ceo's report

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THE GROUP'S STRATEGIC FRAMEWORK ACCOMMODATES A BROAD SET OF GROWTH OPPORTUNITIES ACROSS THE FINANCIAL SERVICES UNIVERSE FROM A PRODUCT, MARKET, SEGMENT AND GEOGRAPHIC PERSPECTIVE.

The group chooses to diversify its portfolio to deliver both growth and premium returns.

INTRODUCTION

Pleasingly for the year to 30 June 2018, FirstRand reported growth in earnings that exceeded nominal GDP, maintained its return profile slightly above the group's long-term target range of 18% – 22%, and increased the dividend in line with earnings.

These can be considered a solid set of numbers and there is a detailed explanation of the group's financial performance in the CFO's report. In addition, detailed financial and operating reviews of the underlying businesses can be found on pages 46 to 61.

This report provides some commentary on the group's current strategic themes across its three geographic regions (South Africa, rest of Africa and UK), an update on its operating model and some insight on traction of new growth strategies.

A STRATEGY DESIGNED TO MAINTAIN OUTPERFORMANCE DESPITE MACRO, REGULATORY AND COMPETITIVE PRESSURES

The group continues to operate in an uncertain and challenging operating environment. Most macro issues remain material and include:

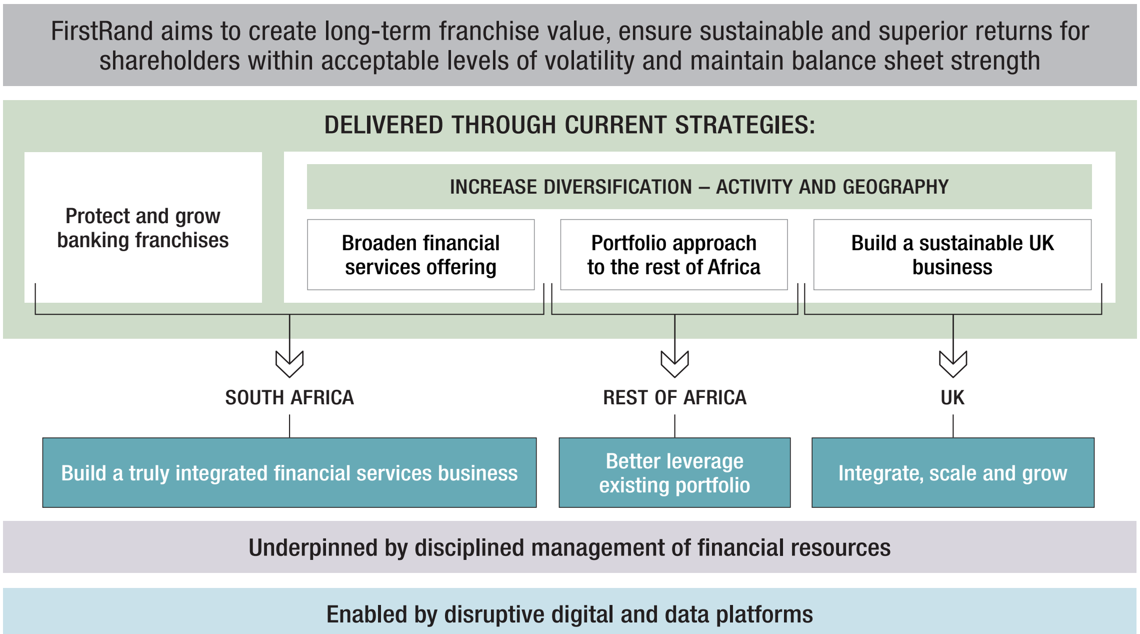
- persistently low GDP growth in South Africa;
- fiscal challenges coupled with rising government indebtedness;
- political and policy uncertainty;
- increasing cost and scarcity of financial resources;
- ongoing introduction of new regulations and legislation (particularly in banking activities), which will impact profitability over the medium to long term;
- intensifying competition in banking profit pools from non-traditional disruptors (specifically those with low cost infrastructures) and insurance players;
- rising regulatory and macro risks in the rest of Africa.

FirstRand believes that certain of these pressures are structural rather than cyclical in nature and will prevail for some time. In order to continue to deliver on its commitments to stakeholders, the group chooses to diversify its portfolio to deliver both growth and premium returns going forward.

Last year in his report to shareholders, Johan Burger outlined the group's new strategic framework. Over the past twelve months the group has further refined this framework and has taken some significant steps to expedite execution.

As demonstrated in the schematic below, the group's strategic framework accommodates a broad set of growth opportunities across the financial services universe from a product, market, segment and geographic perspective.

