cfo's report

"The group's performance rebounded strongly with normalised earnings increasing 54% to R26.6 billion, approaching pre-pandemic peak earnings levels.

Pleasingly, the group also produced an ROE of 18.4%, back in the long-term target range of 18% to 22%, and paid FirstRand's highest final dividend."

In order to appropriately navigate the economic crisis brought about by the pandemic, for the year to 30 June 2021 the group anchored execution of its strategy to the following FRM principles:

> Carefully price for financial resources.

> Appropriately provide against lending portfolios.

> Apply strict cost management.

> Further strengthen and appropriately tilt the balance sheet to the macro outlook.

> Accrete capital and net asset value (NAV) – the deployment of capital to reflect the updated cost of equity.

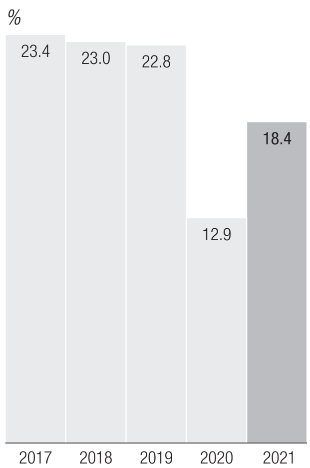
> Emerge from Covid-19 with limited vulnerabilities, with capital for growth.

Adherence to these principles supported the group over the year under review. Earnings recovered faster than expected, with ROE and NIACC coming back strongly. The group continued to accrete capital with NAV per share up 10%, resulting in a healthy CET1 level, which provides sufficient capacity for growth. The group's CET1 ratio increased to 13.5% (2020: 11.5%) and the group was in a position to pay a full-year dividend at the bottom end of its cover range (56% payout).

HARRY KELLAN ~ Chief Financial Officer

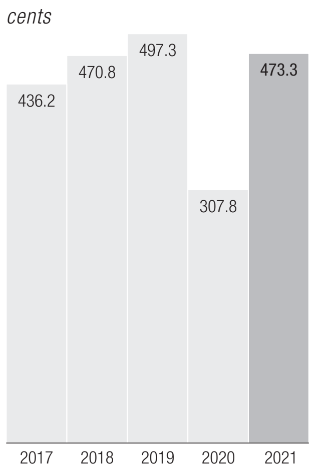
Key performance metrics

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.

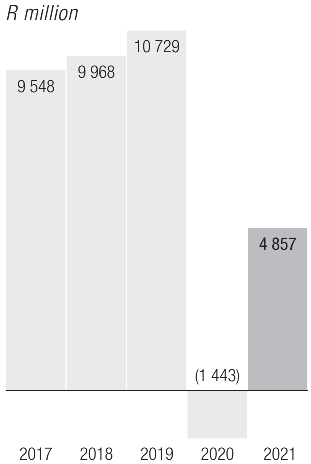
Diluted normalised EPS



The group targets earnings growth of nominal GDP* growth plus >0% to 3% for normal economic cycles.

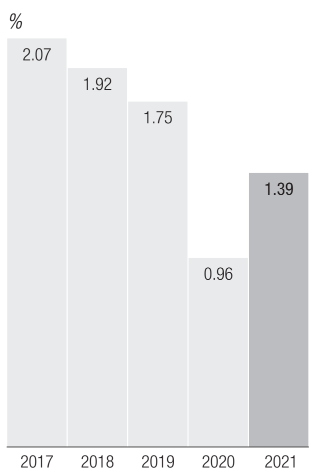
** Defined as real GDP growth plus CPI.*

Net income after cost of capital



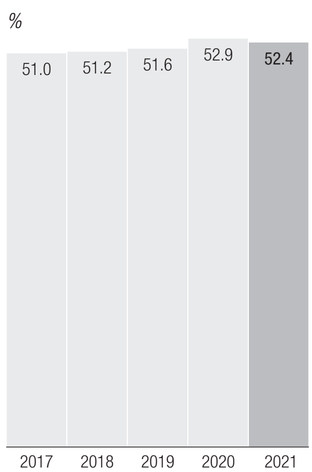
Net income after cost of capital is the group's internal benchmark for assessing performance.

ROA



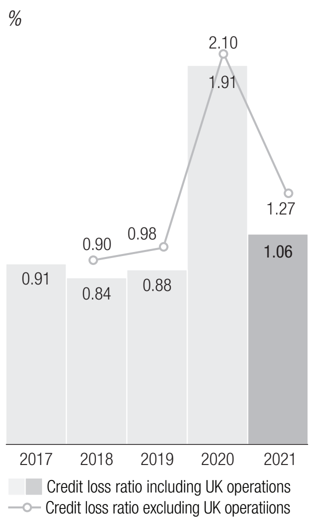
Maximising ROA is a key objective in creating shareholder returns.

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 is key to value creation.

Credit loss ratio



The group believes that pricing appropriately for credit risk is a key requirement for sustainable returns and targets a through-the-cycle charge range (excluding Aldermore) of 100 to 110 bps. The prior year credit loss ratio of 191 bps was a consequence of the Covid-19 economic crisis.

Total revenue increased 4%, despite the negative endowment impact. Group Treasury employed mitigation strategies that benefited deposit margins, which supported net interest income.

Non-performing loan (NPL) growth of 6% was lower than expected, benefiting from a 35% increase in write-offs. This together with the improved macroeconomic environment and collection efforts, supported the 44% reduction in the overall impairment charge to R13.7 billion (2020: R24.4 billion).

