in its expanded growth strategy.

RMB's origination franchise, combined with FNB's customer base and distribution channels, both relationship driven and digital, are key to the successful execution of this strategy. From a product origination perspective, Ashburton Investments provides third parties with the opportunity to invest in high-quality asset classes originated by RMB. In the alternative products that Ashburton Investments has already brought to market, specifically corporate credit and private equity, there has been significant customer take-up and many of these funds are already closed.

From a distribution perspective, FNB's relationship management model combined with Ashburton Investments' product generation is already bearing fruit with 80% of retail investment inflows represented by FNB customers. This momentum has been supported by the activation of Ashburton Investment's LISP platform during the course of 2014. The group expects further growth in this customer migration once the asset management platforms are integrated with FNB's digital channels, which is still work in progress. Ultimately the FNB customer base will be presented with a large selection of bespoke investment and savings products, available through all of FNB's channels.

As the group's primary objective is to produce superior returns for its shareholders and its key performance measurement is net income after capital charge (NIACC), the majority of the growth initiatives outlined above are "capital light" and seek to drive growth in NIR and enhance ROE.

The group's revenues and earnings are also geographically highly concentrated, with less than 12% of gross revenue generated from outside of its domestic market. Therefore, in parallel with its domestic growth strategy, the group is also actively seeking to establish meaningful banking franchises in those countries in the rest of Africa prioritised as markets expected to show above average economic growth and which are well positioned to benefit from the trade and investment flows between Africa, India and China. These markets are mainly in the SADC region and the west and east African hubs.

FirstRand is not targeting a preferred level of earnings from outside of South Africa, as it believes the ultimate outcome of its strategy must be predicated on a disciplined approach to capital allocation and result in appropriate returns on the cost of that capital for shareholders. The group does, however, believe that certain territories in the rest of Africa offer attractive opportunities with execution currently taking the form of the following three pillars:

1. Utilise the capabilities of the South African franchise, particularly the domestic balance sheet, intellectual capital, international platforms and the existing operating footprint in the rest of Africa.

2. Start an in-country franchise and grow organically.

3. Acquire small- to medium-sized in-country franchises where it makes commercial sense.

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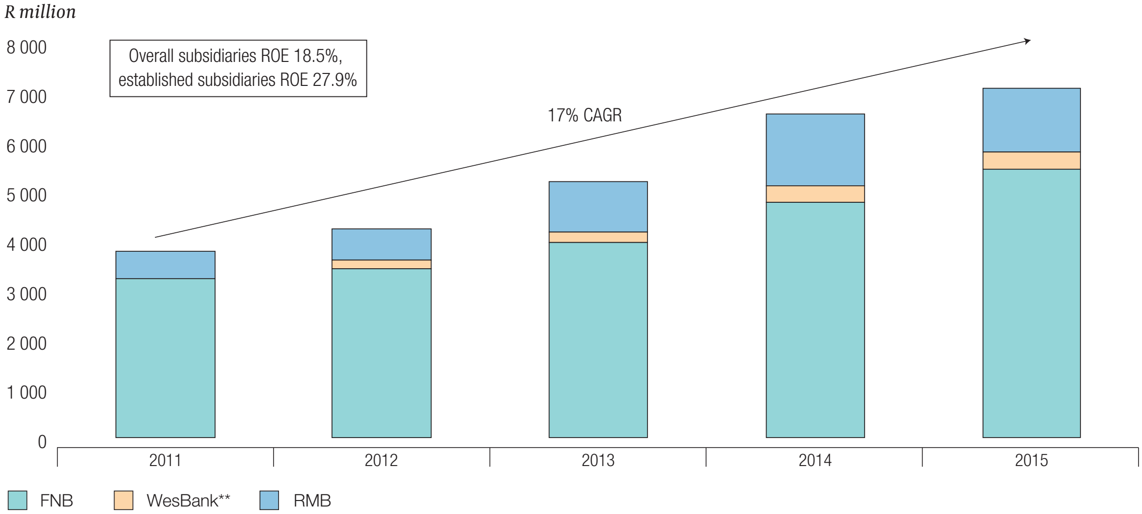
The chart below shows the growth in revenues from the rest of Africa. It is important to note that although the group has seen good growth in revenues from the rest of Africa, much of this has come from pillar 1.

REST OF AFRICA GROSS REVENUE*



* *Excludes FCC (including Group Treasury).*

** *WesBank 2011 rest of Africa revenues scheduled in FNB figures in the graph above. All WesBank rest of Africa profits are reported under FNB Africa in the segmental results.*

It is anticipated that the deployment of capital going forward will be concentrated on pillars 2 and 3 as the group shifts its focus to building more in-country balance sheets and franchises, however, to the extent that this requires more capital, the group will remain disciplined in deployment.

