CFO'S REPORT

Harry Kellan

FirstRand produced a good set of results for the year ended 30 June 2015, growing normalised earnings 14% to R21 286 million and generating an ROE of 24.7%, which, in the group's view, remains at a cyclical high given the slower than expected emergence of the credit cycle.

The group's operating franchises performed well, again demonstrating their leading market positions. The key drivers of outperformance were as follows:

FNB benefited from:

- growing its franchise strongly in both existing and new markets on the back of innovative products and delivery channels, particularly focusing on electronic and digital platforms
- growing and retaining core transactional accounts in targeted segments
- driving cross-sell into the customer base
- applying disciplined origination strategies and providing innovative savings products to attract deposits

RMB benefited from:

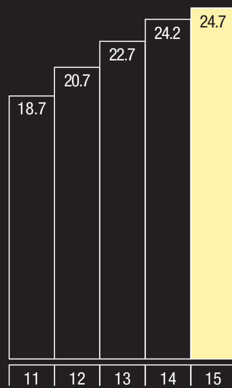
- leading investment banking and advisory capabilities, which resulted in a number of significant domestic and international M&A mandates being secured
- focused client coverage initiatives and increased demand for trade and working capital products in the corporate and transactional franchise
- bespoke structuring transactions which produced significant earnings growth as did the operations in the rest of Africa
- the quality and diversity of its private equity portfolio which produced a strong performance from realisations and robust equity-accounted earnings and income from investment subsidiaries

WesBank benefited from:

- new business volumes increasing across all retail portfolios
- a strong performance from MotoNovo in the UK driven by increased footprint, expanded product offering and growth in supported dealer relationships, which resulted in strong asset growth
- good growth in fee and insurance income on the back of advances growth

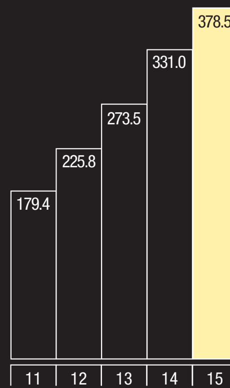
KEY PERFORMANCE INDICATORS

ROE
%



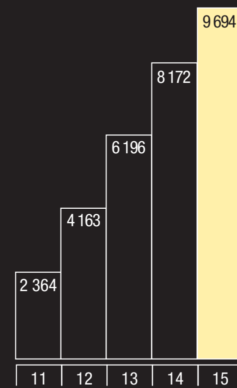
When the group analyses ROE, it also takes into account the relationship between ROA and gearing levels. The group's long-term ROE target range is 18% to 22% for normal economic cycles.

EPS
%



The group targets earnings growth of 3% to 5% above nominal GDP growth over the long term, as this will vary from year-to-year dependent on economic cycles.

NIACC
R million

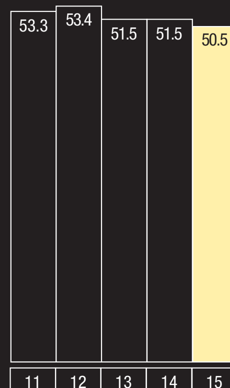


Growth in NIACC is the group's internal benchmark for assessing performance.

ROA
%

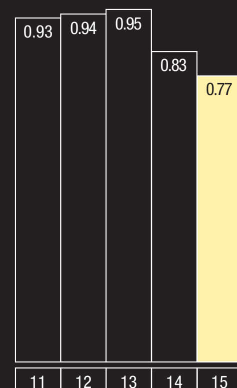
Maximising ROA is a key objective in creating shareholder returns.

COST-TO-INCOME RATIO
%



The group monitors efficiency through the cost-to-income measure. Whilst the group views the cost-to-income ratio as an outcome rather than a target, it recognises that balancing revenue growth and cost growth are key to value creation.