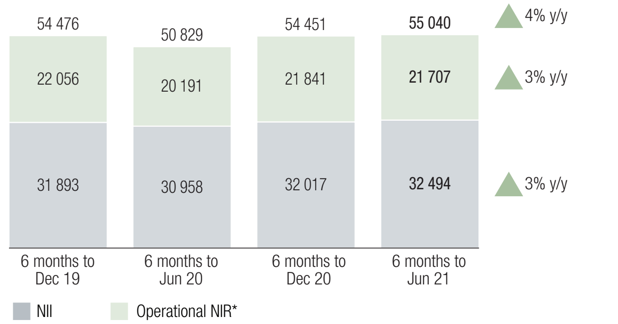
Growth in operating expenses was contained at 3%, reflecting the continued focus on cost management across the business.

The following table and charts provide a high-level overview of the income statement, as well as topline and credit performance for the year under review.

R million	2021	2020	% change
Net interest income	**64 511**	62 851	3 ▲
Operational non-interest revenue	**43 548**	42 247	3 ▲
Share of associate income	**1 432**	207	>100 ▲
Total revenue	**109 491**	105 305	4 ▲
Operating expenses	**(57 342)**	(55 656)	3 ▲
Indirect tax	**(1 516)**	(1 348)	12 ▲
Pre-provision operating profit	**50 633**	48 301	5 ▲
2019: 49 188 ▲ 3%			
Impairment charge	**(13 660)**	(24 383)	(44) ▼
2019: (10 500) ▲ 30%			
Income tax expense	**(8 849)**	(4 874)	82 ▲
Profit after tax	**28 124**	19 044	48 ▲
Other equity and non-controlling interest	**(1 573)**	(1 779)	(12) ▼
Normalised earnings	**26 551**	17 265	54 ▲
2019: 27 894 ▼ 5%			

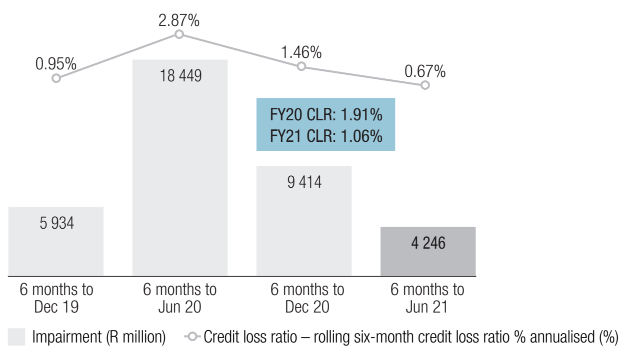
*Rolling six-month topline**

R million



* *Includes share of associate income.*

Impairment charge

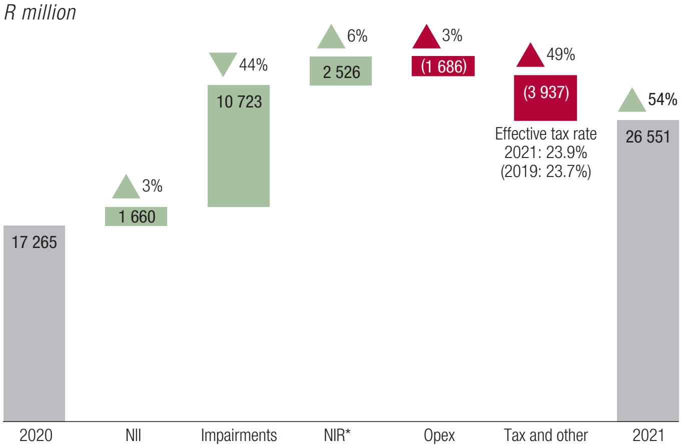


Excluding the impact of the impairment charge, pre-provision operating profit increased 5%, demonstrating the resilient underlying performances from FNB, RMB and Group Treasury.

The reduction in impairments was the most significant driver of earnings growth

The chart below shows a high-level breakdown of movements in the income statement lines for the year under review, and clearly shows that the reduction in the impairment charge was the largest contributor to the increase in earnings. Tax and other charges were higher year-on-year, reflecting higher earnings and the normalisation of the effective tax rate, which was similar to the 2019 financial year.

Normalised earnings
R million



* *Including income from associates and joint ventures.*

Revenue remained resilient

Overall NII increased 3% despite the negative endowment impact resulting from the 300 bps cuts in interest rates since December 2019. This endowment impact was partially offset by higher capital levels and deposit volumes, and the benefit of Group Treasury's asset and liability management (ALM) mitigation strategies to protect earnings.

Lending NII decreased 1% due to the decline in advances, which was to some extent offset by mix change. Advances decreased year-on-year due to low demand for credit, as well as the group's cautious risk appetite for most of the financial year, given ongoing uncertainty, coupled with increased competition.

Transactional NII also benefited from Group Treasury's ALM mitigation strategies as well as customer and deposit growth.

