Financial director's report

Results in brief

Active clients grew by 31% and Capitec Bank now provides easy money management solutions to 3.7 million clients. The branch network expanded by 52 branches to 507 branches and clients are serviced by 2 076 ATMs.

Capitec's attractiveness to the funding market continued to grow and funding from a number of sources was available to fund the growth in the loan book and expand the branch network. Total wholesale deposits at the end of February 2012 amounted to R7.2 billion representing growth of 81% since February 2011. Retail call savings grew by 61% to R6.3 billion and the retail fixed savings balance grew by 73% to R4.0 billion. The average maturity of retail fixed savings as at 29 February 2012 was 15 months compared to 13 months at the end of February 2011.

During the year 4.6 million loans were advanced (2011: 3.9 million), increasing the value of loans advanced by 35% to R19.4 billion. Loans advanced are reflected net of internal loan consolidations. Loans with terms of 12 months and longer contributed 71% of total loan sales. Sales of 60-month loans totalled R6.2 billion and contributed to a 69% increase in the gross loan book to R18.4 billion.

Net loan revenue grew by 49% to R5.7 billion. The growth in loan revenue exceeded growth in loan sales as the annuity income from the lengthening of the term of the loan book during the last number of years continued to have an impact.

The net loan impairment expense as a percentage of average loans and advances was 10.9% compared to 12.0% for 2011. The net loan impairment expense of R1.6 billion grew by 62% compared to 2011. The gross loan impairment expense increased by R692 million. The growth in the loan book contributed R731 million to this increase and the improvement in default rates from 5.7% as at February 2011 to 5.1% decreased the charge by R12 million.

Net transaction fee income (non-lending) grew by 57% to R836 million, reflecting the growth in client numbers and transaction volumes. This income covered 34% of banking operating expenses compared to 29% in 2011. The target is for this income to cover 40% of operating expenses.

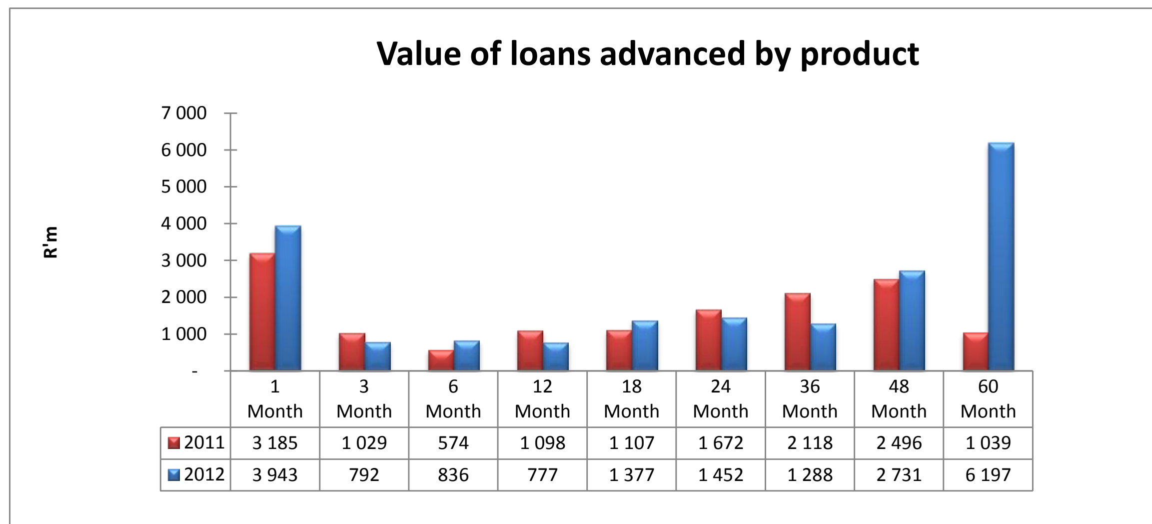
The cost-to-income ratio of banking activities improved from 48% for the 2011 financial year to 44% for the 2012 financial year. Income from banking increased by 51%, while operating expenses increased by 37%, mainly due to growth in the number of branches and employees. Employment costs, including training, comprise 53% of operating expenses compared to 54% for the 2011 financial year.

