ceo's report

ALAN PULLINGER
Chief Executive Officer

Introduction

FirstRand's normalised earnings for the year ended 30 June 2022 increased 23% to R32.6 billion, a performance that is testament to the quality of its operating businesses, FNB, RMB, WesBank and Aldermore. Disciplined execution on strategy has continued to drive shareholder value. Earnings have fully recovered to significantly above peak 2019 levels, and economic profits have more than doubled. The ROE at 20.6% remains well situated in the target range. In addition, the group has declared the highest annual dividend in its history of 342 cents per share, as well as a special dividend of 125 cents per share. This resulted in a total distribution to shareholders of R26.2 billion.

A detailed explanation of the group's financial performance is provided in the *CFO's report*, and comprehensive financial and operating reviews of the underlying businesses can be found on pages 35 to 49.

This report provides an overview of the group's strategic framework and unpacks the performance relative to the specific strategies that the group implemented to successfully navigate the pandemic and position the business to capitalise on a sustained recovery.

Strategic framework

FirstRand Limited is a portfolio of integrated financial services businesses operating in South Africa, certain markets in sub-Saharan Africa and the UK. Many of these businesses are leaders in their respective segments and markets, and offer a broad range of transactional, lending, investment and insurance products and services.

The group's strategic framework is described in the schematic below. Consistent execution on its focused regional strategies, the build-out of its digital platforms, the disciplined management and deployment of financial resources (FRM) and a unique people philosophy remain the cornerstones of FirstRand's distinctive investment proposition, and track record of growth and superior returns.

Group strategic framework

FirstRand commits to building a future of SHARED PROSPERITY through enriching the lives of its customers, employees and the societies it serves. This is the foundation to a sustainable future and will preserve the group's enduring promise to create long-term value and superior returns for its shareholders.

DIVERSIFIED PORTFOLIO WITH UNIQUE STRATEGIES:

SOUTH AFRICA	BROADER AFRICA	UK
Platform-enabled integrated financial services providing ecosystems that create long-term value for clients and shareholders	Build competitive advantage and scale to deliver economic profit and dividends	Modernise, digitise and scale to a more valuable UK business that delivers economic profit and dividends

Enabled by digital platforms

Disciplined management of financial resources (capital, funding, liquidity and risk capacity) to deliver on financial commitments

Committed, accountable and empowered people key to delivering continued outperformance

Purpose

FirstRand's purpose statement, to build a future of shared prosperity, reflects a deep commitment to deliver both financial value and positive social outcomes for multiple stakeholders. This is increasingly achievable as the group intentionally uses core business activities, including its role in allocating capital to the economy, to add value to society – profitably and at scale.

There are already multiple examples of the operating businesses intentionally tackling a wide array of societal challenges through innovative product and distribution strategies, whilst remaining relentlessly focused on driving economic growth and superior returns for shareholders. These two ambitions are mutually inclusive and distinctive, and have the potential to create new sources of value. As such they form the foundation for a sustainable future and the group is working hard to rigorously measure and ultimately report progress on purpose.

"Disciplined execution on strategy has continued to drive shareholder value."

Geographic strategies

FirstRand's earnings remain tilted towards South Africa and are mainly generated by its large lending and transactional franchises, which have resulted in deep and loyal customer bases. These domestic banking operations are mature and systemically important. Against the prevailing backdrop of weak macroeconomic growth, given the group's size, any aspiration to outperform requires strategic distinction combined with sound execution. The key growth imperative in the domestic franchises is to grow customer numbers, do more business with customers, and do this more efficiently. The group is also investing in building capital-light revenues in adjacent activities such as insurance, and investment and asset management.

In the broader Africa portfolio, FirstRand is growing its presence and offerings in certain key markets where it believes it can build competitive advantage and scale over time. The group's expansion strategy has been largely organic, complemented where possible by bolt-on acquisitions. There is a strong focus on building in-country customer and deposit franchises.

The UK operations continue to offer significant optionality in a large market with attractive risk-adjusted returns. The combined businesses of Aldermore and MotoNovo have healthy margins, a diversified asset portfolio, a scalable savings franchise and small shares of deep profit pools. The group remains confident it can build a more valuable business in the UK over time.

