The group has consistently stated that it will not chase earnings growth at the expense of our targeted ROE range and I believe these results strike an appropriate balance between growth, prudent risk management and investment for the future, whilst ensuring sustainable, premium returns.

Johan Burger

ceo's report

Normalised ROE

24%

Normalised NAV

– UP –

10%

RAPIDLY CHANGING OPERATING ENVIRONMENT PROMPTED A REVIEW

Early in the year under review, the group's strategic executive committee (Stratco) embarked on a strategic review process. The first objective of this process was to properly interrogate whether the prevailing strategy of the group was likely to deliver future outperformance, in terms of growth in earnings and return on equity, on a long-term, sustainable basis. The second part of the process was to identify what changes would be required to both strategy and operating platforms to introduce new growth opportunities.

It proved to be a very rigorous, but ultimately fruitful, journey for leadership, which started with an independently-facilitated two-day working session in October 2015, followed by a two-day "deep-dive" with the top 125 leaders in the organisation. There was a detailed presentation on the outcomes from this process at the November 2015 board meeting and the new strategic framework was approved. Since then, the focus has been on execution.

The decision to review the current strategy was prompted by a number of factors. At the beginning of the 2016 financial year, the leadership team was new, the group had enjoyed a long period of outperformance and there were heightened levels of concern regarding challenges emerging in the wider operating environment, both domestically (where the group has a dominant position) and in the rest of Africa.

These challenges were material and can be broadly characterised as follows:

- significant downward pressure on revenues given low GDP growth in South Africa;
- higher probability of a sovereign ratings downgrade;
- increasing cost and scarcity of financial resources;
- ongoing introduction of new regulations and legislation (particularly in banking activities), which could 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; and
- rising regulatory and macro risks in the rest of Africa.

Most of these challenges were considered structural rather than cyclical in nature, and therefore required a fundamental and structural shift in the way the business needed to be positioned for the future, and a different set of strategic responses, particularly to continue to deliver on growth and return commitments to stakeholders.

Leadership considered these challenges and mapped them against any existing portfolio concentrations, in particular, products, segments and geographies. What became clear was that whilst some of these issues were being addressed through diversification strategies, more would be required. Stratco also assessed the group's business model and operating platforms and decided on certain adjustments that were required to ensure that the portfolio was optimally structured.

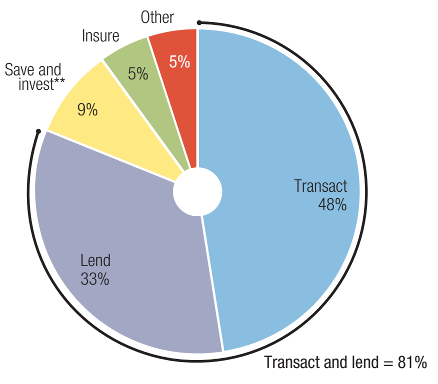
THE REQUIRED RESPONSES BECAME CLEAR

A number of key priorities were identified as building blocks to the group's new strategic framework. A brief overview of these is provided below.

Grow the domestic franchise by leveraging the group's platforms and customer bases to broaden its financial services product offering, whilst protecting and growing its banking franchises

Whilst the group's portfolio of businesses already represented a relatively diversified earnings stream, leadership recognised that these were mainly concentrated in traditional, domestic banking activities, namely retail and wholesale lending, and transactional and related endowment, as shown in the chart below.

*REVENUE SPLIT BY ACTIVITY**



* *Based on gross revenue, excluding consolidation adjustments.*
** *Includes private equity deposit taking and investment management.*