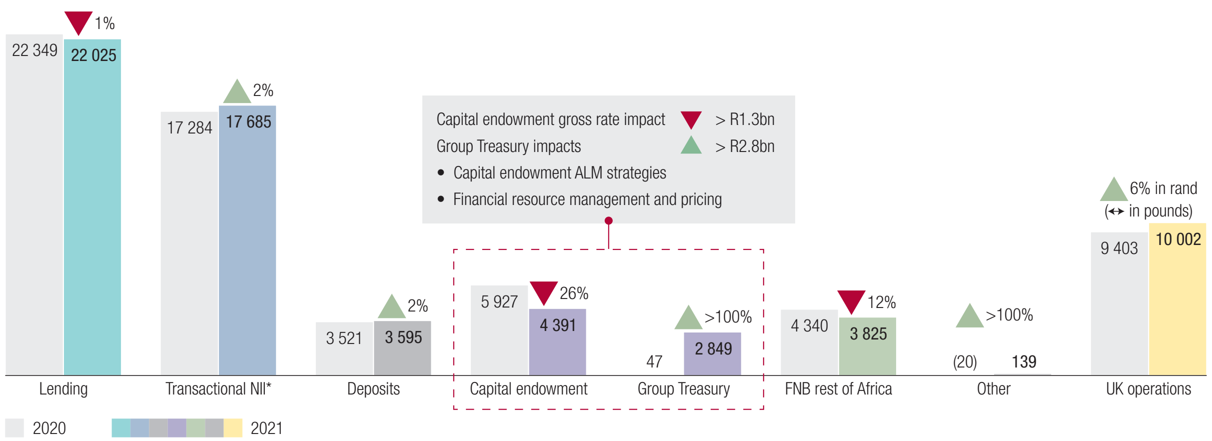
Deposit NII also increased 2%, benefiting from good deposit growth and reflecting customer migration to higher-rate investment products.

Despite good growth in deposits in the rest of Africa, and the inclusion of Ghana Home Loans (GHL) for a full year for the first time, NII was down 12%, due to the decline in advances across the portfolio and the negative impact of rand appreciation.

UK operations' NII was flat in pound terms. Advances increased marginally, supported by growth in vehicle asset finance (VAF), whilst the commercial and other retail books contracted as new lending activity was impacted by Covid-19. Endowment also negatively affected NII.

Capital endowment NII reduced 26%, reflecting the full impact of the rate cuts despite higher capital balances. Group Treasury NII increased R2.8 billion, reflecting the benefit of the capital endowment ALM strategies and lower funding costs from the improved funding mix due to the ongoing growth in the group's deposit franchise.

Net interest income
R million



* *Transactional NII includes the benefit of ALM strategies on deposit endowment.*

ALM strategies softened the negative endowment impact and supported margins

Overall net interest margin (NIM) declined 10 bps to 435 bps, driven mainly by the negative endowment impact – a satisfactory performance given the extent of the rate cuts.

The chart below shows that the UK operations reduce the group's overall margin by 46 bps, due to the secured nature of advances in that business.

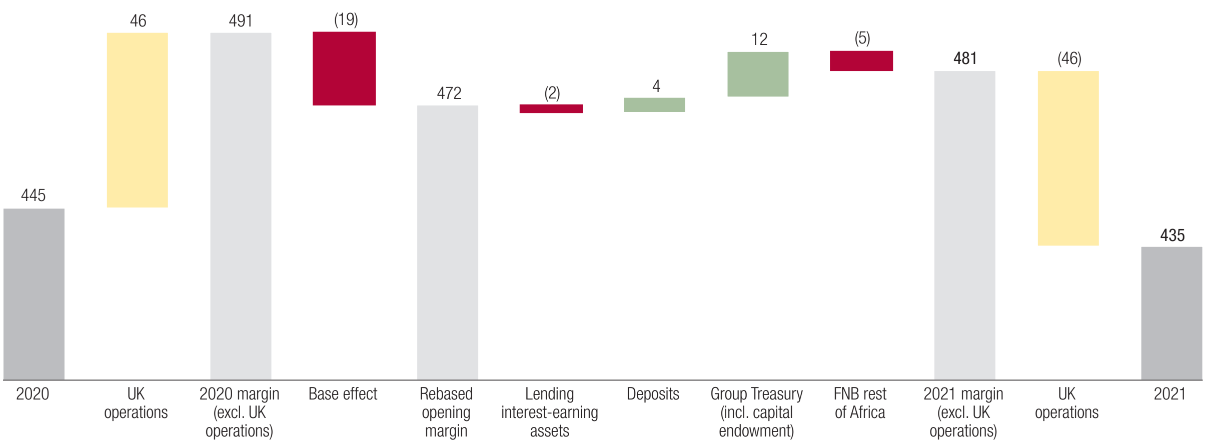
The group adjusted the way it calculates margins in December 2020. The impact of the change in balance sheet movement (base effect) is isolated and margins therefore only deal with rate changes. The boxes at the bottom of the chart show the rebasing of the prior-year margin due to the increase in average assets, which results in a reduction of 19 bps from 491 bps to 472 bps.

Lending margin declined 2 bps, reflecting asset repricing and higher NPLs (higher interest in suspense). This was partially offset by the benefit from a change in advances mix.

Overall deposit margin increased 4 bps. This was an exceptional performance driven by the strong growth in the deposit franchise and the lower proportion of higher-priced institutional funding relative to the prior year.

The benefit from Group Treasury's ALM strategies supported margins, however the total increase does represent a normalisation after the reduction in the prior year.

