Group Financial Director's report

Despite a challenging backdrop, we are pleased with the improved underlying momentum of our new growth strategy.

2018 Overview[1]

Real GDP growth across our regional operations presence countries was considerably higher than South Africa, averaging 5.6% in 2018, compared to South Africa's weak 0.8%. Mozambique and South Africa's GDP growth were below our expectation, while Ghana and Uganda were above our expectation. Interest rates declined in all our markets, with significant cuts in Ghana, Mozambique, Tanzania and Zambia. While good for credit impairments and loan growth, this also reduced our net interest margin. Although differing by country, on average the rand was slightly stronger in 2018 than in the regional portfolio. Currency depreciation in Absa Regional Operations (ARO) reduced its earnings by 4% last year; however, the spot rand rate was almost uniformly weaker year-on-year, which added 13% to asset growth.

Our revenue growth improved from last year, but remains moderate. Our underlying growth was slightly better, with revenue up 5%, excluding the impact of IFRS 9. Our credit impairments fell 10%, although the improvement excluding IFRS 9 was 1%. Operating expenses remain well controlled at 5% and have improved year-on-year, resulting in 1% higher pre-provision profits, or 5% excluding IFRS 9.

Our headline earnings grew 3% to R16.1bn and return on equity improved slightly to 16.8%. Our profit after regulatory capital charge, which is a version of economic profit, rose 5% to R2.7bn.

Our balance sheet remains solid, with strong capital levels and liquidity and prudent provisioning. We are strongly capital generative and our common equity tier 1 ratio of 12.0% is well above our Board target range, which allowed us to declare a 4% higher ordinary dividend per share.

Separation

As outlined on page 26, significant progress has been made in the Separation. We reported in 2017 that Barclays contributed GBP765m or R12.6bn to enable us to take the steps required to achieve the Separation. The benefit of receiving the contribution upfront is the foreign exchange gains and interest earned on the contribution invested.

To date we have spent R7.6bn on Separation execution (including technology and brand projects and programme support) and R1.5bn on transitional services agreement costs. Platinum projects have been about R3bn of this. We still expect that Separation will be capital and cash flow neutral over time as spend is incurred and we have sufficient contingency within the funding to complete the remaining projects and mitigate possible overruns.

ARO enhanced our growth

The return on equity of ARO has improved materially from 13% in 2013, when we purchased eight banks from Barclays, to almost 19%. We believe this should increase further medium-term, as we reduce RBB's high 71% cost-to-income ratio and grow our CIB franchise, where returns are attractive.

ARO continued to enhance our growth with earnings of R3.2bn, up 9% (13% in constant currency), which accounted for 19% of total earnings and 21% of revenue. Although its pre-provision profits increased 3%, significantly lower credit impairments were the main driver of its growth.

CIB Africa grew 7% (11% in constant currency) to R2.5bn and accounts for 75% of ARO's earnings (excluding Head office, Treasury and other). RBB Africa's earnings rose 26% (29% in constant currency) on 10% higher pre-provision profits and 14% lower credit impairments.

View our 2018 results presentation on absaafrica2018ar.co.za

[1] The Separation will impact the Group's financial results for a number of years, and so we provide normalised financial results to adjust for the Separation's consequences and to better reflect our underlying performance. We will present normalised results for periods where the financial impact of the Separation is considered material and use this view in our internal reporting, performance management and capital and dividend decisions. We continue to present International Financial Reporting Standards (IFRS)-compliant financial statements, as required by the Companies Act and the JSE Listings Requirements, as well as a reconciliation of these two views in our 2018 Financial results booklet.

Accounting changes

We adopted IFRS 9 from 1 January 2018, and as a result, credit impairments have moved to a lifetime expected credit loss approach from an incurred basis. Relative to previously published numbers, IFRS 9 has resulted on a reduction of R5.4bn in retained income which is mainly reflected in an increase of R7.0bn in the Group's credit provisions and interest in suspense on the adoption of IFRS 9. IFRS 9 brings forward the recognition of credit provisions, although our charge should not differ through the cycle. This creates some new business strain as banks grow their loans and also introduces greater volatility, as there is a cliff effect when loans move between stages. For instance, our December 2018 coverage on retail mortgages in South Africa ranged from 0.15% in stage 1, to 1.7% in stage 2 and 26% in stage 3.