MANAGEMENT OF FINANCIAL RESOURCES

The management of financial resources, defined as capital, funding and liquidity, and risk appetite, is critical to the achievement of FirstRand's stated growth and return targets and is driven by the group's overall risk appetite. As such, the group sets financial and prudential targets through different business cycles and scenarios. The group is expected, at a defined confidence level, to deliver on its commitments to the providers of capital.

The management of the group's financial resources, is executed through Group Treasury and is independent of the operating franchises. This ensures the required level of discipline is applied in the allocation of financial resources and pricing of these resources. This also ensures that Group Treasury's mandate is aligned with the operating franchises' growth, return and volatility targets, in order to deliver shareholder value.

Balance sheet strength

Capital position

Current targeted ranges and actual ratios are summarised below.

%	CET1	Tier 1	Total
Regulatory minimum*	6.5	8.0	10.0
Targets	10.0 – 11.0	>12.0	>14.0
Actual**	**14.0**	**14.8**	**16.7**

* *Excludes the bank-specific individual capital requirement.*

** *Includes unappropriated profits.*

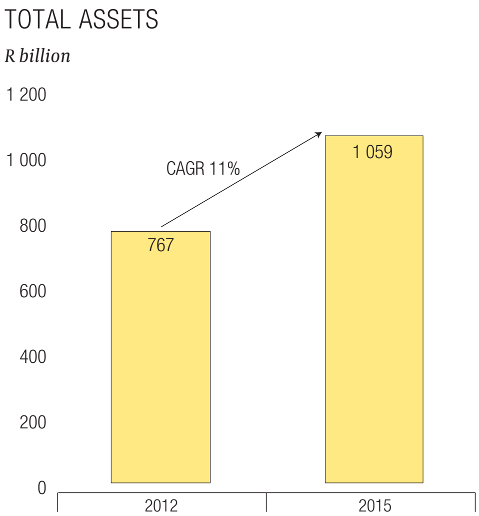
The group has maintained its strong capital position reflecting the group's strong return profile. Capital planning is undertaken on a three-year forward-looking basis, and the level and composition of capital is determined taking into account business unit organic growth plans and stress-testing scenario outcomes. In addition, the group considers external issues that could impact capital levels, which include regulatory and accounting changes, macroeconomic conditions and future outlook.

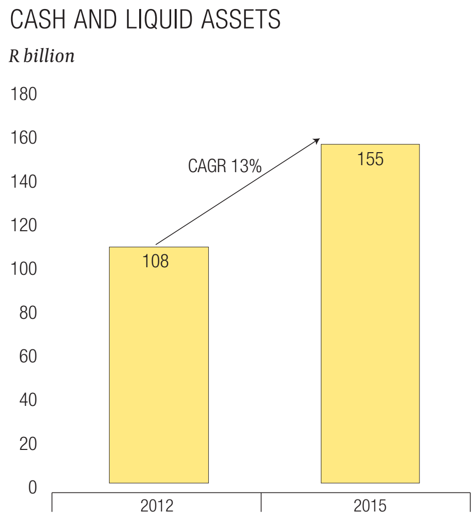
Liquidity position

Taking into account the liquidity risk introduced by its business activities, the group's objective is to optimise its funding profile within structural and regulatory constraints to enable its franchises to operate in an efficient and sustainable manner. Liquidity buffers are actively managed via high quality liquid assets that are available as protection against unexpected events or market disruptions. The quantum and composition of the available sources of liquidity are defined by the behavioural funding liquidity at risk and the market liquidity depth of available liquidity resources. In addition, adaptive overlays to liquidity requirements are derived from stress testing and scenario analysis of the cash inflows and outflows related to business franchise activity.