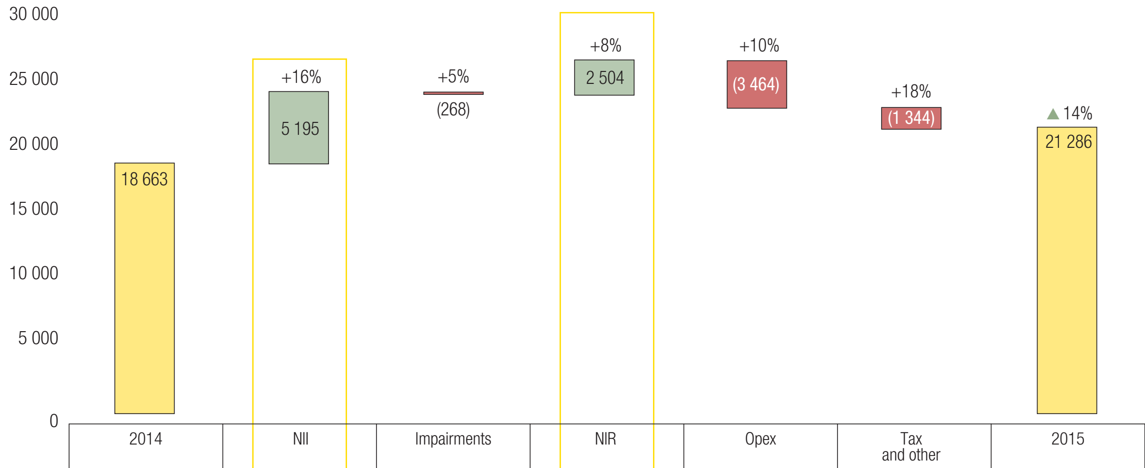
CREDIT LOSS RATIO
%



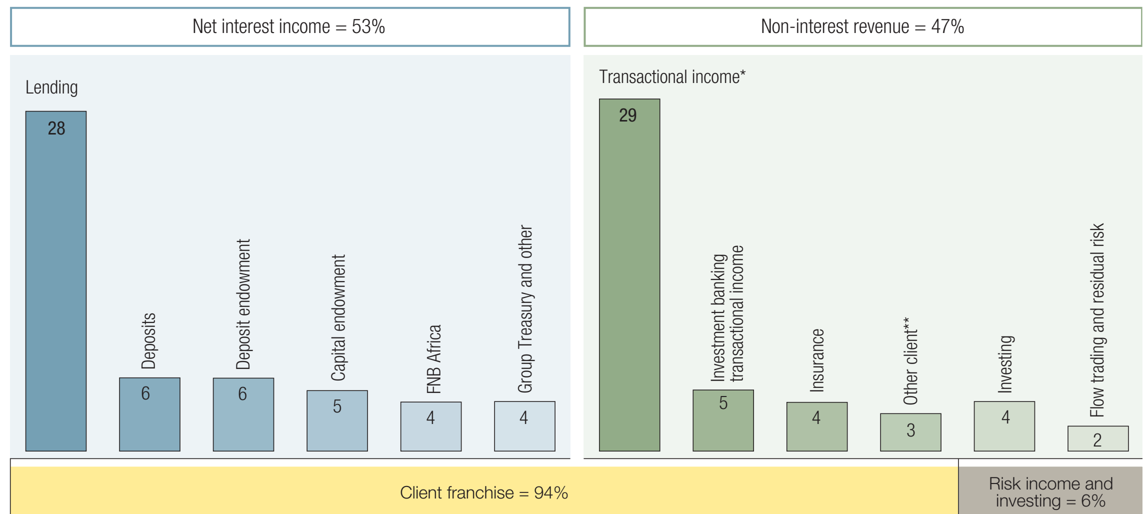
The group believes that pricing appropriately for credit risk is a key requirement for sustainable returns and expects a through-the-cycle charge of between 100 bps and 110 bps.

Continued strong topline growth

The graph below illustrates the group's performance which was underpinned by continued topline growth of 12%. Net interest income (NII) was the biggest contributor, growing 16% on the back of good growth in advances and deposits, and further margin expansion.



As illustrated below, the group continues to earn the majority of its revenue from client activities which represent 94% of gross revenue and support the group's strategy of producing sustainable earnings within an acceptable level of volatility.



* From retail, commercial and corporate banking.

** Includes WesBank associates.

Diversification of earnings

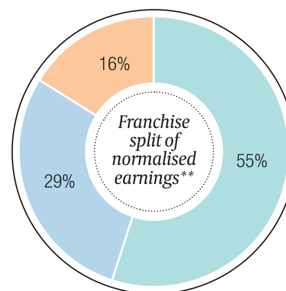
The group constantly evaluates the inherent value within its business model and portfolio as a whole and there are specific filters through which it makes these assessments.

A key consideration is the level of diversification that exists in the portfolio and the group considers this in the context of its strategy, performance targets and the macroeconomic environment. Key diversification measures relate to the relative contribution to earnings from each franchise, market segment, product and geographic footprint.

FirstRand's portfolio provides good diversification and represents the appropriate mix of business activities, at both a franchise and segment level.

FRANCHISE DIVERSIFICATION

Normalised earnings R million	2015	2014	% change
FNB	**11 300**	9 701	16
RMB	**5 888**	5 507	7
WesBank	**3 309**	3 013	10
FCC (incl. Group Treasury) and other*	**789**	442	79
FirstRand group	**21 286**	18 663	14



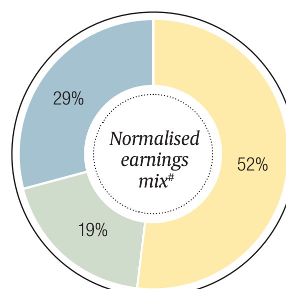
* *Other comprises FirstRand company, consolidation adjustments and NCNR preference dividend.*

** *FCC (which includes Group Treasury) is excluded from franchise contribution analysis.*

The group believes the current franchise contribution is appropriate given the macro cycle. RMB's contribution reduced from 30% to 28% year-on-year, impacted by the negative commodity cycle.

SEGMENT DIVERSIFICATION

Normalised earnings R million	2015	2014	% change
Retail	**10 688**	9 295	16
Commercial*	**3 921**	3 419	15
Corporate and investment banking	**5 888**	5 507	7
FCC (incl. Group Treasury) and other**	**789**	442	79
Group normalised earnings	**21 286**	18 663	14