Operating environment in the year under review

South Africa's macroeconomic environment did not escape the heightened global economic uncertainty brought about by:

> the war in Ukraine;

> an inflation leap across almost all major developed economies; and

> given the above, from the beginning of the 2022 calendar year, the major central banks became more hawkish and started to increase policy rates.

South Africans also had to deal with the damage brought about by the floods in KwaZulu-Natal and a step-up in power interruptions. These factors saw a macro environment characterised by:

> a significant lift in inflation;

> the start of an interest rate tightening cycle; and

> lower business and consumer confidence.

However, positive spillovers from the global environment came in the form of a material boost in the terms of trade supporting income growth in several external facing sectors, pushing the current account balance to the highest levels in decades, providing a very useful windfall to the fiscus. This allowed a pick-up in the country's private sector credit extension from the post-pandemic lows that marked macroeconomic conditions at the start of the previous financial year.

Given the proximity of the UK to the effects of the war in Ukraine, the associated increase in international energy prices, and the absence of a terms of trade boost, the country's macros have been characterised by a significant lift in inflation and a tightening of monetary policy. With inflation at levels not seen since the 1970s, the UK has been dealing with an unfolding cost-of-living crisis, which has been followed by some extraordinary fiscal measures.

The housing and labour markets did, however, hold up relatively well over the year under review, with the unemployment rate remaining at very low levels. Wage growth stayed solid – at least in nominal terms. The strength of the labour market does, however, reflect a shortage of labour supply in the face of structural changes brought about by Brexit and the pandemic, which has posed its own set of challenges to policy makers and businesses over the last year.

Disciplined execution on specific strategies shaped growth and ROE outcomes

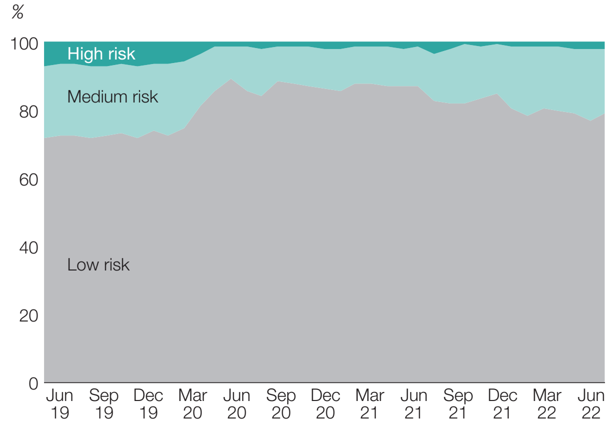
The underlying composition of the group's earnings growth and superior return profile directly correlate to the consistent and disciplined execution on certain key strategies:

> carefully price for financial resources;
> appropriately provide against lending portfolios;
> strengthen and appropriately tilt the balance sheet to the macro environment; and
> accrete capital and net asset value (NAV).

These strategies, tightly managed through the group's FRM process, were designed to contain the negative impact of the Covid-19 pandemic, strengthen the balance sheet, build available financial resources and position the group appropriately to grow into a post-pandemic recovery. Economic profit, the group's key performance measure, defined as net income after cost of capital (NIACC), increased >100% to R10.1 billion (2021: R4.9 billion) and NAV accreted 9% to R164.9 billion (2021: R151.6 billion).

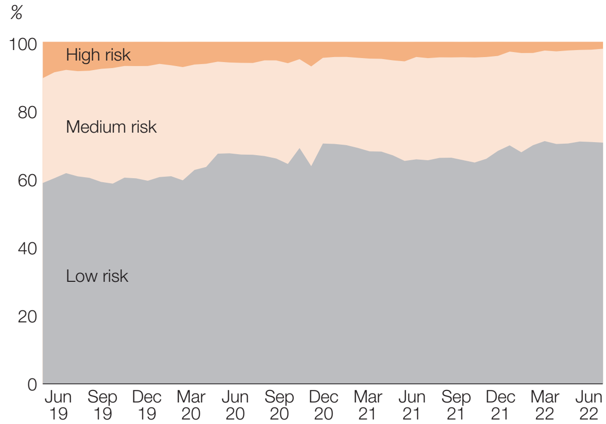
FirstRand continued to be discerning in pursuing growth emanating from the rebound that immediately followed the pandemic. There was a particular focus on allocating financial resources to growth opportunities tilted to the group's macro view, whilst continuing to serve the needs of its customers. Identifying and originating quality new business has been a fine balancing act given competitive actions in the market and the level of real, although uneven, recovery taking place in the economy. The group remained cautious on origination, which resulted in lower year-on-year growth in advances relative to the sector. The adjacent charts demonstrate the tilt in FNB's and WesBank's retail lending portfolios towards good-quality, lower-risk customers.