The implementation of IFRS 9 was complicated and we highlight two topical technical issues. Firstly, there has been substantial global technical debate on how to treat post write-off recoveries in calculating loss given defaults. We reconsidered our treatment and have excluded these recoveries from loss given defaults, which resulted in a R1.9bn or 7% increase in our credit provisions and interest in suspense adjustment as at 1 January 2018. Secondly, in November the sector received the conclusion from the International Financial Reporting Interpretations Committee (IFRIC) on how to treat interest in suspense which is recovered on cured stage 3 assets. As a result, for 2018 we have amended our accounting treatment and included R608m as a credit impairment gain rather than reflecting this in interest income as we previously did. The change reduced both our revenue and our credit impairments, and had no impact on our bottom line.

Further information on IFRS 9 and the adoption of other new standards are outlined in our 2018 Financial results booklet (page 148 Reporting changes).

Income statement analysis

on a normalised basis

	2016 Rm	2017 Rm	**2018 Rm**	Change %
Net interest income	42 003	42 319	**43 425**	3
Non-interest income	30 391	30 671	**32 235**	5
1 **Total revenue**	72 394	72 990	**75 660**	4
2 Operating expenses	(39 956)	(41 403)	**(43 642)**	5
3 **Pre-provision profit**	32 438	31 587	**32 018**	1
Credit losses	(8 751)	(7 022)	**(6 324)**	(10)
Other impairments and indirect tax	(2 120)	(1 876)	**(1 832)**	(2)
Associates and joint ventures	115	170	**179**	5
Profit before taxation	21 682	22 859	**24 041**	5
4 Taxation	(5 835)	(6 290)	**(6 766)**	8
Profit after taxation	15 847	16 569	**17 275**	4
Attributable earnings	14 708	15 370	**15 903**	3
Non-controlling interest	1 139	1 199	**1 372**	14
Headline earnings	14 980	15 623	**16 128**	3

1 Revenue growth improving

Revenue growth improved from last year but remains moderate. Our underlying growth was slightly better, with revenue up 5% excluding the impact of IFRS 9.

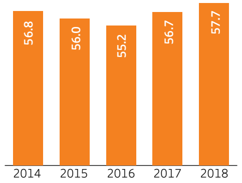
Momentum building in non-interest income

Non-interest income growth improved from 1% in 2017 to 5% (6% in constant currency) increasing to 43% of total revenue. Net fee and commission income is 70% of non-interest income, and it grew 4% (or 6% excluding the sale of Employee Benefits). Net trading income increased 7%. In South Africa, Markets income increased 10% off a relatively low base, while Absa Regional Operations Markets declined 2% off a high base.

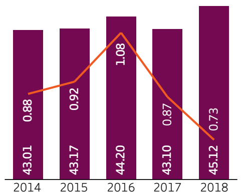
IFRS 9 reduced net interest margin

Reclassifying recoveries on cured accounts from interest income to credit impairments, along with increased suspended interest, decreased our net interest income by R1.1bn and reduced our margin by about 12 basis points. Excluding these IFRS 9 transition impacts, on a like-for-like basis, our Group net interest margin declined slightly in line with our guidance.

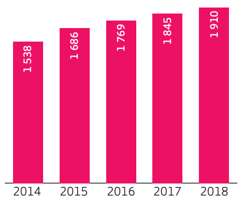
Cost-to-income ratio (%)



Credit loss ratio/ Non-performing loan coverage ratios (%)



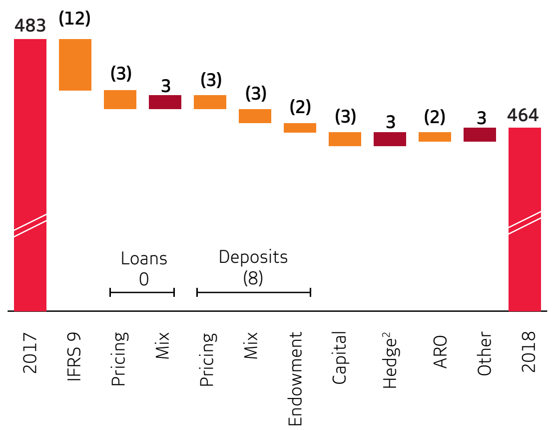
Diluted headline earnings per share (cents)



Despite stronger CIB growth, loan mix improved our margin largely because of slow growth in mortgages, although the latter improved in the second half. Our deposit margin narrowed due to pricing competition for retail fixed deposits and higher wholesale funding, while lower interest rates reduced the endowment on our equity and deposits. We continue to hedge structural balances of about 13% of our South African capital and liabilities. Our structural hedge released R518m to income, 3 basis points more than last year, to partially offset the negative endowment impact.

Lower rates across ARO reduced our group margin by 2 basis points. Within 'Other', Treasury's improving asset/liability construct in South Africa added 6 basis points which was partially offset by the reduction between the prime interest rate and JIBAR. With 7% higher average interest-bearing assets, our net interest income rose 3% to R43bn.