Normalised margin
Basis points



BASE EFFECT ADJUSTMENT

2020 NII	**R53.4bn**	2020 NII	**R53.4bn**
Divided by:		Divided by:	
2020 average balance sheet	R1 088.8bn	**2021 average balance sheet**	R1 132.3bn
2020 margin excluding UK operations	**4.91%**	**Rebased opening margin excluding UK operations**	**4.72%**

(19 bps)

Strength of deposit franchise supported lower institutional issuances

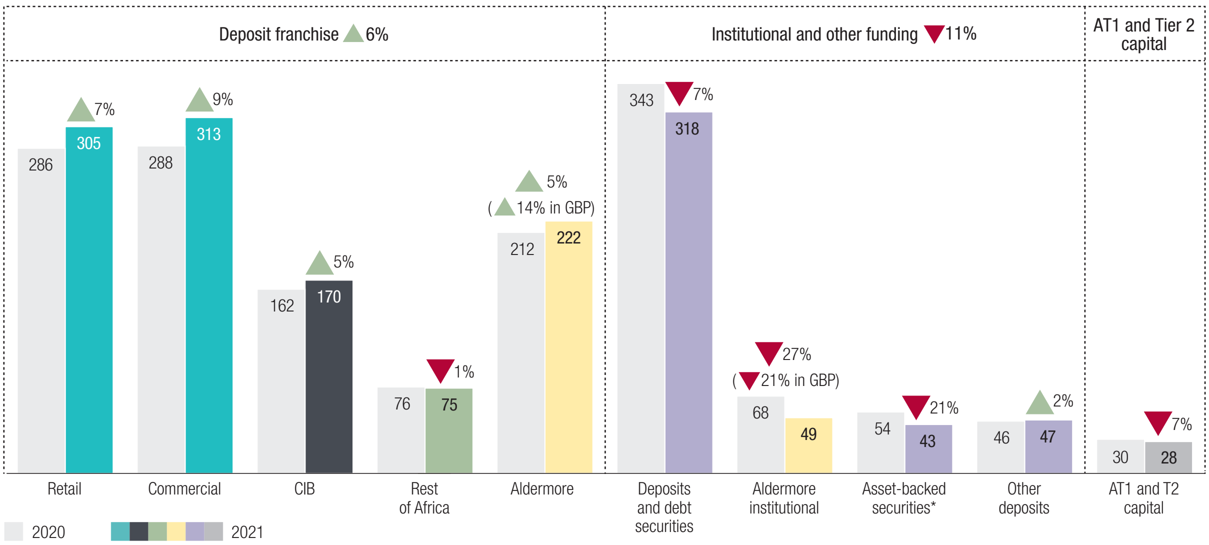
Due to the liquidity risk inherent in its activities, the group optimises its funding composition within structural and regulatory constraints to enable business to operate in an efficient and sustainable manner. The group entered the Covid-19 crisis in a strong liquidity position. The diversification and strength of the deposit franchise resulted in the liquidity position further improving during the crisis and thereafter.

The overall deposit franchise grew 6%, with strong performances from South Africa and the UK. The rest of Africa deposit growth was impacted by currency conversion due to the strengthening of the rand.

Strong deposit growth across operating businesses was driven by precautionary savings (due to uncertainties/lockdowns related to the pandemic), compelling savings propositions and good customer acquisition. In South Africa, FNB remained the top household deposit franchise from a market share perspective.

Because of the strong deposit performance and a slight decline in advances year-on-year, the group was able to marginally reduce its reliance on institutional funding and add to its liquidity buffers. The group's institutional funding issuances declined 7% year-on-year to R318 billion and FirstRand Bank's institutional funding reduced to 27.2% of total funding (2020: 31.7%), the lowest level in more than a decade. With this lower level of issuance, the group was also able to lengthen the weighted average term of institutional funding to 41 months (2020: 37 months), further improving its liquidity profile. Excess liquidity was mainly invested in short-dated government treasury bills.

Funding liabilities (up 0.3%)
R billion



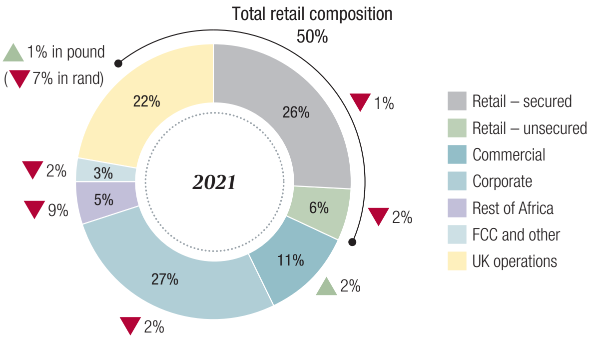
* *Asset-backed securities include Aldermore's securitisations.*

Note: Percentage growth is based on actual rather than rounded numbers shown in the bar graphs.

Disciplined risk appetite resulted in lower advances

Advances decreased 3% year-on-year and the following chart provides a breakdown of the movement in advances across the lending portfolios.

Advances breakdown



FNB's advances contracted marginally during the year, reflecting the business's continued prudent risk appetite and lower demand given the ongoing impact of Covid-19 on its customer base. Total rest of Africa advances reduced due to macroeconomic uncertainties and currency fluctuations – excluding the currency impact, FNB rest of Africa advances declined 5%. Commercial customers continued to maintain liquidity to support cash flow demands given the prevailing uncertainty.

RMB's core advances also contracted due to low levels of corporate activity and business confidence, and paydowns from clients as their liquidity requirements normalised compared to the Covid-19 drawdowns in the previous financial year. In addition, there was a negative impact of currency appreciation from the cross-border book.

WesBank advances declined 3% as the business adjusted its approach to origination given the competitive lending environment.