Headline earnings attributable to ordinary shareholders increased by 68% to R1.1 billion.

The return on ordinary shareholders' equity decreased from 34% to 29% due to the increase in ordinary share capital of R1.1 billion from the rights issue that took place in January 2011 and R787 million from the private placement in November 2011.

Loans advanced

Loans advanced increased by 35% and amounted to R19.4 billion



	1 Month	3 Month	6 Month	12 Month	18 Month	24 Month	36 Month	48 Month	60 Month
2011	3 185	1 029	574	1 098	1 107	1 672	2 118	2 496	1 039
2012	3 943	792	836	777	1 377	1 452	1 288	2 731	6 197

Loans with terms of 12 months and longer contributed 71% of total loans advanced (2011: 67%) and increased by 45% to R13.8 billion. Sales of loans with terms shorter than 12 months increased by 16% and totalled R5.6 billion

The maximum loan value increased to R150 000 from R120 000 in the previous financial year and the maximum loan term remained 60 months.

Loans advanced are reflected net of internal loan consolidations. The National Credit Regulator reflects credit granted gross of internal and external loan consolidations in its statistics. Credit granted by the market is therefore inflated.

The 60-month loan product, launched during the 2011 financial year, contributed R6.2 billion in sales and totalled 32% of sales. Amendments to credit granting criteria during the 2012 financial year enabled a larger number of clients to qualify for 60-month loans and contributed to the increase in sales of the product. Credit criteria were adjusted taking the bank's risk appetite into consideration and ensuring that the indebtedness of clients measured against disposable income remained in line.

The lower pricing of loans as dictated by market forces further contributed to the increase in longer-term loan sales as affordability for clients improved.

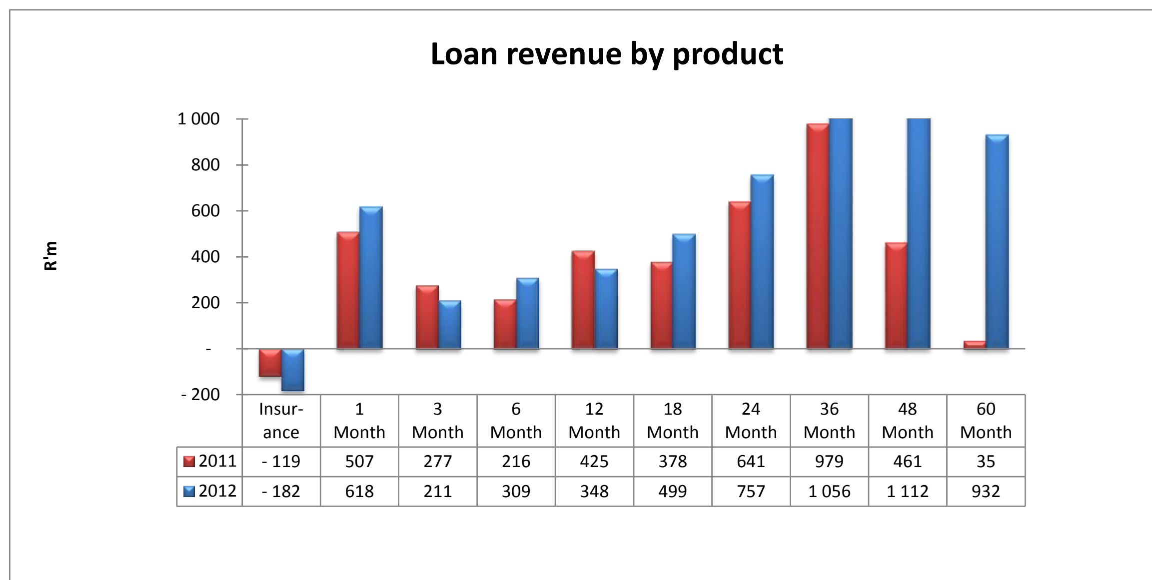
The increase in the granting of 60-month loans led to a decrease in sales of the 24- to 48- month loan products as clients qualified for loans with a longer term without increasing instalments.