Change in net interest margin[1] (basis points)



1 Average interest bearing assets
2 Interest rate risk management

2 Continued to manage costs while investing

Operating expenses remain well controlled, growing at 5% (6% in constant currency), to R44bn. Although negative, our operating Jaws improved and our pre-provision profits were 1% higher, or 5% when excluding the effects of IFRS 9. Operating costs included R750m in incremental run costs as we build out the capabilities required following the Separation, R200m in RBB SA restructuring costs and R200m in rebranding costs. Excluding these items, the underlying cost growth was 3%, and the constant currency cost growth has been in line with inflation for the past three years.

Staff costs increased by 4% with salaries up 7%, while incentives declined 2% largely due to lower share-based payments and deferred bonuses. Non-staff costs increased 7% with cash transportation and depreciation up 16% and 17%, respectively. The latter reflects IT investments and new property that was brought into use. Total property-related costs rose only 1% as we continue to optimise across our real estate portfolio. Communication costs were flat, with telephone and postage, plus printing and stationery well contained.

Professional fees grew 7%, reflecting incremental run costs which mostly related to a large technology outsourcing contract while marketing declined 7% due to lower product campaign spend. Amortisation of intangible assets increased 25% given investment in digital, data and automation and our direct IT costs rose 2%. Our total IT spend including staff and depreciation increased 7% to almost R8bn (18% of Group expenses).

We remain focused on efficiency and plan for further savings opportunities in Group operations, ARO's cost base and technology and discretionary costs.

3 Credit impairments improved further

Our Group credit impairment fell 10% to R6.3bn resulting in a 73 basis point credit loss ratio from 87 basis points in 2017. The underlying improvement, excluding the IFRIC revenue reclassification on how to treat interest in suspense, was closer to 1%. Excluding the impact of the IFRIC guidance:

- RBB SA's credit impairments grew 2% in line with our expectations, with noticeable improvements in card and home loans offsetting underlying strain in retail vehicle finance.
- Business Banking's credit impairments increased 34%, due to book growth and some commercial defaults.

CIB SA's credit impairments increased 76% due to a large single name charge. CIB's watchlist has improved since 2017 although it remains at elevated levels and we continue to closely monitor the construction sector, mining and state owned entities.

ARO's credit impairments were better than we expected, dropping 38%, resulting in a 77 basis point credit loss ratio. This reflects a benign macro backdrop, including lower interest rates in all markets, proactive risk management and strengthened collections. CIB's credit loss ratio of 7 basis points is well below its through-the-cycle levels and could increase going forward.

Stage 3 assets decreased to 5.1% of total loans from 5.5% and our cover improved to 45.1%, which we consider appropriate.

4 Responsible tax payer

Our taxation expense rose 8% to R6.8bn, raising our normalised effective tax rate to 28.1%, with the main driver being non-tax deductible expenses. Our Group tax rate continues to be relatively high and we seek to optimise the tax position of our commercial operations, while ensuring a responsible approach to tax through our tax philosophy. This philosophy considers the needs of all stakeholders, including shareholders, customers, tax authorities, regulators and wider society and we ensure that all taxes are paid in accordance with the legislative requirements of the countries in which we operate.

Balance sheet analysis

on a normalised basis

	2016 Rm	2017 Rm	**2018 Rm**	Change %
Total assets	1 101 023	1 168 683	**1 285 52**	10
1 *Of which* Loans and advances to customers	720 309	749 772	**841 720**	12
3 **Total equity**	102 280	108 506	**112 853**	4
Capital and reserves attributable to ordinary equity holders of the Group	93 057	97 862	**100 700**	3
Non-controlling interest – ordinary and preference shares	9 223	10 644	**12 153**	14
Total liabilities	998 743	1 060 177	**1 172 699**	11
2 *Of which* Deposits due to customers	674 865	689 867	**736 305**	7
Total equity and liabilities	1 101 023	1 168 683	**1 285 552**	10
Loans-to-deposit and debt securities ratio (%)	88.4	90.6	**93.8**	

1 Group loan growth momentum continued

Growth in loans and advances improved 12%, increasing our total loans to R842bn. South Africa, which accounts for almost 90% of our loans, increased 12%. Retail in South Africa (our largest book) grew 5% from 2% in 2017. Business Banking's gross loans rose 11% driven by 19% growth in term loans. CIB's gross loans increased 25%, or 13% on average, with strong growth in reverse repos particularly at year-end, good momentum in commercial property finance and 23% higher term loans. ARO's gross loans rose 26% (12% in constant currency) with very similar growth from RBB and CIB.