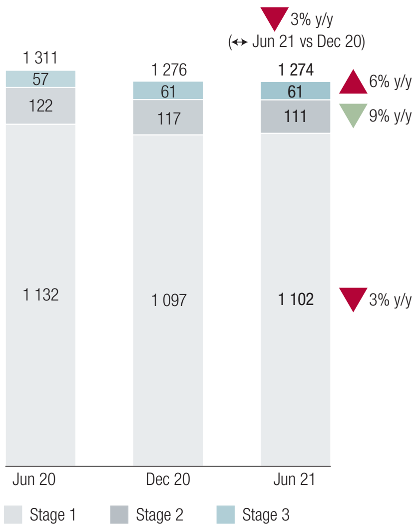
As previously mentioned, advances in the UK operations increased marginally, supported by growth in VAF, whilst the commercial and other retail books contracted as new lending activity was impacted by Covid-19.

Slight deterioration in stage distribution of advances

The following graph shows that the overall stage distribution of the book deteriorated marginally as the group followed a conservative approach to stage 2 migration and rolls into NPL. This was expected as relief periods expired and economic strain continued. The 9% decline in stage 2 reflects NPL migration, collection efforts and customer paydowns.

Advances

R billion



Note: Advances based on rounded numbers.

Relief book performed better than expected

The Covid-19 relief books fared better than expected. The retail relief book chart below shows a decline of 11% year-on-year, with almost a third of the book in arrears and half of the arrears in NPLs. This was a much better outcome than expected, demonstrating the group's prudent approach, supported by the economic rebound. Corporate and commercial relief advances halved with slight changes in arrears. The UK operations' relief portfolio also reduced.

RELIEF BOOK

Note: Rest of Africa decreased 49% since June 2020 (from R6.6 billion to R3.4 billion).

In summary, at a group level, the total relief book reduced to R167.1 billion (2020: R229.6 billion), with only 10% in NPLs.

NPL formation normalised, collection strategies supported lower NPL formation

The next table deals with the rolling six-month change in group NPL balances. It is pleasing to see that the reduction in operational NPLs continued in the second half of the financial year. Collection efforts resulted in paying NPLs increasing R2.7 billion year-on-year. The UK experienced a 34% increase in NPLs, which resulted in an overall increase of 6% in NPLs to 4.76% of advances (2020: 4.37%). Overall NPL coverage increased marginally to 45.3% (2020: 43.1%), mainly driven by mix change but partially offset by a higher proportion of paying NPLs. Product coverage was largely maintained.

INCREASE IN NPLs

	30 June 2021 vs 30 June 2020			30 June 2021 vs 31 December 2020		
	R million	**% change**	**Percentage point contribution to overall NPL increase**	R million	% change	Percentage point contribution to overall NPL increase
Operational NPLs*	**(1 559)**	**(4)**	**(3)**	(1 797)	(5)	(3)
Covid-19 relief paying NPLs**	**1 855**	**79**	**3**	776	23	1
Other paying NPLs#	**840**	**10**	**2**	(172)	(2)	–
NPLs (excluding UK operations)	**1 136**	**2**	**2**	(1 193)	(2)	(2)
UK operations	**2 288**	**34**	**4**	613	7	1
Total group NPLs	**3 424**	**6**	**6**	(580)	(1)	(1)

* *Include advances that received Covid-19 relief, other advances and debt-review ≥ 90 days in arrears.*

** *Include Covid-19 relief loans <90 days in arrears still subject to curing criteria.*

\# *Include debt-review and other advances <90 days in arrears still subject to curing criteria.*

SA retail NPLs as a percentage of advances grew to 9.05% (2020: 8.44%), driven mainly by the increase in residential mortgage NPLs given the ongoing pressures on consumers.

SA corporate and commercial NPLs as a percentage of advances decreased marginally, benefiting from the reduction in operational NPLs. However, NPLs relating to certain private equity exposures increased.

In the UK operations, NPLs increased to 3.16% of advances (2020: 2.18%), mainly due to the impact of lockdown restrictions and normalisation of book growth. Aldermore and MotoNovo granted second and third payment holidays to existing clients, with third payment holidays being viewed as a default event, these clients were classified as stage 3/NPL. The previous ban on collateral repossessions in the UK also contributed to NPL growth.

As mentioned above, the overall relief book decreased from R229.6 billion to R167.1 billion, given that no further relief was extended and customers commenced repayments. Corporate and commercial reflected the largest decline as these counterparties paid off their facilities as liquidity improved. The proportion of the portfolio under relief was 13% of advances at 30 June 2021 (2020: 18%).

Impairment charge was driven by stage migration

As required under IFRS 9, FirstRand revised its macroeconomic forward-looking outlook, with positive revisions to key economic variables compared to the prior year given the rebound in the economy. Overall performing coverage reduced given this change. However, the group included an additional stress scenario given the ongoing uncertainty in the system resulting in only a marginal reduction in performing coverage. NPL growth of 6% was better than expected, benefiting from a 35% increase in write-offs. These drove the 44% reduction in the overall impairment charge to R13.7 billion (2020: R24.4 billion) as analysed in the table below.