* *Includes FNB commercial and WesBank*

** *Other comprises FirstRand company, consolidation adjustments and dividends paid on NCNR preference shares.*

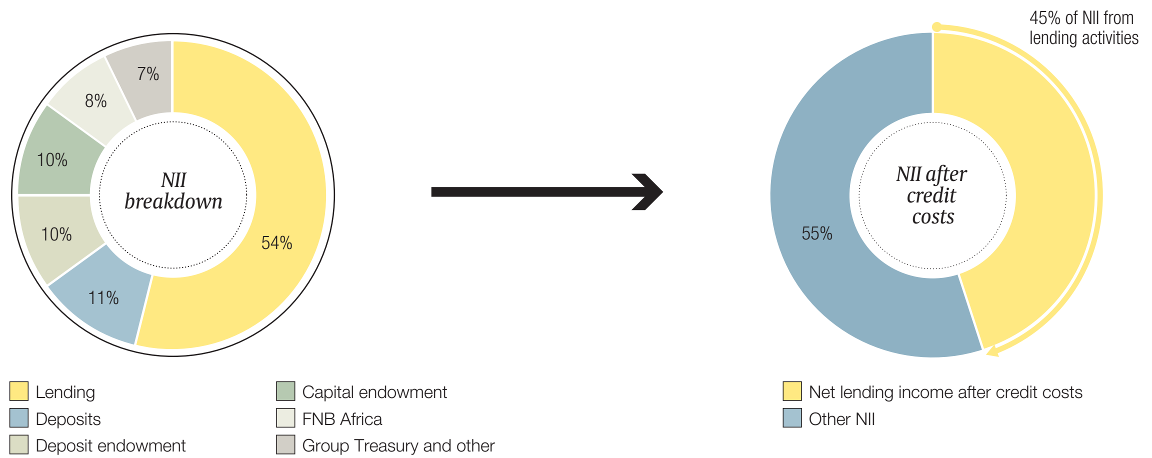
\# *FCC (which includes Group Treasury) is excluded from the segment contribution analysis.*

The contribution from the commercial segment reflects good progress made in rebalancing the portfolio and specific strategies in the commercial and business segments. The group continues its focus on growing its lending and transactional banking activities in the corporate segment.

Net interest income

NII showed strong growth of 16% on the back of resilient advances and deposit growth.

As can be seen from the charts below, although lending still remains the largest component of NII (with growth underpinned by advances and a slight widening in margins on certain asset classes), the picture is more balanced on a risk-adjusted basis.



Deposit income benefited from the absolute growth in deposit balances and the positive endowment effect.

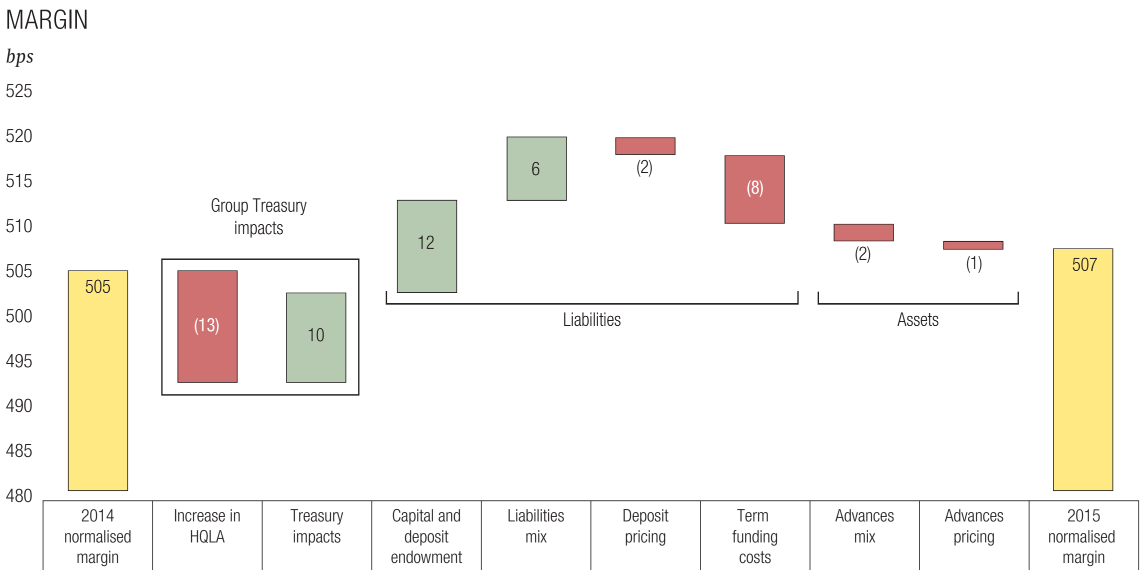
Margins

Net interest margin improved slightly from the restated 5.05% to 5.07% during the year. The positive endowment on capital and deposits, and the change in deposit mix were the main drivers of the uplift in margin, although the accumulation of HQLA assets and higher term funding costs dampened absolute growth.

As mentioned in the CEO's report, the group's strategy to make the balance sheet more liquid through increasing the levels of HQLA (which include certain large corporate related instruments that have lower comparative yields than existing average advances) had a negative margin impact of 13 bps. Group Treasury impacts shown in the graph below reflect mark-to-market movements on term funding instruments and the difference between actual liquidity costs incurred and liquidity costs recovered from business units.

Although certain portfolios benefited from asset repricing, many of the asset generators experienced pressure from higher term funding and liquidity costs.

A breakdown of the drivers impacting margin is depicted in the chart below.



> Margins benefited from positive endowment due to higher interest rates and a change in deposit mix, although higher term funding cost and a change in asset mix curtailed absolute growth

Retail advances growth

Retail advances growth of 9% reflects the more constrained economic environment, although new business volumes in WesBank's MotoNovo (UK) business, credit card and transactional account-linked overdrafts and revolving loans at FNB remained resilient.

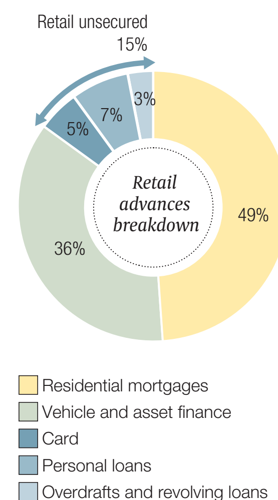
The table below provides insight into the group's risk appetite and origination strategies, highlighting above- or below-trend growth rates in the current year.

