

Research Update:

Capitec Bank Ltd. 'BB-/B' Ratings Affirmed On Resilient Business Performance; Outlook Stable

May 28, 2024

Overview

- South Africa-based Capitec Bank Ltd.'s (Capitec's) business model was resilient, weathering economic cycles and the weak economy in South Africa. Additionally, the bank's strategic execution to date strengthened its competitive positioning in the sector.
- We anticipate that Capitec's wider business scope will accelerate revenue diversification and support profitability and capital over the medium term.
- We therefore affirmed our 'BB-/B' long- and short-term global scale and 'zaAA/zaA-1+' long- and short-term South Africa national scale ratings on the bank.
- The rating outlook is stable and reflects that on South Africa.

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Rating Action

On May 28, 2024, S&P Global Ratings affirmed its 'BB-/B' long- and short-term global scale credit ratings on Capitec. The outlook is stable.

At the same time, we affirmed our 'zaAA/zaA-1+' long- and short-term national scale ratings on the bank.

Rationale

Capitec continues to improve its business profile through new product offerings and client selection. The bank increased its product diversification and balanced its mix of lending and transactional income by targeting higher-income earners and moving away from unsecured retail lending. Capitec's business profile also benefited from an increase in product offerings and target markets via a new business banking division, as well as retail insurance, including credit life and funeral insurance. Capitec's revenue diversification has evolved over the past five years. Retail lending contributed 38% to operating income in financial year 2024 (ended Feb. 29, 2024), from 76% in August 2017, while transaction income, funeral insurance, business banking, and value-added services contributed 62%, from 24%, over the same period. The increase in

non-funded income helped maintain revenue growth and earnings stability during economic downturns. We believe the acquisition of Avafin mark the beginning of Capitec's geographical revenue diversification, which is currently concentrated in South Africa.

Capitec's strong capital position and its high earnings mitigate elevated credit losses. Due to its focus on unsecured retail lending, Capitec's credit losses are considerably higher than those of top South African peers. We expect loan impairments will remain elevated but broadly in line with historical levels on the back of high food prices. The cost of risk will remain high at about 8.4% in financial year 2025 (ends Feb. 28, 2025), from 8.7% in financial year 2024, while nonperforming loans (NPLs) will increase to 26%, from 25%, over the same period. The NPL coverage ratio was 89%, as at Feb. 29, 2024.

We expect our risk-adjusted capital ratio will remain a credit strength and forecast that it will improve to 11.5% in financial year 2025, from 10.9% in financial year 2024. We forecast the bank's earnings will remain strong with a return on equity (ROE) of 26% in financial year 2025. Despite the bank's large capital base, their ROE exceeds that of peers by an average of about 10 percentage points. Despite elevated impairment charges, earnings will benefit from higher net interest margins that result from higher interest rates and strong growth in non-funded revenues.

Revenue growth, client selection, and expanding business segments and products will support the bank's creditworthiness. We therefore improved our assessment of Capitec's business position and raised its stand-alone credit profile (SACP) by one notch to 'bb+' from 'bb'.

The ratings on Capitec are constrained by the sovereign ratings on South Africa. Although we raised Capitec's SACP to 'bb+', the long-term rating on the bank is constrained by the 'BB-' foreign currency long-term rating on South Africa. We do not rate South African banks above the sovereign because of the likely direct and indirect effect of sovereign stress on banks.

Outlook

The stable rating outlook on Capitec mirrors that on the sovereign.

Downside scenario

We would lower the ratings on the bank over the next 12 months if we lowered the ratings on the sovereign.

Upside scenario

We would raise the ratings on the bank if we took a similar action on the sovereign.

Ratings Score Snapshot

	To	From
Issuer credit rating	BB-/Stable/B	BB-/Stable/B
SACP	bb+	bb
Anchor	bb+	bb+

	To	From
Issuer credit rating	BB-/Stable/B	BB-/Stable/B
Business position	Adequate (0)	Moderate (-1)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and strong (0)	Adequate and strong (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	-2	-1

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Capitec Bank's Avafin Acquisition Could Be A Bellwether For Further Diversification Afield, March 13, 2024
- South African Banking Outlook 2024, Jan. 18, 2024

- Tech Disruption In Retail Banking: South African Banks Move In Lockstep With System And Technology Innovation, Jan. 15, 2024
- South Africa 'BB-/B' Foreign Currency And 'BB/B' Local Currency Ratings Affirmed; Outlook Stable, Nov. 17, 2023
- Banking industry Country Risk Assessment: South Africa, June 15, 2023

Ratings List

Ratings Affirmed

Capitec Bank Ltd.

Issuer Credit Rating	BB-/Stable/B
South Africa National Scale	zaAA/--/zaA-1+

Regulatory Disclosures

Primary Credit Analyst: Charlotte Masvongo, Senior Analyst

Rating Committee Chairperson: Sergey Voronenko

Date of initial rating assigned: Oct. 13, 2015

Date of previous review: March 13, 2023

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

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Glossary

- Anchor: The starting point for assigning a bank a long-term rating, based on economic and industry risk.
- Asset quality: A key measure of the quality and performance of the assets of a bank.
- Business position: A measure of the strength of a bank's business operations.
- Capital and earnings: A measure of a bank's ability to absorb losses.
- Cost of risk: As a percentage of total loans, the charge for bad and doubtful debts.
- Credit losses: Losses arising from credit risk.
- Credit risk: Risk that a borrower will default on its payment obligations.
- Customer loans (gross): Total customer loans before loan-loss reserves.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Fee income over operating revenues: Net income on fees and commissions over operating revenues.
- Gross nonperforming assets over customer loans plus other real estate owned over customer loans: Nonaccrual loans, plus restructured loans, plus repossessed assets plus loans 90-days past due; over gross customer loans plus repossessed assets.
- Loan-loss reserves over gross nonperforming assets: General plus specific reserves, over adjusted nonperforming assets (nonaccrual loans plus restructured loans plus repossessed assets plus 90-day past due loans).
- National scale rating: An opinion of an obligor's creditworthiness or overall capacity to meet specific financial obligations, relative to other issuers and issues in a given country or region.
- Net interest income over operating revenues: Net interest income (including net interest income on loans, securities, and other assets), over operating revenues.
- New loan-loss provisions over average customer loans: Credit loss provisions (including specific loan provisions and general and other provisions) minus recoveries, over average gross customer loans of current period and last fiscal year.
- Operating revenues: Net interest income, plus operating noninterest income (mainly includes fees and commissions and trading gains).
- Return on equity: Net income before extraordinary results minus preferred dividends over

average common equity (average between current period and last fiscal period).

- Risk position: Our view of the specific risk characteristics of a particular bank.
- Risk-adjusted capital (RAC) ratio before diversification: This is calculated according to S&P Global Ratings' methodology as total adjusted capital over risk-adjusted assets.
- Stand-alone credit profile (SACP): An interim step in assessing a bank's overall creditworthiness. It includes government support, but not extraordinary government support.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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