GROUP STRATEGIC FRAMEWORK



Group earnings are significantly tilted towards South Africa and are still mainly generated by FirstRand's large lending and transactional franchises, which have resulted in deep and loyal customer bases. Many of the expected competitive and regulatory pressures will, however, target these traditional banking operations, particularly the transactional activities, and the group remains focused on protecting that large and profitable revenue stream.

At the same time, FirstRand is working hard to find other sources of capital-light revenues and its strategy to deliver integrated financial services to the group's more than 8.1 million customers is gaining traction. This approach, which is underpinned by the disciplined allocation of financial resources and enabled by disruptive digital and data platforms, allows FirstRand to better optimise the franchise value of its broader portfolio.

CUSTOMER CENTRICITY AT THE HEART OF INTEGRATED FINANCIAL SERVICES

Put simply, an integrated financial services company provides insurance, banking, and investment products to its customers through a variety of distribution channels. Historically, this strategy was largely limited to the concept of cross-selling products between banking and insurance channels (the traditional bancassurance model).

The new starting point is to develop a detailed view on financial services from the customer's perspective. With regard to the retail segment, at various stages of life, a customer may need products that focus on asset protection, asset accumulation and asset distribution, and neither a standalone bank nor a standalone insurer can meet all these needs. An integrated financial services business does, however, have the capability to develop and distribute products across the entire life cycle. Similarly, for corporate clients, an integrated approach can provide a holistic set of products to enable "being in business" (from vanilla lending to more structured lending products, transactional and advisory services, potentially right through to the provision of employee benefits).

Ultimately it is critical to shift from only supplying banking, insurance, or investment products to customers. A successful integrated financial services business must offer financial solutions that cater for the customer's ever-changing needs and, in the process, create a long-term relationship. This relationship will ultimately translate into a real competitive advantage, lower costs, better service, an improved value proposition for the customer, and increased returns to shareholders.

Other critical components include:

- using data to understand and anticipate customer needs;
- an efficient technology infrastructure;
- a trusted brand or multiple brands that create confidence when offering banking customers non-banking products; and
- multiple distribution channels – digital and physical.

Lower distribution costs on new sales and customer acquisition, an increase in the number of products per customer (cross-sell) and better profitability on existing business due to higher retention will result in sustainable and beneficial customer and shareholder outcomes.

FIRSTRAND'S INTEGRATED FINANCIAL SERVICES MODEL IS BECOMING A REALITY IN SOUTH AFRICA

In its domestic market, through the effective utilisation of the origination capabilities, operating platforms and distribution networks of its banking operations, FirstRand is busy transforming into a financial services business with a fully integrated, customer-centric approach. The group is incrementally capturing a larger share of profits from providing savings, insurance and investment products to its customers and the growth opportunity is significant given the annual flows to other providers from FNB's customer base alone.

Some examples of traction are outlined below.

On the back of a massive focus on gathering retail deposits, and when tracking the group's performance relative to money supply, FirstRand has, over several years, been able to gather a greater share of deposits. This has been achieved through product innovation and tactical pricing, which has driven cross-sell of savings products into its customer base. FNB has more than R430 billion of deposits from retail and commercial customers.

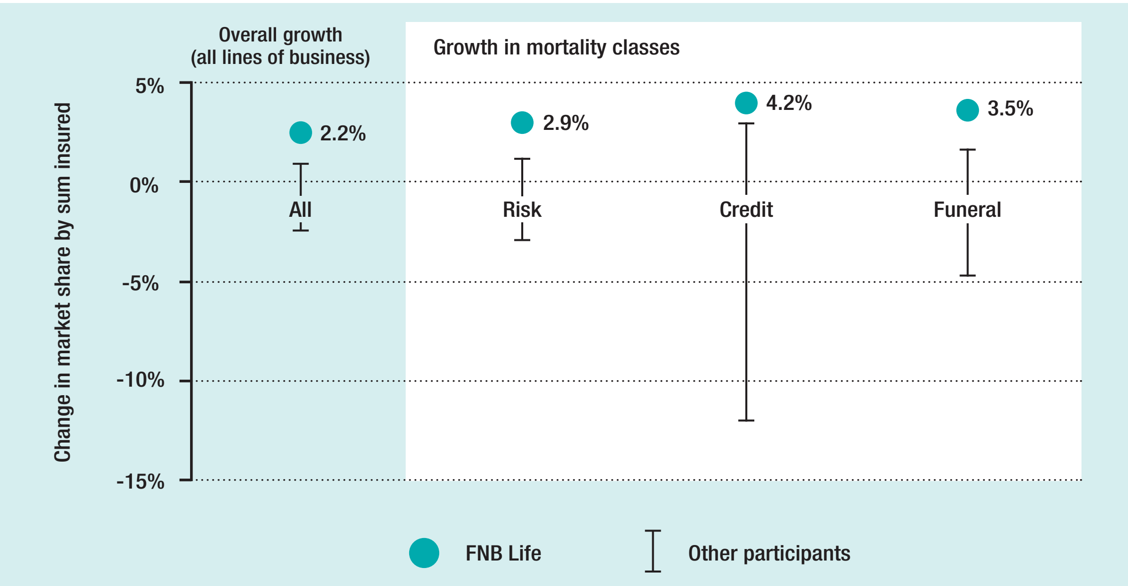
Looking at wealth and investment management, this business is all about integration and distribution – integration into FNB's ecosystem and distribution into the retail and commercial customer base. Advice channels focus on pre-packaged solutions and top picks or best buy. The business has continued to grow assets under management and the group is optimistic that its wealth and investment management activities will scale further in the years ahead.