Retail advances			
Mortgages	**Affordable housing**	**SA VAF**	**UK VAF (MotoNovo)**
→	↗	→	↗
Remaining conservative with focus on low-risk FNB customers; gradual improvement in demand	Continued strong demand and credit performance	Volumes tracking vehicle sales with appetite marginally reduced for higher-risk customers	Strong market position and benefiting from economic recovery
Card	**Personal loans**	**Rest of Africa**	**Other**
→	→	↗	→
Strong growth in line with FNB customer cross-sell strategy and transactional spend growth	Steady risk appetite maintained – growth benefiting from cross-sell	Strong growth across most markets focusing on FNB-banked customers	Neutral risk appetite, strong focus on cross-sell and lending activation

The composition and growth in the retail portfolios are detailed below.

RETAIL ADVANCES BREAKDOWN

R million	2015	2014	% change
Residential mortgages	**180 208**	171 173	5
VAF	**132 743**	119 120	11
Card	**19 488**	15 761	24
Personal loans	**24 333**	21 670	12
– Mass segment (FNB)	**4 203**	4 219	–
– Consumer segment	**20 130**	17 451	15
FNB	**9 653**	8 297	16
WesBank loans	**10 477**	9 154	14
Transactional account-linked overdrafts and revolving term loans	**12 314**	9 470	30
Retail advances	**369 086**	337 194	9
Retail VAF securitisation notes	**7 301**	–	



Credit card grew 24%, driven by FNB's strategy to leverage customers with transactional accounts, especially in the premier segment, as well as additional incentives for customers to spend on their credit cards.

Personal loan growth in the consumer market reflects a consistent strategy and appetite across both FNB loans and WesBank. Mass market loans remained relatively flat year on year.

For 2015 normalised reporting, certain investment securities have been reclassified into advances; the investment securities reclassified include debt securities qualifying as HQLA and securitisation notes. As the current securitisation notes reference retail VAF exposures, these are highlighted as part of the group's retail exposures in the table on the previous page.

Corporate and commercial advances growth

The origination appetite across corporate and commercial did not change with the exception of cross border transactions where appetite has moderated in high risk sectors, in line with the adverse commodity cycle. The table below again illustrates risk appetite and certain actions taken in the corporate and commercial portfolios, which provides insight on the group's origination strategies.

Commercial advances				
Commercial property finance	**Agri finance**	**Asset-backed finance**	**Small businesses (SMEs)**	**Rest of Africa and India**
→	→	→	→	↗
Remained focused on banked owner-occupied and selective multi-tenanted deals	Continued to diversify exposure across commodities and geographically	Growth focus on customers across targeted industries	Cross-sell to relationship base with some tightening on new-to-bank and higher-risk business	Continue to target Africa-India corridor clients and introduce specialised product offerings

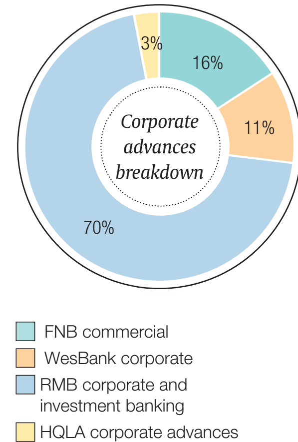
Corporate advances			
Working capital finance	**Infrastructure finance**	**Cross-border rest of Africa**	**South African corporates**
→	→	↗	→
Tracking nominal SA GDP	SA renewable energy projects still drawing down	Moderated appetite in high-risk sectors	Lead arranger of the larger acquisition, leveraged finance and listed property transactions

Commercial includes all advances to commercial clients across FNB and WesBank. Corporate includes advances to corporate and public sector customers across RMB, FNB and WesBank.

Overall corporate advances growth did slowed in the second half of the financial year reflecting macro pressures, although full year growth remained robust at 11%.

R million	2015	2014	% change
RMB core South Africa	**184 010**	169 762	8
HQLA corporate advances	**9 494**	–	
Investment banking-related corporate advances	**193 504**	169 762	14
RMB cross-border	**27 871**	28 502	(2)
RMB repurchase agreements	**35 600**	32 753	9
RMB corporate banking	**6 147**	6 422	(5)
WesBank corporate	**39 796**	38 763	3
FNB commercial	**58 251**	49 903	17
Corporate advances	**361 169**	326 125	11
FNB Africa advances*	**45 740**	40 443	13

* *Includes corporate, retail and FRB India.*



Domestic corporate advances (including HQLA corporate bonds) growth remained strong at 14% and emanated from some large corporate actions in the market.

FNB commercial grew 17%, benefiting from targeted client acquisition and increased cross-sell.

For more information on the group's credit portfolio, refer to pages 177 to 214 of the risk and capital management report.