The one-month loan was the second highest contributor to loan sales amounting to R3.9 billion and 20% of sales. The ease of access to these loans via cell phone and the ATM network continued to contribute to the increase in sales.

The definition of the number of loans advanced as reflected in the key performance indicators was amended to count one multi-loan per month and not each draw-down on a multi-loan as a loan advanced. Statistics for comparative years were restated.

Loan revenue

Net loan revenue increased 49% to R5.7 billion



Net loan revenue consists of interest, origination fees and monthly administration fees net of insurance.

The loan pricing structure was amended during the year to include price differentiation according to the risk profile of clients. This differentiation will be expanded and refined during the 2013 financial year.

Loans advanced are priced in compliance with the National Credit Act (NCA) which prescribes ceiling interest rates. Loans are advanced at fixed interest rates and clients are therefore not exposed to interest rate fluctuations. Interest on all loan products remains fixed regardless of whether the prescribed ceiling rates increase or decrease after the loan is granted. The uncertainty that existed around this treatment at the end of the 2011 financial year has been settled and the Capitec Bank treatment was confirmed as correct.

Clients do not pay extra for the credit life and retrenchment insurance which is provided on the loan products with terms of 6 months and longer. The cost of credit life and retrenchment insurance is carried by the bank while competitors add these charges to their loan pricing. The insurance expense amounted to R182 million (2011: R119 million).

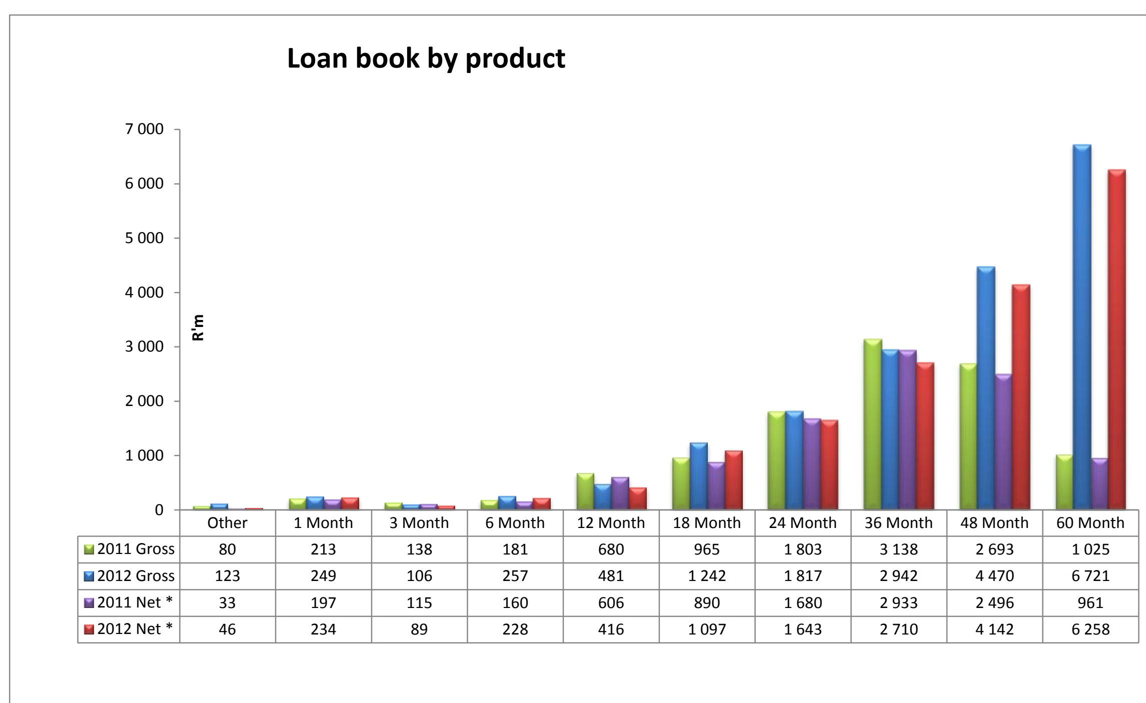
Growth in net loan revenue exceeded growth in loan sales as the annuity income from the lengthening of the term of the loan book during the last number of years continued to have an impact. Interest received on loans increased by 58% to R4.2 billion.