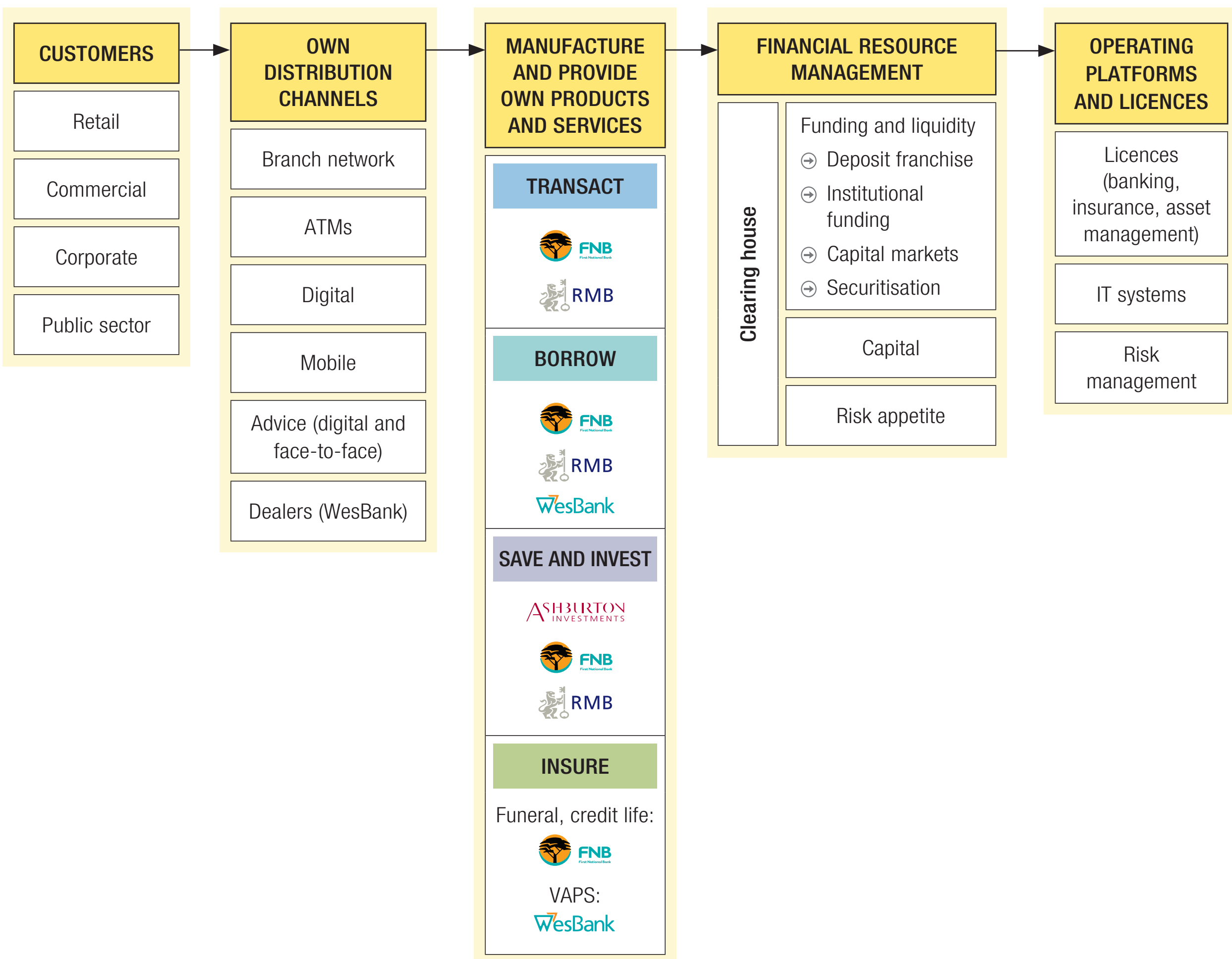
Whilst the high quality of these lending and transactional franchises were a direct result of a very deliberate group strategy embarked on in 2010, they faced significant challenges to grow and therefore the group would need to capture a larger share of profits from the broader financial services markets. FirstRand, however, recognises the imperative to continue to protect and grow these very valuable banking franchises whilst diversifying, particularly as their origination capabilities, customer bases and distribution networks are significant enablers to diversification.

The group believes it can 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 a relatively small proportion of gross revenue, and many of them have become more attractive following changes in regulations.

In pursuit of this strategy, the group intends to use its model to participate in the full value chain presented by the manufacture and sale of its own best-of-breed financial services products and services.

Through an integrated business model, which provides full ownership of the value chain, the group can build differentiated value propositions for customers, thus capturing a larger share of the profit pools available and, over time, generate new and potentially significant revenue streams for the group.