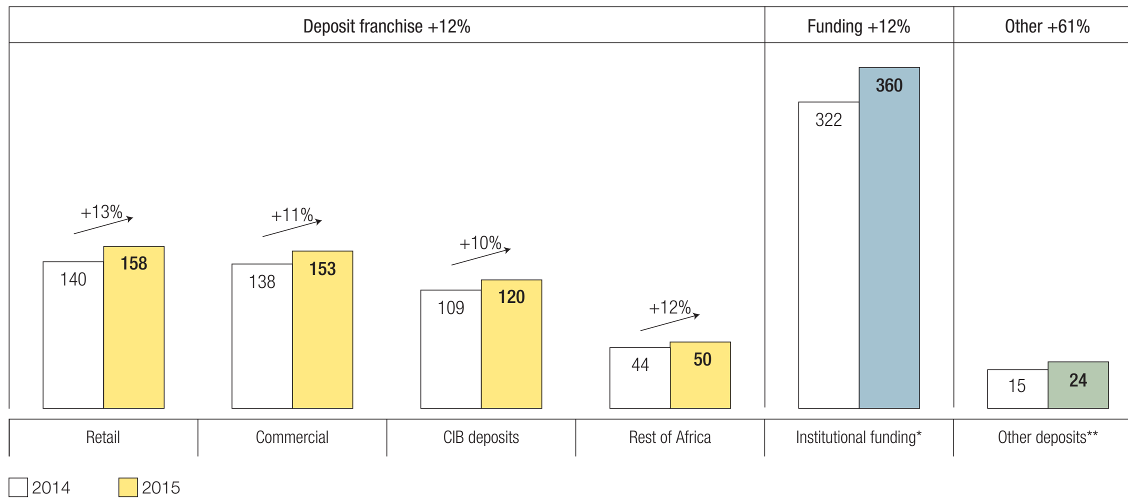
RMB and FNB delivered good growth in advances although slowing in the second half of the year reflecting more constrained macros

Deposit growth

The deposit franchise showed strong growth across all portfolios, driven by innovative products and certain pricing strategies.

Institutional funding now represents approximately one third of total funding, down from 41% in 2011. The institutional funding growth of 12% year-on-year reflects some specific foreign currency issuances in the current year – excluding these, institutional funding grew 5%. The growth in institutional funding in the current year also reflects the group's strategy to improve diversification in terms of maturity and investor base.

GROUP FUNDING BY SEGMENT
R billion

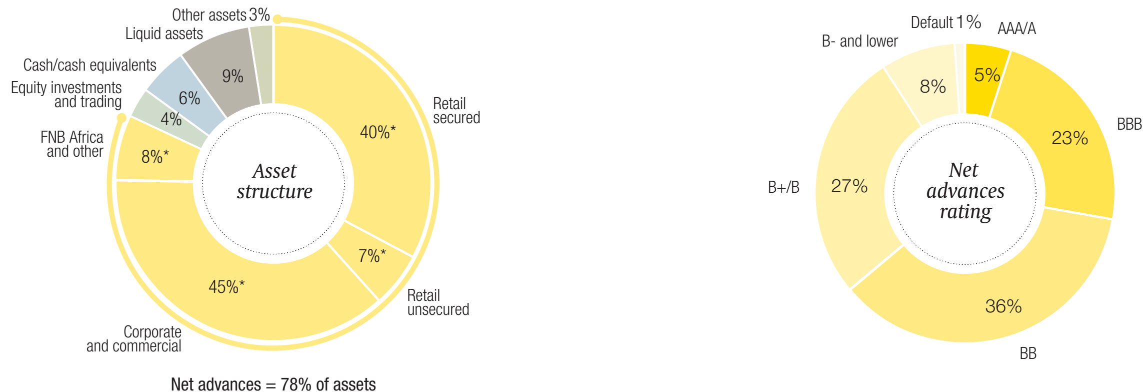


* *Includes CIB institutional funding and foreign currency issuances during the year.*

** *Includes liabilities relating to conduits and securitisations.*

Balance sheet strength and quality

When assessing the underlying risk in the balance sheet, the group's asset profile is dominated by a balanced advances portfolio, which constitutes 78% of total assets. The composition of the net advances portfolio consists of retail secured (40%), retail unsecured (7%), corporate and commercial (45%) and FNB Africa and other (8%). Total NPLs were R17.55 billion (2.21% as a percentage of advances) with a credit loss ratio of 0.77% and 91% of advances were rated B or better.



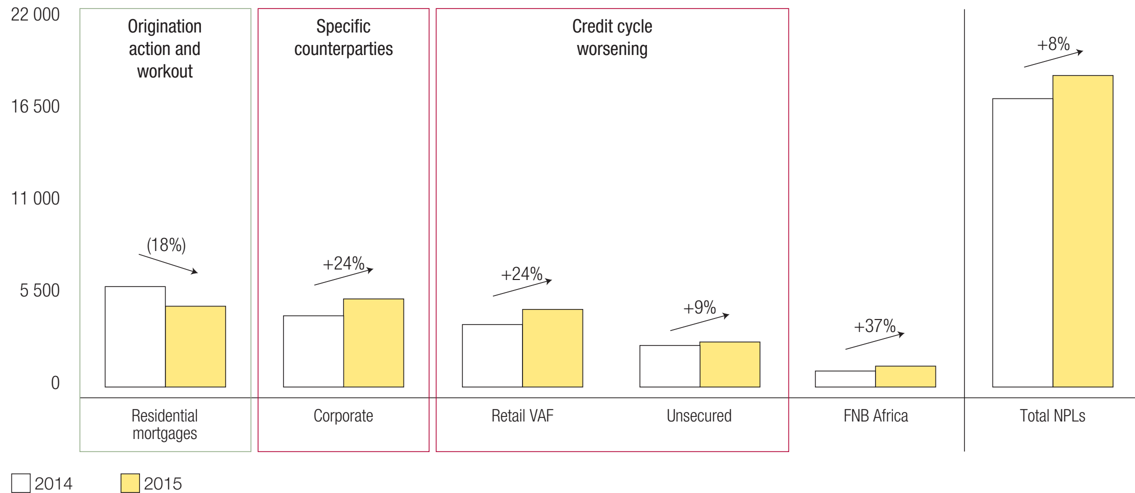
* *As a proportion of net advances.*

Note: Asset and liabilities trading positions for non-recourse, derivatives, securities lending and short trading position have been netted off.