Our key retail products in South Africa (48% of our total gross loans) showed improved momentum with Home Loans (56% of South Africa retail) growing for the first time in several years as it gained share of new business. Vehicle and Asset Finance (retail and commercial) increased 12%, which was ahead of the market. Card increased 4% (up 9% when excluding one of our store card portfolios) and Personal Loans was up 12% as our share of business increased. Momentum in retail lending as well as the quality of new production shows potential for improved annuity business.

2 Deposits in RBB improved while lower in CIB SA

Although our total deposit growth improved to 7% from 2% in 2017, it lagged our loan growth. RBB SA grew 11% to R333bn (45% of our total deposits) with retail increasing 11% and gaining market share as a result of strong growth in fixed and notice deposits, while transactional deposits increased 10%. Business Banking rose 10% with solid growth in transactional and investment products. In South Africa, CIB deposits declined 2%, although average transactional deposits increased 8%, demonstrating progress in gaining primary customers. Growing deposits is a focus for CIB SA and it launched an innovative on-balance sheet money market product in February 2019.

ARO's 23% deposit growth is flattered by the weaker spot rand (10% in constant currency) and is well funded with a 72% loan-to-deposit ratio. Given the gap between our customer loans and deposit growth, deposits from banks and debt securities in issue increased strongly. Growing core deposits is a significant focus for us going forward.

3 Maintained strong capital levels

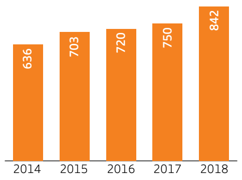
Our capital levels remain strong with our common equity tier 1 ratio stable. Group risk-weighted assets grew 11% to R819bn in line with our customer loan growth. IFRS 9 reduced our common equity tier 1 ratio by 7 basis points during 2018 as we are phasing the IFRS 9 effect in over 3 years. We remain strongly capital generative, with profit adding 2% to our common equity tier 1 ratio, while dividends reduced it by 1.2%.

Our resulting normalised common equity tier 1 ratio of 12.0% is well above the 11.5% top end of our Board target range. Capital levels are stronger on a statutory basis, which includes another 0.8% for the remainder of the contribution from Barclays. Our total normalised Group capital ratio is healthy at 15.4%, which includes the USD400m of Basel III compliant Tier 2 capital which we issued in April 2018.

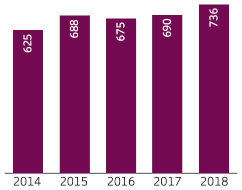
Healthy liquidity

Our liquidity position remains healthy with a net stable funding ratio of 110.1% and a liquidity coverage ratio of 116.7%, both above the regulatory requirements.

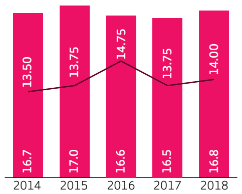
Advances (Rbn)



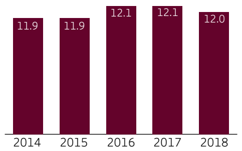
Deposits (Rbn)



Return on equity/ cost of equity (%)



Common equity tier 1 (%)



Segment Performance

Stable underlying divisional returns

Most of our divisions produced stable returns for the period. RBB SA's return on regulatory capital of 24% remained strong, while CIB SA's return on regulatory capital of 15.6% was lower than 2017 which was entirely due to a single name provision. ARO's return on equity improved further to almost 19%. Lastly, WIMI's 22% return on equity is well above its cost of equity.

Benefits of a well-diversified portfolio

Our Group earnings remain well-diversified both by activity and geography. RBB SA's grew 2% to contribute 53% of our earnings. In total, CIB SA and CIB Africa's earnings increased by 2% and accounted for over a third of Group earnings, which is evenly split between the Corporate Bank and the Investment Bank. CIB SA's earnings decreased 1% due to negative Jaws and significantly higher single name credit impairments. ARO's contribution increased to 19% of Group earnings with earnings up 9%, including strong 26% growth from RBB. WIMI contributed the remaining 8% of earnings, after growing 3%.

Retail and Business Banking

Headline earnings increased 2% due to 10% lower credit impairments as pre-provision profits declined 2%. Revenue grew 2% with non-interest income increasing 5% largely due to card issuing and merchant acquiring volumes growing 9% and 13%, respectively. Momentum in Retail's fee and commission income, which accounts for over half group non-interest revenue, has consistently improved since the second half of 2016. Costs rose 5% resulting in a 59.1% cost-to-income ratio. The credit loss ratio improved to 0.94% from 1.10%.