FNB Life, launched three years ago, showed a very strong performance in in-force annual premium equivalent, up 35% in the current year. What is pleasing, apart from the growth in credit life and funeral products, is how the standalone risk products are starting to scale in both the consumer and premium segments. The number of policies increased 14% to >3.7 million in FNB Life. Branches continue to be important points of distribution and sales through digital channels are expected to increase. Often, where a transaction is initiated on a digital channel, fulfilment happens in a branch or call centre.

The value of new business (VNB) was up strongly (+32%), whilst gross embedded value (EV) increased 18%. The lower EV increase was due to model adjustments based on actual experience, as well as dividends paid out of the insurance businesses up to the group. Adjusting for both of these factors, EV would have increased more than 40% year-on-year.

In the industry survey shown below, it is clear that FNB Life is scaling fast, already attaining the number 1 position in digital market share, banks market share, growth in overall market share and growth in mortality market share for risk products, credit and funeral. Going forward, the group will be increasingly focused on standalone risk products and also expects to activate the short-term insurance business, FNB Insure, in the coming year following the granting of its short-term insurance licence.

FNB Life: #1 in growth in new business in 2017



FNB Life:
#1 Digital direct market share
#1 Banks market share
#1 Growth in overall market share
#1 Growth in mortality market share for risk products, credit and funeral

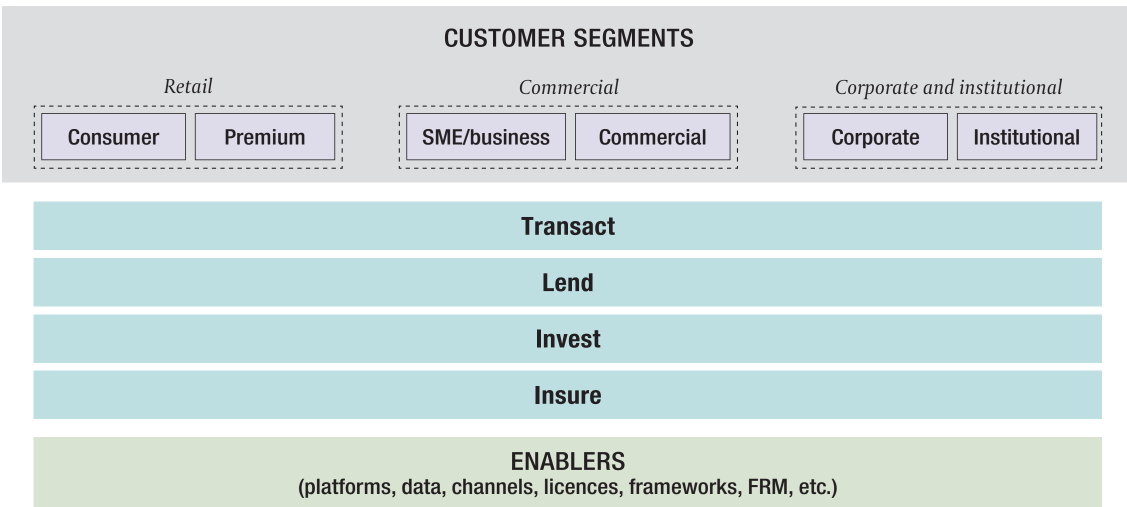
Source: Swiss Re Individual Risk Market New Business Volume Survey 2018. Market share and change in market share are by sum assured for the 2017 calendar year.

The biggest contributor to WesBank's insurance activities is MotoVantage, which relates to post-sale value added products and services (VAPS) linked to the vehicle. These are sold on a per unit basis, so the 1% decline in the number of MotoVantage policies and 11% increase in gross written premium reflects vehicle sales and inflation. The majority of VAPS sales happen at point of sale.