ANALYSIS OF IMPAIRMENT CHARGE

	Six months ended						
R million	**30 June 2021**	31 December 2020	30 June 2020	31 December 2019	Jun 21 vs Dec 20 % change	Dec 20 vs Jun 20 % change	Jun 20 vs Dec 19 % change
Performing book provisions	**(2 228)**	663	8 950	90	(>100)	(93)	>100
NPL provision	**(544)**	3 347	4 868	1 310	(>100)	(31)	>100
Credit provision increase/(decrease)	**(2 772)**	4 010	13 818	1 400	(>100)	(71)	>100
Modification	**348**	294	513	494	18	(43)	4
Gross write-off* and other**	**7 940**	6 267	5 115	5 417	27	23	(6)
Post write-off recoveries	**(1 270)**	(1 157)	(997)	(1 377)	(10)	(16)	28
Total impairment charge	**4 246**	9 414	18 449	5 934	(55)	(49)	>100
Credit loss ratio (%)	**0.67**	1.46	2.87	0.95			
Credit loss ratio excluding UK operations (%)	**0.90**	1.64	3.15	1.06			

* *Write-off of gross balances excluding prior year provisions held.*

** *Net interest recognised on stage 3 advances of R3 369 million (2020: R3 125 million) is excluded from write-off and other.*

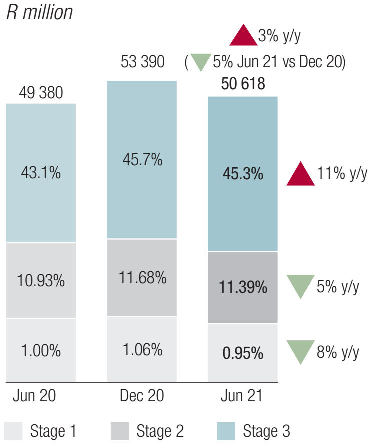
This table also demonstrates the move in impairments on a rolling six-month view, based on movements in the balance sheet. Provisions for the six months to June 2020 reflect the significant impact of the negative macros. For the six months to December 2020, the performing book coverage increased despite the improving macro environment, largely due to judgemental out-of-model provisions recognised, given the ongoing uncertainties at that time. The provision release of R2.2 billion for the performing book for the six months to June 2021 was driven by the improvement in macro assumptions, relatively lower levels of uncertainty and the release of Covid-19-related provisions. The NPL provision release reflects the relative improvement in mix, with a larger portion of paying NPLs.

Provisioning remains prudent

The table below shows the value of balance sheet provisions and credit loss ratios for the last three reporting periods. The bar chart depicts the balance sheet provisions with coverage for each stage shown inside the bars and demonstrates that the level of stage 2 balance sheet provisions declined 5% year-on-year. Stage 3 provisions increased 11% year-on-year, but declined 2% since December 2020. Although macros rebounded, impairment coverage remains prudent across stages, with the incorporation of an additional temporary short-term stress scenario and other post-model adjustments to capture the uncertain environment and lag effects.

Balance sheet provisions, coverage and credit loss ratio

R million



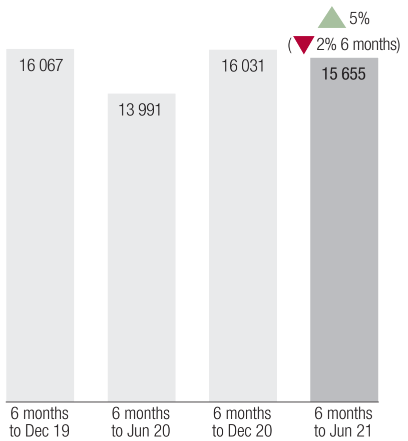
	June 2021	December 2020	June 2020
Provisions (R million)	**50 618**	53 390	49 380
Credit loss ratio (%)	**1.06**	1.46	1.91

Stage 1 coverage reduced 5 bps to 95 bps given the improvement in the group's forward-looking outlook. Overall NPL coverage increased to 45.3%, mainly driven by mix change partially offset by a higher proportion of paying NPLs. Product coverage was largely maintained.

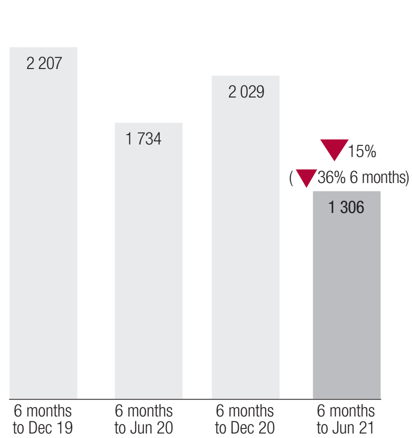
Operational NIR benefited from the economic rebound

Total group operational non-interest revenue increased 3%, mainly driven by resilient growth in fee and commission, and trading income.

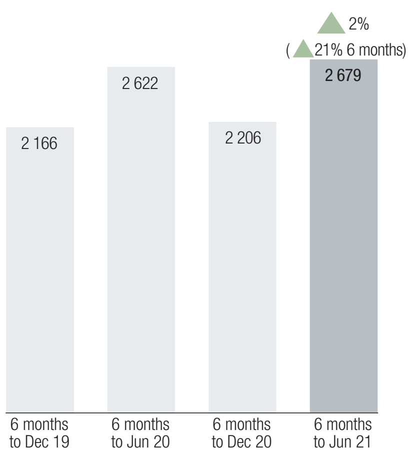
Fee and commission income
R million



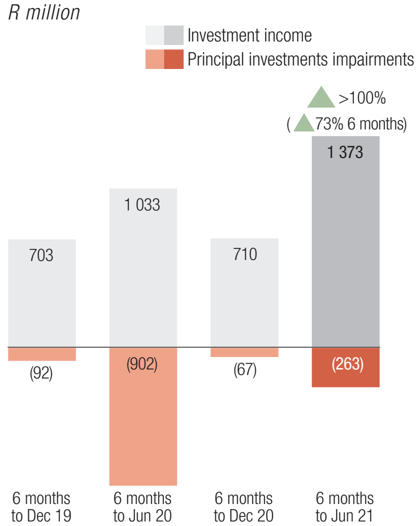
Insurance income
R million



Trading and other fair value
R million



*Investment income**
R million



* *Includes share of profit from associates and joint ventures.*

Fee and commission income grew 5%, benefiting from the economic rebound and base effect, as well as the increase in active customers, despite no increase in headline fees in the last year.