NPLs and bad debts

The bad debt charge trended down from 84 bps to 77 bps in the current year, however, NPLs increased 8% and as can be seen from the graphs below, reflect a mixed picture characterised by:

- Mortgage NPLs declining more than R1 billion or 18%, benefiting from the workout actions and disciplined origination strategies;
- Increasing corporate NPLs driven by RMB, reflecting the impact of the adverse commodity cycle on certain counters in the mining and metals sector.
- VAF and unsecured NPLs reflecting increases of 24% and 9% respectively. The increase in VAF and unsecured lending NPLs reflect the worsening credit cycle, although NPL formation remains within expectations. FNB personal loan NPLs benefited from a reduction of 22% in the mass segment.

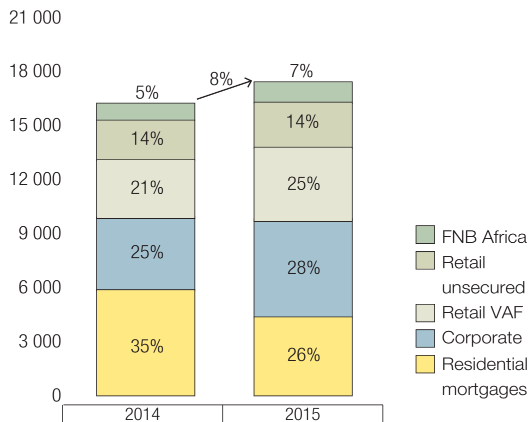


The group increased overall levels of portfolio overlays reflecting its view that the credit cycle will deteriorate going forward

The marginal reduction in the total coverage ratio from 85.4% to 84.3% was driven by the relative change in mix of NPLs, as well as a marginal reduction in the performing book coverage ratio, as shown below.

NPLs

R million



COVERAGE RATIOS

%	2015	2014
Retail – secured	**26.3**	24.0
Residential mortgages	**20.1**	19.9
VAF	**32.9**	30.6
Retail – unsecured	**67.0**	68.7
Credit card	**72.7**	73.0
Personal loans*	**62.1**	65.9
Retail – other	**77.6**	73.1
Corporate	**52.3**	62.8
FNB Africa	**35.5**	41.9
Specific impairments	**40.1**	40.8
Portfolio impairments**	**44.2**	44.6
Total coverage ratio	**84.3**	85.4

* *Includes FNB and WesBank loans.*

** *Includes portfolio overlays.*

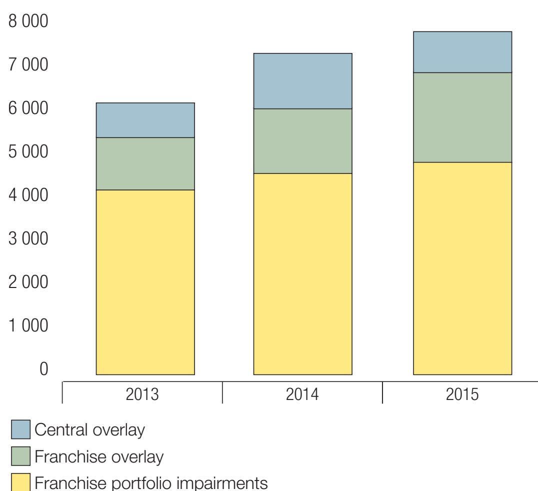
The specific coverage ratio reduced marginally, primarily due to:

- Mass unsecured NPLs decreasing 22% with a higher relative coverage ratio.
- Corporate coverage decreasing, largely driven by RMB NPLs, a combination of certain higher provision exposures being resolved in the current year and newer NPLs having higher security values.
- The decline in FNB Africa coverage which was driven by the overall change in mix in the underlying portfolios.

Portfolio impairments increased 7% and, as shown in the chart below, the impact of proactive provisioning was a key driver. Total overlays increased year-on-year, with the franchises increasing their overlays given the emergence of the credit cycle, which allowed for the release of R325 million of central overlays. The central overlay still amounts to R925 million. Even with current book growth, the group maintained a performing book coverage ratio of 1% which still significantly exceeds the current annual charge.

PORTFOLIO IMPAIRMENTS

R million

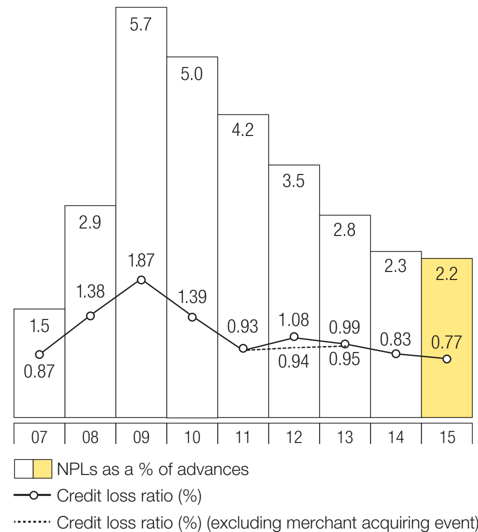


	2015	2014
Portfolio impairments as % of performing book	**1.00%**	1.05%
Bad debt charge (%)	**0.77%**	0.83%
Portfolio impairments (R million)	**7 760**	7 259

The overall increase in the bad debt charge was 5%, although strong book growth resulted in a reduction in the credit loss ratio from 0.83% to 0.77%. At a franchise level, this ratio increased to 0.81%.