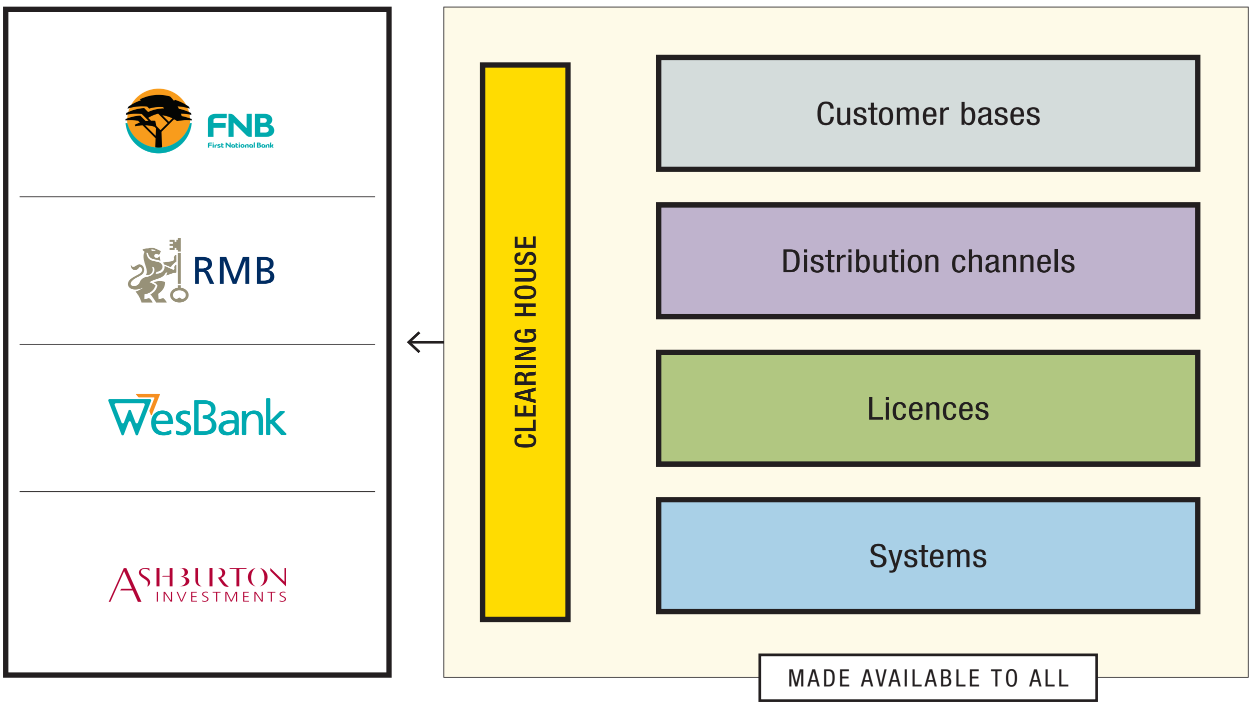
As can be seen from the graphic below, the group has made a great deal of progress executing on this model. Although the group has embarked on initiatives to grow in insurance and investment management, there remains significant opportunities to capture the full value chain in these business lines.



Create a platform- and franchise-neutral business model to enable origination businesses and grow liabilities

Because regulatory changes – both from a prudential and conduct perspective – have increased the cost of providing certain products to customers on banking platforms and in some product lines (e.g. lending), these costs could ultimately exceed the economic cost of granting credit, which would then result in other financial services providers, such as asset managers and insurance companies, becoming more competitive providers of credit. These players are already exhibiting increased appetite for credit assets to back certain of their liabilities, and, in some cases, are already building in-house credit origination skills. Therefore, in order to protect its very valuable origination franchises, FirstRand must create similar platforms.

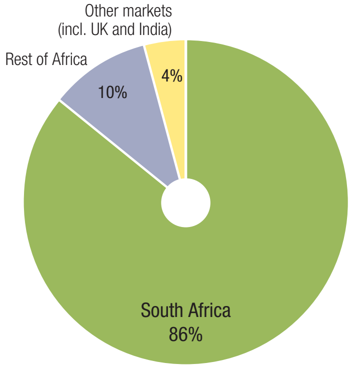
As shown below, the group's business model allows franchises access to all platforms and can facilitate cross-sell and up-sell for franchises.



Accelerate the group's rest of Africa expansion to support growth and diversification

The group's revenues and earnings remain highly concentrated geographically, with less than 15% of total pre-tax profits generated from outside of its domestic market. Whilst significant growth opportunities exist in a number of countries in the rest of Africa, the group's current strategy is proving slower than expected in delivering meaningful diversification.

