FirstRand

CHAIRMAN'S STATEMENT 2024

"A challenging backdrop, but the group is cautiously optimistic for the future."

JOHAN BURGER
Chairman

The ANC's performance in the 2024 elections was ultimately a foregone conclusion. Voters expressed their anger and disillusionment at ever-increasing joblessness, inequality and unsustainable levels of loadshedding, resulting in support for the ANC falling to 40.2%, compared to 57.5% in 2019.

However, what stands out was the mature leadership of President Ramaphosa and the parties involved in forming South Africa's Government of National Unity. The importance of this cannot be underestimated. In other countries, governing parties have refused to accept the "voice of the people" and used all means to stay in power.

In contrast, President Ramaphosa called the election a "victory for our democracy". "This is the time for all of us to put South Africa first," he said. Other members of the ANC stated that the party was "humbled" by the result, and committed to forming a government "that is stable and able to govern effectively".

It's interesting that a country ever haunted by the spectre of social unrest once again navigated itself to a place of unity. This says something important about the psyche of South Africans. They want the country to prosper, they want to work together to make that happen, and even the most extreme rhetoric of the more partisan politicians did not destroy that will to unite. Over those two tense weeks after the election, everyone was willing the government to find a new path to collaboration and partnership, and whilst the Government of National Unity is not perfect, is fragmented and still finding its feet, the opportunity for change has not been wasted. Of particular importance is the narrative from the new government that it intends to work closely with the private sector, with a reformist agenda.

There is no doubt that the financial markets were delighted at the outcome. Equity markets swiftly re-rated, the bond market rallied and the currency strengthened. Whilst these improvements are only early signs of optimism and it will take a long time for the real economy to also benefit, there are multiple reasons to be positive.

The Director-General of the National Treasury recently mentioned that 35% of the growth slowdown from 2007 to 2021 can be attributed to the underperformance of the state-owned enterprises running critical infrastructure such as electricity, rail and ports. This underperformance has undermined economic growth and constrained trade. The Presidency responded with the creation of Operation Vulindlela, with a mandate to accelerate structural reforms. If these reforms are successfully implemented GDP growth could trend back above 2% over the medium term.

Also weighing on economic activity is the collapse of service delivery in several municipalities. Not only has the lack of basic services created hardship for vulnerable households, it is also restraining business activity and adding to the cost of doing business. Many of the municipalities are also facing financial difficulties, unable to pay their service providers or conduct important infrastructure maintenance.

With the attention now shifting towards supporting reforms on a municipal level, there is further potential to improve conditions, achieve a higher growth trajectory and improve socio-economic conditions. The challenges however remain significant. Municipal finances need to be addressed, skills developed and infrastructure repaired and upgraded.

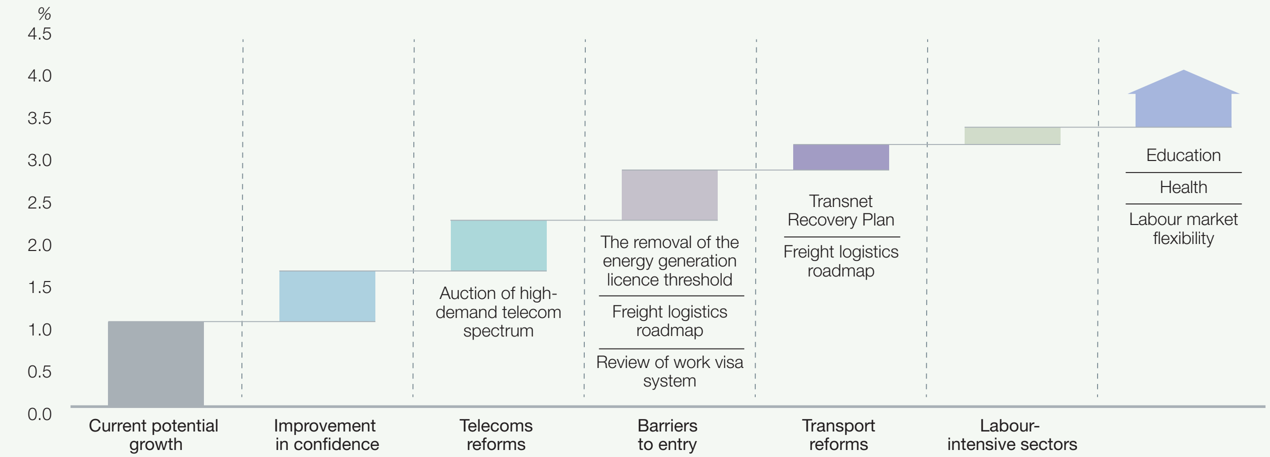
Operation Vulindlela is now reporting on progress actually made, rather than reporting on future plans or policy discussions. This is a subtle but significant shift that provides stakeholders with greater reassurance that, after a few "false dawns", this time may be different. Progress that has been reported to date, which FirstRand is encouraged by, includes:

- The removal of the energy generation licence threshold in December 2022 allowed for an increase in private investment in projects of any size selling power to multiple customers. This, along with improved Eskom fleet management, has resulted in a significant reduction in loadshedding this year. The pipeline of confirmed projects now numbers over 130, equalling a generation capacity of approximately 22 500 MW, with an estimated investment value of R390 billion, excluding rooftop solar.
- The auction of the high-demand telecommunications spectrum (completed in March 2022 – ending a ten-year delay) has allowed for the rollout of 5G networks, enhancing network quality and download speeds.
- The Transnet Recovery Plan has seen an improvement of approximately ten million tonnes of carrying capacity on the rail network against the pre-recovery trend. Interventions at key port terminals have seen a 73% reduction in vessels at anchorage since November 2023. Security incidents on the Northern Corridor transport route have reduced by over 60%.
- Seventy-two per cent of water use licence applications have been processed within a new 90-day target (from a baseline of over 300 days), and the backlog of licence applications has largely been cleared.
- The revised immigration regulations to make it easier to apply for a South African work visa were published on 20 May 2024, following consideration of public comments.

These developments are very encouraging, but possibly more encouraging is the working relationship that is being formed between government and business, and their social partners. Stakeholders are now working together and holding each other to account in the interests of a revived, pluralistic, national project.

The particular success of the private sector's role in addressing the energy crisis of the country represents a blueprint for many further initiatives to unlock these much-needed reforms.

This will however require substantial investment by both government and the private sector, and more importantly partnership and collective accountability. Private Public Partnerships will be key to unlocking these large infrastructure projects, which will over the medium to long term drive economic growth, create jobs and reduce poverty and inequality.



Source: Operation Vulindlela, National Treasury, FirstRand

The schematic above demonstrates how structural reforms can contribute to lifting the production capacity of the South African economy. A first version was produced by National Treasury in the 2018 Budget Review and the group continues to adjust and track it as policy and reform developments play out.

These reforms will also contribute to lowering the cost of doing business and creating access to markets, which was previously difficult to achieve. This should create a more supportive environment for small, medium and microsized enterprises (SMMEs), which can be further enhanced if the government implements business-friendly policies designed to enable this crucial sector of the economy to thrive. Access to finance and markets remains a critical concern for SMMEs.

This is where the banking sector needs to step in more deliberately. It is possible that large corporates may wait longer for clearer signals on structural reform, whilst SMMEs will respond faster, and look for funding to embark on growth opportunities. The broader benefits of a thriving SMME sector cannot be underestimated as they create income and job opportunities, ultimately uplifting the communities in which they operate.

Removing South Africa from the Financial Action Task Force (FATF) grey list will also go a long way to boosting business confidence and assist in attracting foreign capital. So far progress in achieving this has been encouraging. That said, demonstrating a sustained increase in investigations and prosecutions of corruption and money laundering will not only represent a significant step towards grey-list removal, but it will also enhance confidence in South Africa's institutions.

A stronger and more vibrant economy will make it easier for government finances to remain sustainable. So far, the Minister of Finance and National Treasury should be commended for their efforts to achieve fiscal consolidation. Whilst without stronger growth even these efforts may not be enough, if South Africa's institutions strengthen, if the government and the private sector continue to build production capacity and if confidence consistently improves, higher economic growth will follow. This will provide the government with renewed fiscal space to address the social challenges the country faces.

FirstRand's performance for the year to June 2024

FirstRand's franchises are well positioned for growth opportunities as they emerge. The quality of its results for the year to June 2024 is testament to the strength of the business, particularly its client franchises, and its ability to make big strategic calls to deliver value to shareholders.

As Mary Vilakazi, group chief executive officer (CEO), said in September when FirstRand announced its year-end results, the operating environment remained challenging.

How the rate cycle played out was probably the most significant macro call-out, particularly as it was worse than the group initially predicted, with rates higher for longer.

However, the group's origination thesis offset the full impact of this unexpected cycle as the lending businesses drew back completely from high-risk business and focused on low-to-medium-risk business.

The group has previously alerted shareholders that it would be raising an accounting provision relating to the regulatory review of the payment of commissions in the UK motor finance sector.

As explained, the group's vehicle and asset finance business in the UK, MotoNovo, together with the rest of the motor finance sector, is under review by the Financial Conduct Authority (FCA), which is looking at dealer commission practices.

The group does not believe that MotoNovo contravened any legislation or regulations. The cases that have been tested in the UK courts support this view, given that more than 70% of these cases have found in favour of MotoNovo.

However, the FCA process creates uncertainty for the next six months, therefore, in line with other players in the market, FirstRand raised an accounting provision of R3.3 billion.

Even when including the provision, the group's financial strength was demonstrated by resilient earnings growth of 4%, a return on equity (ROE) well placed in the middle of the stated range of 18% to 22% and solid growth in net asset value.

It is also demonstrated by the group's capacity to grow the dividend significantly above earnings (+8%), given the high ROE and ongoing capital generation.