The 15% decrease in insurance income was mainly due to the ongoing impact of the pandemic, resulting in an increase in mortality and retrenchment claims paid and provisions raised. The reduction in new business sales was as a result of a decline in credit life policies. There was good growth in all other insurance business lines, resulting in in-force annual premium equivalent (APE) growth of 11% and gross premiums increasing 9%.

RMB's trading activities delivered another strong performance. The performance was due to a significant rebound from domestic fixed income and specifically the inflation desk, which benefited from the normalisation of market conditions, market making and client facilitation. This was partly offset by reduced activity in nominal bonds and options. The commodities business performance benefited from increased gold demand from India together with revenue earned from the hedging of client flows.

Investment income includes principal investments and private equity. Private equity income growth was driven by annuity income growth as both old and new vintages performed strongly, benefiting from the cyclical recovery in SA macroeconomic conditions. The strong annuity performance was supplemented by realisation income of c. R400 million, which mitigated the impact of additional credit provisioning and equity impairments required against specific counterparties. Private equity loan impairments are included in the credit charge. The impairments against principal investments are included in NIR, and these decreased from c. R1 billion in the prior year to just over R300 million in this financial year. The quality and diversity of the private equity portfolio are reflected in the unrealised value of R4.4 billion (2020: R3.3 billion). Acquisition opportunities were muted during the year, resulting in limited new investments.

Below-inflation increase in operating expenses

Growth in operating expenses was contained at 3%, reflecting the continued focus on cost management across the business. It was also achieved despite ongoing investment strategies in:

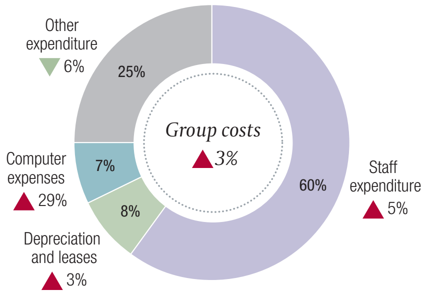
> insurance and asset management;

> build-out and consolidation of the domestic enterprise platform;

> build-out of the group's footprint in the rest of Africa; and

> process and system modernisation in the UK business.

Additional costs associated with managing employee and customer well-being on premises and in branches, and the facilitation of remote working for a significant proportion of employees, continued to be incurred. Overall cost growth did benefit from lower travel and related costs as well as lower cooperation agreement costs. The cost-to-income ratio improved marginally to 52.4% (2020: 52.9%).



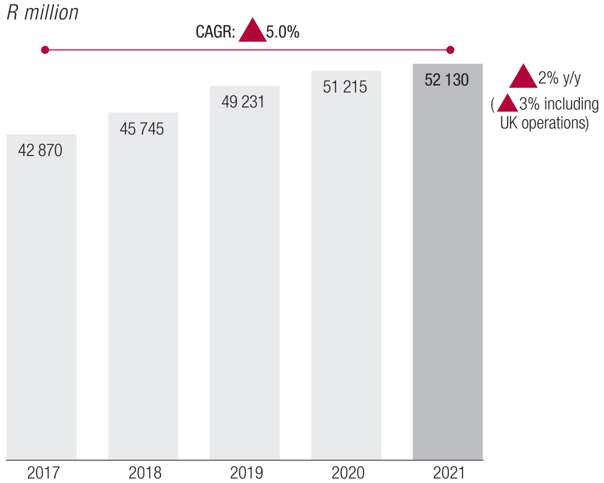
The group continues to invest in technology and platform and the majority is expensed. Total IT costs grew 12%, including computer expenses, which increased 29%.

Staff expenditure accounts for c. 60% of the group's total cost base and increased 5%, due to growth in variable remuneration as earnings recovered. Direct staff costs increased 3%, which reflects average unionised salary increases in South Africa of 4.2% and a 3% reduction in overall headcount (excluding FirstJob) despite continued growth in new initiatives.

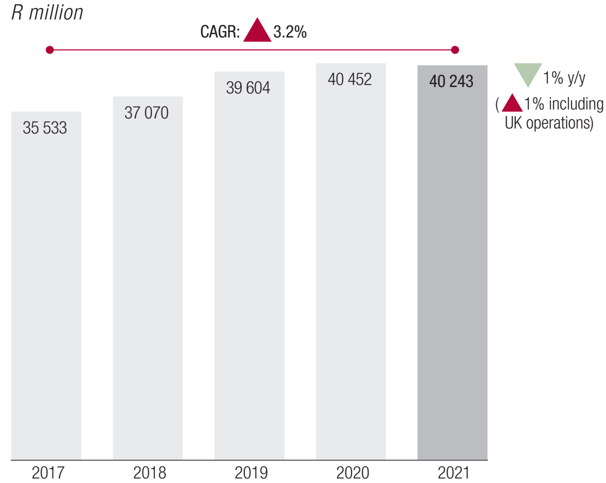
The following charts demonstrate that expenditure is aligned to strategy. The build-out of the group's platform enablement is reflected in the operating cost trend. Excluding the UK operations' overall costs (as Aldermore was only acquired in 2018), there was a 5% compound annual growth rate (CAGR) in overall operating expenses since 2017. This was weighted towards IT spend, which increased 12.8% over the same period. Staff expenditure grew at a compound rate of 5.4%, a combination of above-inflation salary increases and headcount growth.