FNB new business risk distribution*



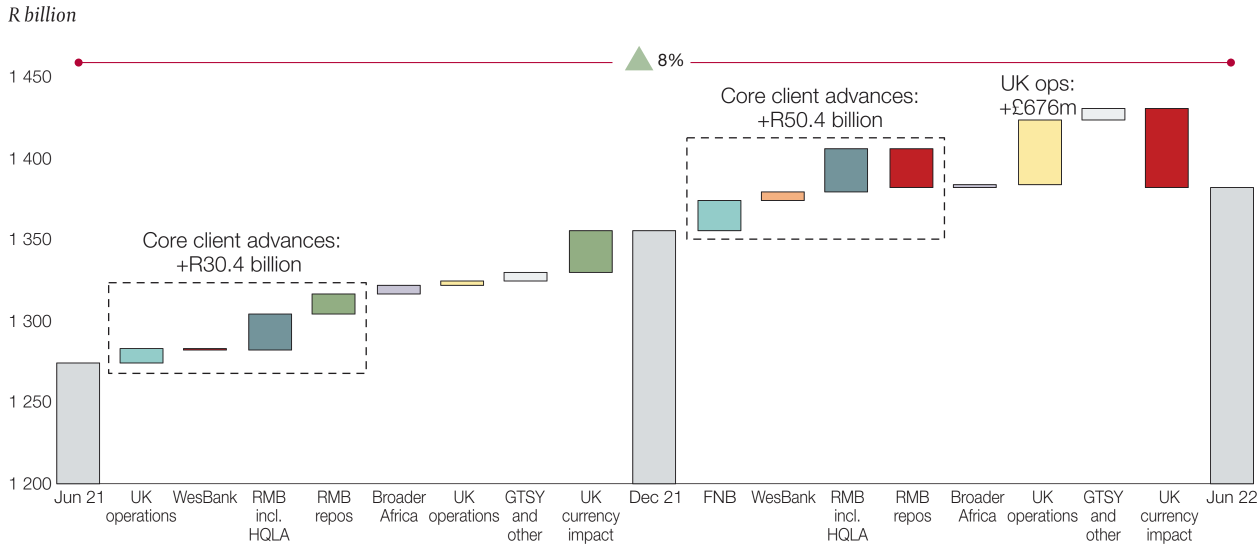
* *Reflects origination of retail products (excluding DirectAxis).*

WesBank new business risk distribution



The group believes this discerning approach to origination will ensure that, across its portfolio, it will capture a higher market share of lower-risk business, whilst continuing to satisfy the credit demand from customers as incomes recover.

New business production levels lifted by the fourth quarter of the financial year, resulting in all core lending portfolios growing year-on-year apart from retail vehicle asset finance (VAF) and unsecured revolving loans. The following chart shows the group's cautious but tactical advances growth into an uneven recovery.



* *Broader Africa excludes the cross-border book.*

The deposit franchise and transactional balances increased strongly during the year under review. The group's deposit gatherers, notably FNB, performed admirably. FNB was the top household deposit franchise in South Africa at 30 June 2022. The continued strong growth in customer deposits enabled Group Treasury to optimise the funding mix, resulting in lower funding costs.

The objectives of Group Treasury's asset-liability management (ALM) strategies are:

> to protect and enhance group earnings;
> be countercyclical to the operating businesses;
> add resilience to the group's balance sheet and risk profile – following an ALM matching philosophy; and
> to provide the most optimal outcome through an economic rate cycle on a risk-adjusted basis.

This focus on the deposit franchise, combined with Group Treasury's ALM strategies, to a degree offset the muted retail advances growth trajectory in the first half and provided an underpin to the ROE. The deposit franchise and ALM strategies have also contributed to an improvement in risk-adjusted margins relative to 2019.