Product impairment charges are shown in the table below, however, it is worth noting that:

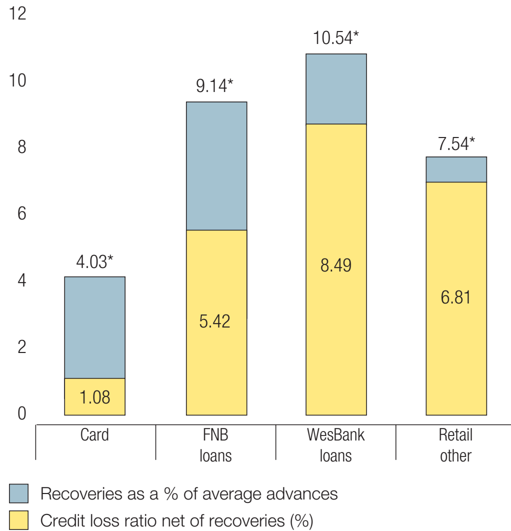
- the residential mortgages charge of 6 bps has not changed since December 2014, but remains at a cyclical low; and
- the card and personal loans portfolios benefited from ongoing strong post-write off recoveries.



Credit loss ratios (%)	2015	2014
Retail – secured	**0.53**	0.54
Residential mortgages	**0.06**	0.09
VAF	**1.19**	1.22
Retail – unsecured	**4.82**	5.20
Credit card	**1.08**	0.70
Personal loans*	**6.73**	7.56
Retail – other	**6.81**	7.09
Total retail	**1.16**	1.18
Corporate and commercial	**0.45**	0.28
FNB Africa	**0.96**	0.90
Franchise impairment charge	**0.81**	0.74
Central portfolio overlay (releases)	**(0.04)**	0.09
Total credit loss ratio	**0.77**	0.83

* *Includes FNB and WesBank loans.*

The impairment charge for unsecured portfolios was significantly impacted by the high levels of post write-off recoveries, with over 69% of the R1.8 billion recoveries coming from the unsecured portfolios, as shown in the graph below.

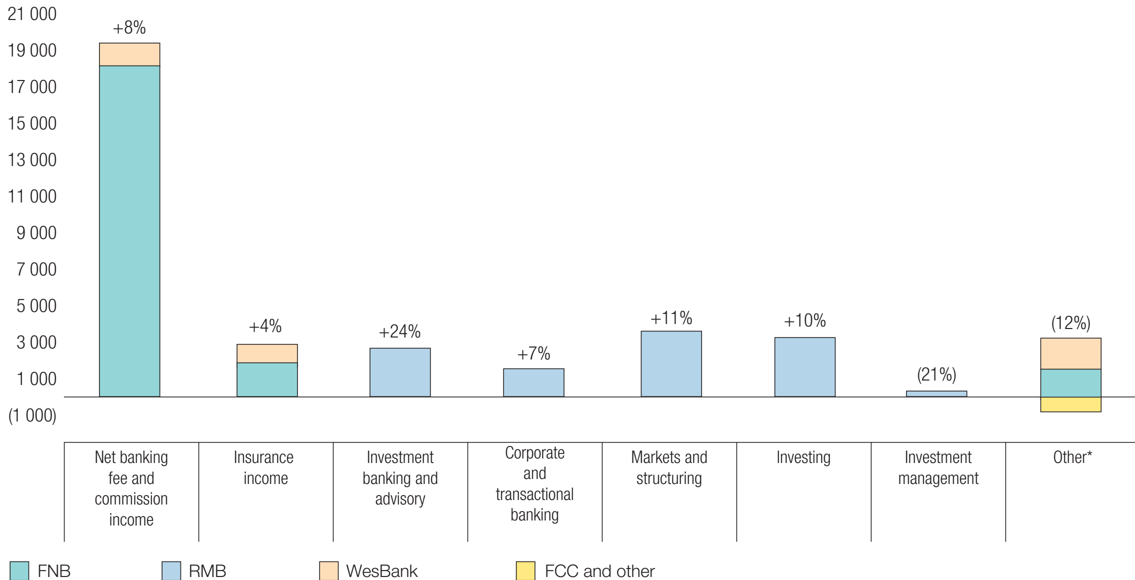


* *Credit loss ratio gross of recoveries (%).*

The group maintained a performing book coverage ratio of 1% which still significantly exceeds the current annual charge

NIR

NIR growth continued to be driven by client-centric activities, as illustrated in the chart below.



* *Other includes FCC (including Group Treasury) and other.*

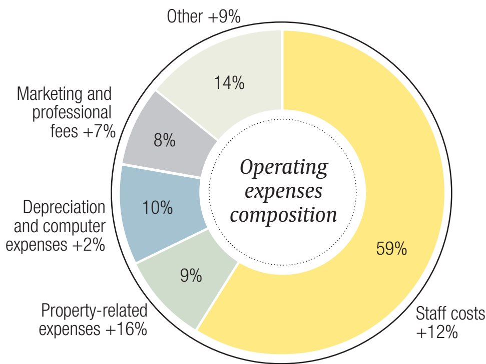
Total NIR, including income from associates and joint ventures, increased 8% year-on-year, with another strong contribution from FNB, which grew NIR 9% and continued to benefit from its strategies to grow fee and commission income (+9%), drive customers onto electronic platforms and generate good momentum in cross-sell.