*GEOGRAPHIC PBT MIX**



* *Based on PBT (inclu. GTSY), excluding FCC, FirstRand company, consolidation adjustments and NCNR preference dividend.*

The group believes that the countries it has chosen for expansion are the right countries and that it does not need to look further afield. Its approach is to build a diversified portfolio in the rest of Africa that recognises that risks are generally higher and that many of the countries on its target list, whilst attractive in the long run, are undiversified. In most cases, these countries rely on one or two commodities for growth and, as a result, are susceptible to macro shocks, often exacerbated by policy mistakes. The current macroeconomic backdrop is a harsh reminder that external factors can quickly affect the performance of both a country and its banks. Whilst the current macroeconomic backdrop in most target countries is uncertain, growth rates in these markets are still considerably higher than those expected in South Africa. The group is also cognisant of the potential opportunities that may arise from the prevailing conditions and is closely monitoring possible acquisition opportunities in these markets.

The strategy is expected to take time to deliver, but will be executed appropriately in order to build sustainable returns for shareholders over the longer term. The group will continue to follow a disciplined approach to the allocation of financial resources, such that portfolio returns and risks are optimised.

Expand the group's current developed market presence for protection, diversification and growth

FirstRand's operations remain heavily concentrated in South Africa and the rest of Africa and, within both of these regions, the growth and risk dimensions have deteriorated, whilst certain developed markets currently represent better risk/reward dynamics. The group already has a sizeable, successful business (MotoNovo) in the UK. For the year ended 30 June 2016, MotoNovo produced a PBT of R1 360 million (2015: R937 million). The group continues to evaluate opportunities for expanding this business.

In addition, with the increased prospect of a sovereign rating downgrade, the group needs to protect its counterparty status and access to hard currency funding. FirstRand is exploring certain options to ensure ongoing access to financial markets and hard-currency funding in the event of a downgrade. For example, the group has recently become a member of the interest rate derivatives clearing service, SwapClear, one of the clearing platforms provided by multi-national clearing house, LCH. A clearing house acts as a central counterparty between trades, and has an independent credit rating.

Ensure the group's platforms are optimally structured and appropriate to drive efficiencies and flex the cost base if required

Given the expected pressures on revenue growth, the group has to optimally manage its operational platforms to both structurally reduce costs and enable efficiencies. Whilst a great deal of work has already taken place in all of the franchises, there is a now a more urgent requirement for a top-down/cross-franchise assessment to understand if the existing business model, and a history of highly-empowered business units, has created value traps in the portfolio.

Further entrench the group's culture

The group needs to place even greater focus on driving a strategic human capital agenda, underpinned by a more formalised process to deeply embed the FirstRand philosophy and owner-manager culture. Transformation remains a key strategic issue for the group.

FINANCIAL RESOURCE MANAGEMENT

One of the critical pillars to the successful execution of this strategy is FirstRand's financial resource management (FRM) approach. Financial resources are defined as capital, funding and liquidity, and risk appetite, and one of the strengths of the group is its track record in allocating these resources to generate superior returns for shareholders.

Through the FRM process, the pricing and deployment of capital and funding is anchored to the generation of net income after capital charge (NIACC) and this has proved, over time, to be a significant differentiator for the group. It achieves three important objectives:

- through the process of assessing resource allocation with the objective of maximising shareholder returns, management has been able to pursue strategies and utilise platforms in the most efficient and value generating ways;
- actively management of the portfolio of businesses to achieve an appropriate balance of capital-light and capital-heavy businesses; and
- the application of discipline in allocation of risk appetite to manage volatility through the cycle.

STRIKING THE APPROPRIATE BALANCE BETWEEN RISK, RETURN AND GROWTH

To conclude, when assessing FirstRand's performance it is important to analyse multi-dimensionally. When considering the year to June 2016, despite five years of outperformance, the group continued to show real growth in earnings off a very high base and, given all the economic and regulatory headwinds, 8% growth in earnings per share and a 24% ROE was a very good outcome. This performance was also achieved whilst the group is investing heavily in future growth strategies that it believes will ensure outperformance over the longer term.

All of this demonstrates the quality of the group's portfolio of businesses, combined with its ability to allocate financial resources to maximise shareholder returns.

The group has consistently stated that it will not chase earnings growth at the expense of targeted ROE range and these results strike an appropriate balance between growth, prudent risk management and investment for the future, whilst ensuring sustainable, premium returns.

JOHAN BURGER
CEO: FirstRand