Corporate and Investment Bank

Headline earnings in South Africa decreased 1% primarily due to 76% higher credit impairments. Pre-provision profits grew 5% although 12% higher costs exceeded 8% revenue growth. CIB SA's non-interest income increased 7%, due to Markets growth and 9% higher transactional income in Corporate. Corporate earnings grew 4% largely due to 11% revenue growth. Investment Bank earnings decreased 4% due to 70% higher credit impairments.

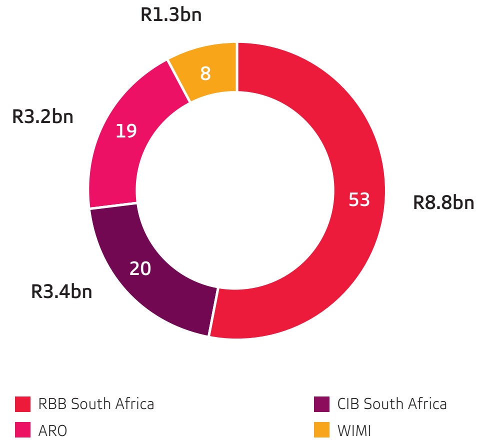
Absa Regional Operations

Headline earnings grew 9%, or 13% in constant currency, largely due to 38% lower credit impairments. Pre-provision profits increased 3%. Revenue grew 5% (6% in constant currency) to R16 323m with non-interest growth of 6% (9% in constant currency) reflecting growth in card and payments, bancassurance and corporate. Costs grew 6% (8% in constant currency) resulting in a 58.4% cost-to-income ratio. RBB earnings increased 26% or 29% in constant currency, given positive operating leverage and 14% lower credit impairments. CIB earnings grew 7%, or 11% in constant currency as its credit impairments reduced by 91%.

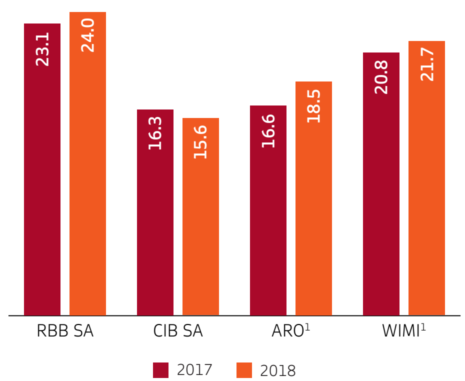
Wealth, Investment Management and Insurance

Headline earnings grew 3% while earnings from continuing business lines increased 8%. WIMI's non-interest income grew 6%, with life insurance net premium income up 10%, offsetting slightly lower investment management revenue. Gross operating income grew 10% and costs decreased 3%. Life insurance earnings grew 4% with the embedded value of new business increased 15%. The investment cluster's earnings declined 6%, largely due to margin compression since assets under management grew 1%. Short-term insurance earnings grew 32%. South Africa underwriting margins increased to 9.6%. WIMI SA's earnings increased 9% while WIMI Africa Regions reported a loss of R58m.

Headline earnings per market segment (%)
Excluding Head Office, Treasury and other operations in South Africa and the impact of the Separation effects.



Divisional return on regulatory capital (%)



[1] Return on equity

Audit quality and independence

Following the decision leading to EY becoming the sole group auditor, significant attention was given by EY to the planning, processes and outcomes of the Group audit, including the adequacy of their specialist resources, the robustness of their level of audit challenge and communication to ensure the quality of the audit. The quality and rigour of the audit was carefully monitored by both management and the Group Audit and Compliance Committee and a formal assessment of the effectiveness of the audit was carried out and proved satisfactory.

2019 performance outlook

In South Africa, we expect 1.7% real GDP growth and we forecast real GDP growth of 5.9% in our regional operations. Based on these assumptions, and excluding any major unforeseen political, macroeconomic or regulatory developments, we expect stronger deposit growth this year and it should exceed our loan growth. We again see better loan growth from the regional operations in constant currency than from South Africa, where momentum should continue.

Net interest margin is likely to decline slightly this year, given higher wholesale funding and regulatory costs.

Normalised costs will remain well controlled and we are targeting positive operating Jaws for the full year, although this could be challenging in the first half, given the slow start we expect in the economy and financial markets.

Our credit loss ratio is likely to increase off a low base.

Normalised return on equity should increase slightly in 2019, on the path towards achieving our target of 18% to 20% in 2021.

Normalised common equity tier 1 ratio should remain above Board targets and we are comfortable with our dividend cover at current levels.

Jason Quinn
Financial Director