This performance is a highly positive outcome for shareholders given the provision and the difficult macros.

The group delivered R10 billion of net income after cost of capital (NIACC), which is its key performance measure. The 13% decrease year on year (2023: R11.9 billion) is made up of the provision (representing 6% of the decrease) and the increase in cost of equity (representing 7% of the decrease). Shareholder value continues to be created in a year of managing difficult externalities.

Excluding the provision mentioned above, normalised earnings increased 10% to R40.4 billion, which is a more accurate reflection of the actual underlying operational performance of the business.

The outperformance in the second half of the year was significant. Compared to the 6% growth in the six months to December 2023, earnings increased 14% in the six months to June 2024.

Excluding the provision, the group's ROE is trending close to the top end of its stated range and NIACC increased 6%.

Also unpacked at the results presentation was an explanation of the reasons for the group's superior ROE remaining resilient and sustainably higher than peers. This is an important topic I would also like to touch on.

The superior ROE is due to the shape of the business in terms of asset mix, in particular the relative size of lending portfolios that deliver higher risk-adjusted margins, and the relative size of the deposit franchise which brings with it capital-light net interest income.

This balance sheet outcome has been very deliberate and is a direct result of FirstRand's financial resource management process which ensures disciplined allocation of financial resources to optimise shareholder value.

The ROE is also supported by the group's large transactional franchise (particularly at FNB) and its long-standing strategy to diversify sources of non-interest revenue and grow new sources of capital-light revenues. By way of example, FirstRand has built a highly profitable insurance business, and RMB is unique in that it has a long track record in private equity, which has been a consistent generator of high returns.

Managing a successful succession process

In October 2023 the FirstRand board informed shareholders that following a succession planning process, developed over multiple years, a number of executive management changes were to take place from 1 April 2024.

Alan Pullinger stepped down as group CEO and was succeeded by Mary Vilakazi, who at that time was FirstRand's chief operating officer (COO).

Alan's career at FirstRand spanned 26 years, including the role of RMB CEO until his promotion to FirstRand deputy CEO in early 2015. He became group CEO in early 2018 and, at the time of this appointment, indicated to the board a time horizon of six years. As such, succession planning for this role was anchored to his expected departure in 2024.

Mary joined FirstRand as group COO in 2018 and the board was delighted to appoint a strong internal candidate to the group CEO role. As one of three FirstRand executive directors, Mary worked closely with Alan and developed a deep knowledge of the strategies and operations of the underlying portfolio of businesses.

At the same time, after ten years as chief financial officer (CFO) and financial director of FirstRand, Harry Kellan took up the role of CEO at FNB. Harry joined FNB in 2005 and spent seven years as CFO, after which he was appointed FirstRand CFO in 2014. Harry's long tenure at FNB prior to his group role has positioned him well to lead the largest customer franchise in the portfolio. Harry was succeeded by Markos Davias, who was the CFO of FNB and previously the CFO of RMB. His tenure as CFO of the two largest franchises in the group made him the ideal candidate for group CFO. Gideon Joubert, at the time the CFO of the group's broader Africa portfolio, has replaced Markos at FNB.

After ten years as CEO of FNB, Jacques Celliers has taken up a new role with executive responsibility for the group's fintech strategy. The group has a stated objective to grow revenue streams from activities ancillary to financial services, and many of these activities have been built within FNB over a number of years. This strategy now requires dedicated leadership to scale and grow and Jacques's track record means he is the ideal person to drive this initiative.

These multiple changes perhaps looked challenging, however the board believes these management appointments have created significant longevity in critical leadership roles and demonstrate the benefits of a structured, multi-year succession programme.

This programme, which has allowed this level of promotion from within, has translated into a very smooth transition of responsibilities. The board is comfortable and excited in equal measure about the calibre of the individuals and the quality of new collective thinking Mary has already unlocked as CEO.

Conclusion and thanks

In conclusion I need to thank a number of people.

Firstly, Roger Jardine, who retired as chairman in December 2023. Roger made an invaluable contribution as a director and following his appointment as chairman in 2018, provided strong stewardship of the board, including its reconstitution, the challenges presented by the Covid-19 pandemic and management succession.

After nine years on the board as a non-executive director, Russel Loubser retired during the year. I would like to acknowledge the significant contribution Russel made during his tenure. His passion for the group and incredible work ethic made him a formidable board member. His institutional knowledge will be missed.

As mentioned above Alan Pullinger retired in June 2024, after a 26-year career at FirstRand. He steered RMB through the difficult years post the global financial crisis, building a diversified corporate and investment banking business, still considered the best in class in South Africa. As CEO of the group, he navigated the challenges of Covid-19, from which the group emerged in better shape than many of its peers.

Finally, I would like to express my respect for and gratitude to every employee of the group. It is your hard work and commitment that produces FirstRand's proud track record of outperformance.

JOHAN PETRUS BURGER
CHAIRMAN

FirstRand

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