Ashburton Investments, the group's asset management business, is distinct from the wealth and investment management business, and is about origination and product differentiation, and the track record of the asset manager. The customers are institutional (for example, pension funds and IFAs).This business has had good success in fixed income, renewable energy and private equity and RMB is the origination platform for these attractive institutional assets making it an important enabler. It will take time to build and mature this business, however, Ashburton Investments has been able to grow assets under management in the current year particularly on the back of fixed income, although equity markets remained challenging.

During the year under review, the internal operating model was changed in order to better execute on the integrated financial services objectives. The group believes that real customer centricity is necessary to effectively deliver integrated offerings. Where the group was previously structured around business silos, it has now designed a model structured around customer segments – i.e. putting the customer at the centre of business.

A high-level depiction of this internal operating model is shown below.



The segments are responsible for customer value propositions across the lend, transact, invest and insure universe, as they are mandated to understand customer context/needs. Externally these customer propositions will continue to be delivered through the market-facing businesses, namely, FNB, RMB, WesBank, Ashburton Investments, DirectAxis and MotoVantage.

Enablers are both product- and segment-neutral to ensure equitable prioritisation in line with overall group objectives. In addition, enablers will be mandated to:

- extract efficiencies by removing/avoiding duplication;
- run independent transfer pricing and cost recovery principles to ensure neutrality; and
- ensure collective decision making (involving all segments).

The group believes this model change is appropriate to encourage collaboration in delivering an integrated offering to customers.

BUILDING OUT THE REST OF AFRICA PORTFOLIO

The group's strategy outside of its domestic market includes growing its presence and offerings in several markets in the rest of Africa where it believes it can organically build competitive advantage and scale over time.

The group has nine subsidiaries in the rest of Africa and the schematic below gives some insight to the group's portfolio approach.

Mature businesses

Botswana, Namibia, Swaziland

- Universal banks, insurance and asset management
- Systemic, therefore, impacted by macros
  - Credit cycle
  - Economic growth
- Long track records of strong returns and dividends

Start-ups

Ghana

- Business model has to be disruptive
- CCIB is the immediate opportunity
- Regulatory challenges

Emerging businesses

Nigeria

- Focused CIB business
- Profitable
- Ahead of business case
- ROE accretive

Zambia, Mozambique, Lesotho, Tanzania

- Subscale businesses
- Operating in often volatile macro environments
- Need to shift focus to CCIB
- Long-term patience required

The mature businesses (Botswana, Namibia and Swaziland) have a long track record of profitability. They are well-established universal banks and have repeatedly paid dividends to shareholders. The strategies in those markets are similar to FNB's in South Africa, focusing on VSI and broadening financial services offerings. E-channel migration is also playing out in these subsidiaries.

Ghana is a two-year old start-up with a strategy to scale the business with a focus on commercial, corporate and investment banking (CCIB). There are some challenges in that market, most specifically the proposal for a significant hike in the minimum capitalisation of banks by the end of this year.

Nigeria, with an investment banking licence, is profitable, return generative and opportunities are emerging for RMB to enter the corporate transactional space.

In the last category of emerging subsidiaries, the three bigger banks (Zambia, Mozambique and Tanzania) are somewhat challenged. This was primarily due to the macroeconomic environment in those countries, which translated into much higher levels of impairments – typical for a subscale bank in a volatile operating environment. These businesses also need to shift their focus towards CCIB opportunities.

ESTABLISHING A MORE DIVERSIFIED AND SUSTAINABLE UK BUSINESS

In the UK, FirstRand has, over the past eight years, focused on organically transforming its existing business, MotoNovo, into the UK's second-largest independent used vehicle financier. For some time however, the group considered MotoNovo to be undiversified from a product and market perspective and at a long-term structural funding disadvantage without a local deposit raising platform. To resolve these issues in the year under review, FirstRand made a formal offer for Aldermore Group plc one of the UK's specialist lenders. A detailed overview of Aldermore's business can be found on pages 60 and 61 of the operating reviews.

Strategically, the acquisition will result in an appropriately diversified UK business, with an established and scalable local funding platform. This represents a more sustainable and less volatile business model.

The group believes it can also generate additional value for shareholders over the medium to longer term through introducing its successful financial resource management methodology, unlocking synergies between MotoNovo and Aldermore, and over the longer term, potentially building a transactional offering.

LOOKING FORWARD – IT REMAINS CHALLENGING ON MANY FRONTS, BUT THE GROUP IS WELL POSITIONED

As outlined in the prospects section of the CFO's report, in South Africa the macroeconomic environment remains depressed. The group, however, continues to strive for outperformance and the momentum in the business, driven by the current strategies as outlined above, should drive good growth and returns.

With respect to the UK, there is much political noise around Brexit, but Aldermore and MotoNovo are small UK-only operations in a very large market with deep financial services profit pools. This allows for optionality and the ability to respond and adapt as market conditions change.

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