Balance sheet strength increased since 2019

The group's origination strategies, combined with disciplined pricing and conservative provisioning, have resulted in an even stronger balance sheet compared to before the pandemic.

Prudent management of the credit portfolios was reflected in a 16% reduction in NPLs, driven by collections, write-offs, account curing and a reduction in inflows. Coverage remained healthy, notwithstanding a year-on-year provision release, and showed improvement from pre-pandemic levels.

Liquidity buffers have been maintained and are appropriate to withstand unexpected market disruptions. The funding mix has also improved, with the bank's institutional funding at a record low of 25% of total funding compared to 36% in 2019.

The Common Equity Tier 1 (CET1) ratio increased to 13.9% (2021: 13.5%) and, given this strong capital level, the group is in a position to materially increase its payout to shareholders. The combination of a drop in cover to 1.7 times and a special dividend of 125 cents per share results in a total payout of 467 cents per share (the highest payout level in the history of the group at R26.2 billion).

Despite this high level of payout, FirstRand remains capital generative and has the necessary financial capacity to increase momentum in risk-weighted asset (RWA) growth in the 2023 financial year. The growth in advances that took place in the last quarter of the year under review is evidence of already increasing momentum.

Prospects in the short term

In South Africa the current credit cycle will continue to gather momentum, although commodity-induced cyclical tailwinds are expected to fade. As inflation subsides and economic reforms progress, these trends will support accelerated advances growth across the domestic retail, commercial and corporate portfolios.

This in turn will drive stronger lending NII in the 2023 financial year, supported by ongoing growth impetus in deposit balances. Levels of customer growth to date as well as improving activity should underpin growth in NIR.

The broader Africa portfolio is expected to show a steady improvement as inflation pressures abate and many of the countries in the portfolio continue to benefit from the commodity cycle, despite a softening trend.

The UK economy is likely to experience a period of weakness mainly related to sharply increased cost-of-living pressures. A mild, inflation-induced recession seems likely. The pressures on household income trends may affect affordability levels and credit profiles. However, despite this backdrop, the UK businesses anticipate growth (albeit muted) in advances in the 2023 financial year given Aldermore's niche approach to origination.

Given the above, FirstRand's normalised ROE will remain well positioned in the target range of 18% to 22% in the 2023 financial year. Growth in earnings is expected to revert to the group's long-term target of real GDP plus CPI plus >0% to 3%.

A changing global context

Looking more broadly and further out, there are some profound trends emerging from a changing global context and there will be a shift in the allocation of value between stakeholder groups.

The major adjustments taking place right now across the world have their roots in the global financial crisis from which three powerful themes emerged: ultra-low policy rates, ultra-low inflation and significant quantitative easing (QE) by central banks. This has seen the S&P 500 deliver a compound annual growth rate (CAGR) of close to 12% (to date, assuming dividends reinvested) over the past 10 years, which represents an outsized real return given zero inflation.

For a long time the majority of the world's "economic spoils" were captured by equity (asset price inflation), with very little real growth going to wages. This has been a massive driver of rising inequality globally, almost to untenable levels, and was happening in many markets, albeit far more nuanced than in the USA. Some regions of the world experienced very low real growth given country-specific challenges over the same period.

Then the pandemic arrived.

The path out of the pandemic saw inflation begin to rise (supply chain issues, food and energy) and for a while these were considered to be transitory. Then underlying inflation began to rise sharply across the world, driven by wage inflation, and is now no longer considered to be transitory, it has become semi-structural. The retreat from peak inflation will take time. At the same time central banks have responded, pushing through sharply higher policy rates, and withdrawing QE.

The world is likely to settle, after the current period of volatility, at structurally higher interest rates and higher inflation compared to the levels experienced in the last decade. This is not necessarily a bad outcome – there needs to be a period of reallocation between equity and wages. It will furthermore ensure risk assets are better priced. It will, however, present a new set of challenges for corporates generally as lower growth, lower margins and higher costs come at the expense of equity.

FirstRand is extremely cognizant of what this means for the jurisdictions in which it operates and the customers it serves. The group believes its purpose, its current strategies and its financial resources are well calibrated to successfully adapt to and navigate such a scenario.

ALAN PULLINGER ~ CEO