With CAGRs of 5.4% in staff costs and 12.8% in IT costs since 2017, the group has extracted efficiencies in other areas to deliver an overall 5% CAGR in operating expenses.

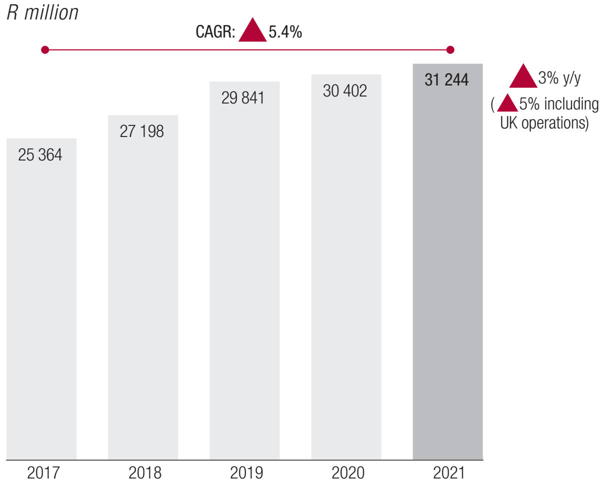
*Operating expenses**
R million



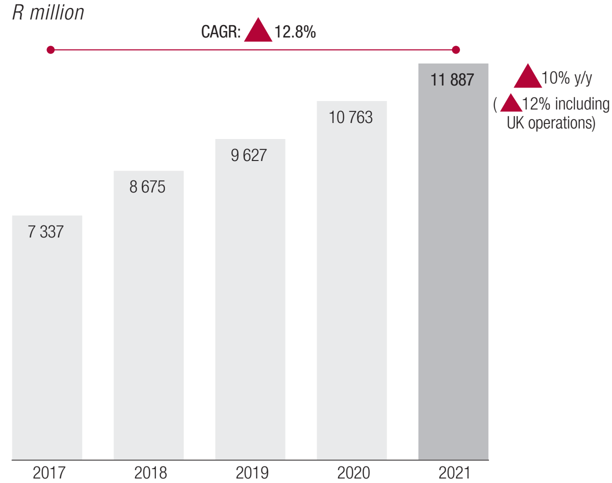
*Operating expenses excluding IT costs**
R million



*Staff costs**
R million



*IT costs**
R million



* *Excluding UK operations.*

The group continues to protect and strengthen its balance sheet

The structure of the group's balance sheet reflects FirstRand's long-term strategy to increase balance sheet resilience, diversify credit exposures across sectors and segments, increase market liquidity, and reduce reliance on institutional funding.

The group's internal capital targets remain appropriate as a maximum domestic systemically important bank (D-SIB) and fully phased-in Pillar 2A requirement are assumed in the target assessment. These targets were not adjusted for any temporary Covid-19 relief measures.

The group's CET1 ratio strengthened further to 13.5% (2020: 11.5%), which is well above its internal target range of 11.0% to 12.0%. In line with FRM principles, both NAV and CET1 have been accretive over the year as the group increased its focus on risk-weighted assets (RWA) optimisation and efficient use of financial resources.

Key factors impacting the CET1 ratio year-on-year:

> positive earnings partly offset by the payment of an interim dividend for the 2021 financial year;

> capital preservation measures introduced by the Prudential Authority (PA) in 2020;

> a decrease in the foreign currency translation reserve given the rand appreciation;

> successful financial resource optimisation strategies;

> a decrease in RWA, mainly from credit and counterparty credit risk driven by rand appreciation and muted advances growth; and

> the incorporation of the IFRS 9 transitional impact

As mentioned earlier, the group entered the Covid-19 crisis in a strong liquidity position. The diversification and strength of the deposit franchise resulted in the liquidity position improving during the crisis and thereafter. Liquidity buffers remain appropriate to meet both prudential liquidity requirements and internal risk targets. In order to allow markets to continue to operate smoothly and provide banks with temporary liquidity relief during the crisis, the PA temporarily reduced the prudential liquidity coverage ratio (LCR) requirement from 100% to 80%, which the group did not utilise. The group's LCR of 113% (2020: 115%) remained well above the minimum requirement. The minimum regulatory requirement for the net stable funding ratio (NSFR) remained unchanged at 100% and the group's NSFR increased to 123% at 30 June 2021 (2020: 117%).

The pandemic continues to negatively affect the South African economy, and key risk metrics and early warning indicators are closely monitored. The group regularly forecasts its liquidity position and uses scenario analysis in its decision-making.

Conclusion

For the six months to 31 December 2020, the FirstRand board repositioned the dividend cover into the bottom end of the group's target range of 1.8 to 2.2 times, in anticipation of the expected medium-term growth in the economies in which the group operates. The group continues to accrete capital, which provides sufficient capacity for growth. The board was therefore comfortable to maintain a dividend cover of 1.8 times for the year and considers this level of distribution to be appropriate and sustainable over the medium term.

The group has emerged from the pandemic in a strong position and is well positioned to fully capitalise on the economic recovery.

HARRY KELLAN ~ CFO