As loan sales increasingly include longer-term, higher-value loans the lower yields on these products do however continue to affect loan revenue. Yields on all loan products declined during the 2012 year as our efforts to make lending more affordable to our clients continued. The rate of decline in yields was however lower than during the 2011 financial year due to the fact that the last cut in Repo rates by the Reserve Bank took place in November 2010.

Loan initiation and monthly administration fee income grew by 30% to R1.7 billion.

Loan book, arrears and provision for doubtful debts

Gross loan book grew by 69% to R18.4 billion



	Other	1 Month	3 Month	6 Month	12 Month	18 Month	24 Month	36 Month	48 Month	60 Month
2011 Gross	80	213	138	181	680	965	1 803	3 138	2 693	1 025
2012 Gross	123	249	106	257	481	1 242	1 817	2 942	4 470	6 721
2011 Net *	33	197	115	160	606	890	1 680	2 933	2 496	961
2012 Net *	46	234	89	228	416	1 097	1 643	2 710	4 142	6 258

** Net – loans and advances net of impairment provisions*

It should be noted that the above chart is not a maturity analysis. Clients repay part of the capital on each of the product types in the following month, the month thereafter and so forth. In a mature book the capital repayment for the following month will approximate the balance divided by the term. A maturity analysis is set out in note 6 to the annual financial statements.

Gross loans and advances with terms of 12 months and longer totalled R17.7 billion at financial year end compared to R10.3 billion at the end of February 2011. These loans comprise 96% of the loan book compared to 94% in 2011.

The 60-month loan product contributed R6.7 billion or 37% to the gross loan book due to the increase in sales of the product since it was launched in December 2010.

Arrears as a percentage of gross loans and advances improved to 5.1%

		Aug 2010	Feb 2011	Aug 2011	Feb 2012
Gross loans and advances	**Rm**	7 796	10 916	14 495	18 408
Loans past due (arrears)	**Rm**	361	626	649	932
Arrears to gross loans & advances	**%**	4.6	5.7	4.5	5.1
Provision for doubtful debts	**Rm**	552	845	1 102	1 545
Provision for doubtful debts to gross loans & advances	**%**	7.1	7.7	7.6	8.4
Provision/arrears coverage ratio*	**%**	153	135	170	166

** The provision/arrears coverage ratio expresses the provision for doubtful debts as a percentage of the loans in arrears. The ratio is therefore affected by the arrears performance of the month in which it is measured while the impairment model is used to determine the provision for doubtful debts over the loan period. The ratio should therefore not be considered in isolation.*

Loans past due (arrears) comprise the full outstanding balance at risk on loans and advances that are in arrears from one day to three months i.e. if a payment of R1 000 is missed on a loan with an outstanding balance of R30 000, the full outstanding balance of R30 000 is considered to be in arrears.

The gross loan book grew by R7.5 billion compared to February 2011. In contrast arrears grew by R306 million.

Loans and advances more than 3 months in arrears which were written off amounted to R1.079 billion compared to R626 million in 2011. The increase in the amount written off is a function of loan book growth and does not necessarily result from deterioration in the quality of the loan book for the year.

The quality of the loan book is reflected in the arrears percentage to gross loans and advances, which has improved from 5.7% at the end of February 2011 to 5.1% at February 2012 despite deterioration in the percentage from 4.5% in August 2011. The arrears percentage reflects the seasonal trend of higher default rates following the traditional vacation months of December and January. The non-payment of government contract employees in certain departments influenced the arrears and impairment charge as government employees comprise 56% of the loan book.

The provision for doubtful debts as a percentage of gross loans and advances increased from 7.6% at the end of August 2011 to 8.4%. This can partly be attributed to the fluctuation in arrears because the impairment provision model is very sensitive to even slight increases in default rates.