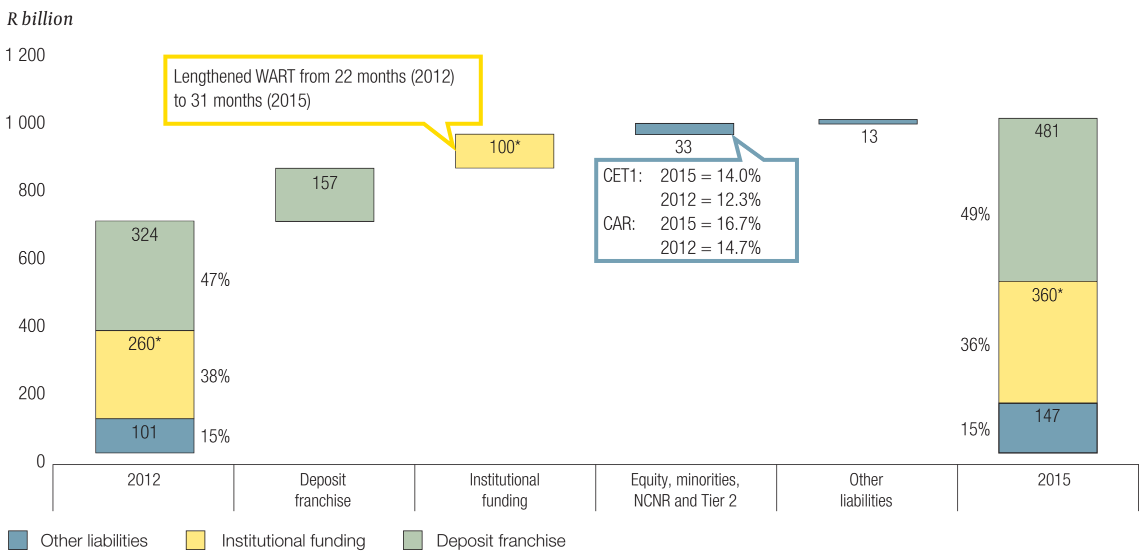
In addressing the LCR requirements, the group followed a two-pronged strategy. Firstly, it focused on making the asset side of the balance sheet more liquid, as illustrated in the opposite chart. This was achieved by originating assets into high quality liquid assets (HQLA) format, e.g. securitisations and corporate bonds. This, combined with the increased holding of liquid assets, underpinned the improvement in balance sheet liquidity.

> The effective management of financial resources ensures the required discipline is applied in the allocation and pricing of these resources





The second part of the strategy was to strengthen the group's deposit franchise and lengthen the term profile of institutional funding. The following graph shows that the deposit franchise now represents a larger portion of total liabilities and the weighted average term (WART) of institutional funding has increased from 22 months in 2012 to 31 months at 30 June 2015.



Note: Derivative- and short-trading position asset and liabilities have been netted off.

* *Non-recourse and securities-lending assets have been netted off against institutional funding.*

These strategies resulted in a group liquidity coverage ratio (LCR) of 76% as at 30 June 2015 (for FRB the ratio was 84%), which exceeds the 60% minimum LCR requirement. The group held available liquidity of R137 billion with an additional R12 billion of management liquidity available.

DIVIDEND STRATEGY

The group continues to seek to protect shareholders from any unnecessary volatility in dividend and annually assesses the appropriate level of payout taking into account the following inputs:

- actual performance;
- forward-looking macros;
- demand for capital; and
- potential regulatory and accounting changes.

The outlook on the macroeconomic environment remains challenging and uncertainty around potential regulatory and accounting changes persists. These pressures lead FirstRand to believe that the level of dividend payout should continue to be considered within the range of 1.8 x to 2.2 x cover. However, given the group's strong capital position, the excellent performance by the franchises in the year under review, and the projected demand for capital, the group believes that a dividend cover of 1.8 x is appropriate for the year ended 30 June 2015.

With respect to the current excess capital, the group's fundamental philosophy has not changed in that it will always return excess capital to shareholders should it not find opportunities to deploy that capital to generate acceptable returns. At this time, however, the group believes that a sufficient number of identified opportunities currently exist in both the domestic market as well as in the rest of Africa, which warrant further assessment of deployment of a portion of the current excess. It will, therefore, continue to set aside a capital buffer in support of its expansion strategy.

Given the strong capital generation from the business in the year under review and the cautious approach to the deployment of this capital, the buffer has further increased. Currently, the group has set aside a R12 billion capital buffer to deploy to:

- protect and grow the domestic and lending franchises;
- provide other franchises with the opportunity to capture profits from the broader financial markets domestically; and
- support the disciplined deployment of capital for organic growth, and allow for small- and medium-sized acquisitions in a number of targeted countries in the rest of Africa.

> The group's fundamental philosophy has not changed in that it will always return excess capital to shareholders should it not find opportunities to deploy that capital to generate acceptable returns

In the group's view, this surplus is appropriate for the growth strategies it has identified (illustrated below), where it believes it can deploy the surplus to deliver acceptable returns for shareholders.

R12.2 billion surplus	*Growth strategies*
1.6	Protect and grow domestic lending and transaction franchises (cross-sell/collaboration) ▸ WesBank – Direct Axis and other JVs
1.5	Capture larger share of profits from the broader financial services markets domestically ▸ FirstRand Insurance, Ashburton Investments, WesBank – Motorite and SMART
2.8	Existing organic strategy in the rest of Africa
5.2	Acquisitions in targeted countries in the rest of Africa
1.1	Other

CONCLUSION

When assessing the results for the year to June 2015, it is pleasing to note that FirstRand continues to deliver on its strategic objectives and will measure, monitor and refine these objectives on a continuous basis. FirstRand believes that its current strategy and focus on financial resource management will allow it to further optimise the financial, strategic and operational levers required to deliver on its commitments to stakeholders.

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