FNB's NIR increased 9% year-on-year with continued strong growth of 12% in overall transactional volumes with electronic transactional volumes up 14%. ADT (automated deposit terminal) deposits increased 12%, whilst branch-based deposits decreased 20%. The ongoing success of FNB's electronic migration strategy is also reflected in strong growth in transactions online (+15%), banking app (+69%) and mobile (+25%). FNB's strategy to drive credit card as a transactional product also resulted in 13% growth in volumes, underpinned by good growth in new active accounts of 6%.

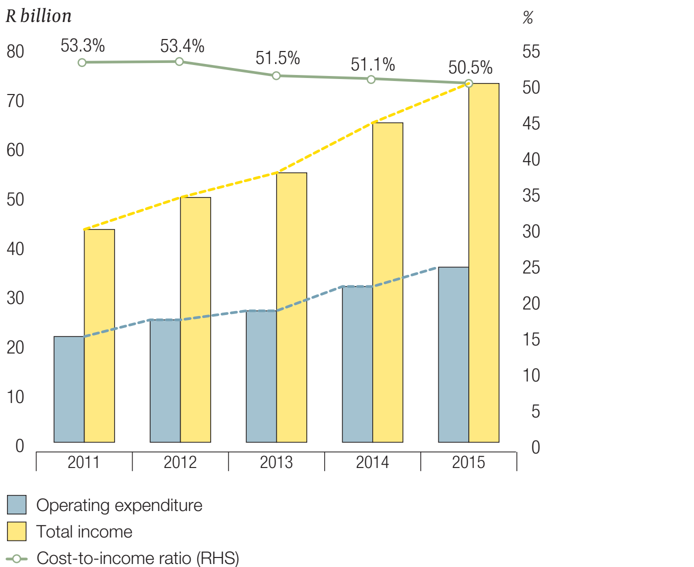
The group's NIR also benefited from RMB's investing activities, with good growth from equity-accounted income generated by private equity-related activities, boosted by realisations in excess of R1 billion. WesBank's NIR, including income from associates, increased 12% driven by strong inflows from insurance income in the VAF and personal loans portfolios as well as robust fee income on the back of advances growth.

Operating expenses

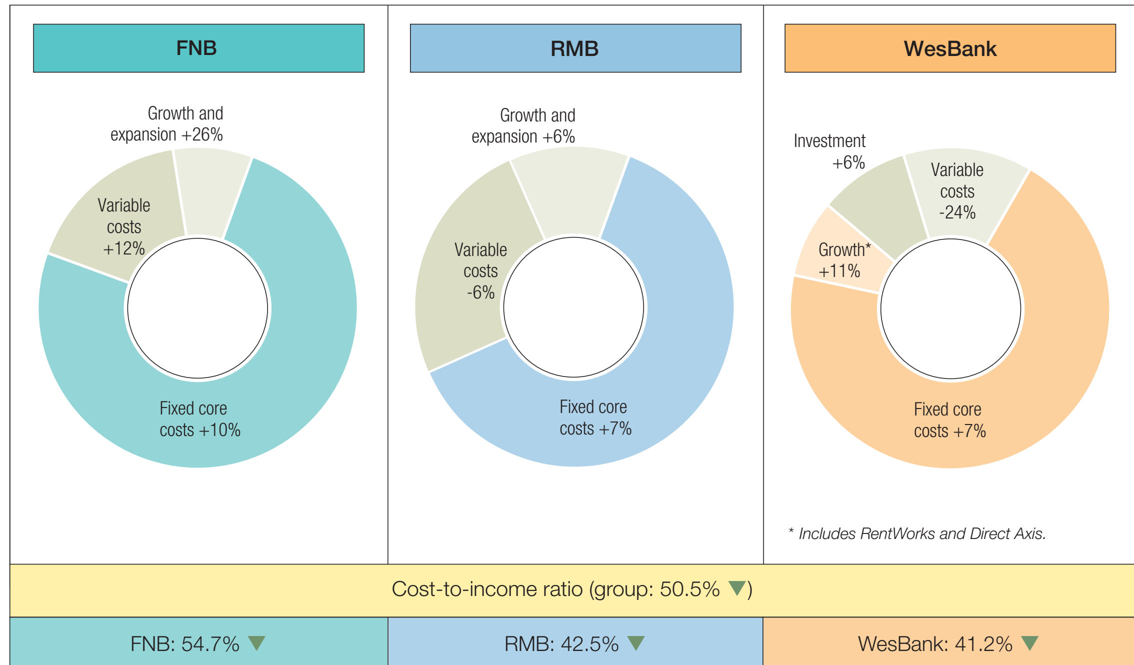
Overall operating cost growth was 10% for the year reflecting a 12% increase in staff costs (which are the largest contributor to costs as shown in the chart below) and continuing investment in infrastructure, operating footprint and regulatory requirements.



As can be seen from the chart below, the group's cost to income reduced further to 50.5% driven by strong topline growth. It is important to note that the group does not target a specific cost-to-income ratio – it is a reflection of its ability to leverage its operating platform to deliver returns to shareholders. The group will continue to focus on efficiencies, especially as topline comes under pressure.



The franchises have continued to invest for growth and platform enhancements, however, the overall cost base can be flexed if required given the level of variable revenue-linked costs and investment. These are shown below.



Taxation increased 18%

The group's effective tax rate increased one percentage point driven by the change in revenue mix, with strong growth in NII and standard-rate taxable NIR, e.g. fee and commission income.

Conclusion

The group continues to produce returns above its internal ROE target range of 18% to 22%. The franchises are well positioned to compete with innovative products, a customer-centric focus and a balance sheet that is well provisioned for the emergence of the credit cycle.

Harry Kellan
CFO