The growth in the less mature, longer-term books during the last six months of the financial year also influenced the provision. The provision calculated by the impairment model is based on historical data and the provision on newer, longer-term loan books like the 48- and 60-month loan books is calculated by stretching the historical information that is available on the shorter, more mature 36-month loan book. The fact that the past does also not always reflect current economic circumstances also needs to be taken into consideration where the total loan book is growing rapidly and increasingly consists of newer, less mature loan products. Uncertainty surrounding the performance of longer-term loan books is also greater at the beginning of the term of the loans. These

factors are addressed by increasing the IAS39 provision on the loan books with terms of 12 months and longer. The additional provision is high at the beginning of the term of the loan and decreases as the loan matures. Effectively this steepens the provisioning curve in the beginning of the product's lifespan.

The breakdown of the loan book between current loans, loans in arrears, as well as the movement in the loan provision account is set out in note 6 to the financial statements.

The weighted average outstanding term of the 12 month and longer loan books as at February 2012 is 45 months (2011: 31 months), while the outstanding term of the loan books with terms shorter than 12 months is 3.5 months (2011: 2 months). The weighted average outstanding term of the total book is 45 months. This compares to 29 months at the end of 2011 and reflects the impact of the 60-month loan product.

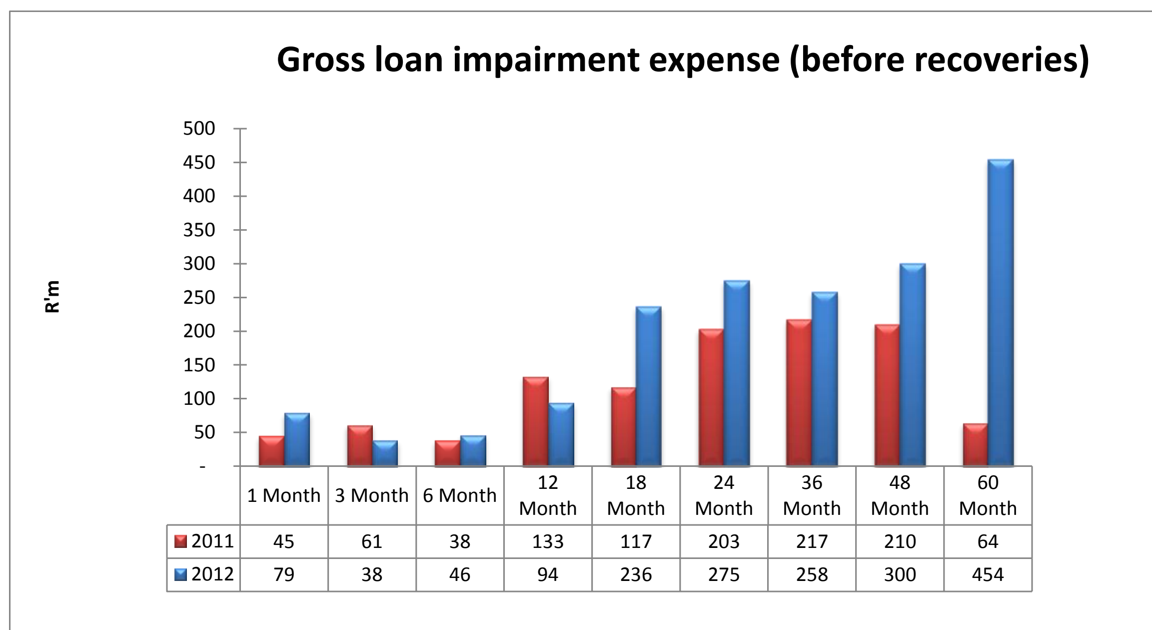
Loan impairment expense

Net loan impairment expense to average gross loans and advances at 10.9%

The net loan impairment expense of R1.6 billion for the year increased by R616 million compared to last year and represents 10.9% of average gross loans and advances compared to 12.0% in 2011.

Loan impairments are calculated at an account level based on historical data and the recent patterns and events are given appropriate consideration. Improvements in default rates are achieved through strict monitoring of credit granting criteria, operational efficiencies and a focus on collections.

Recoveries increased by R76 million to R176 million. Recoveries increased by 76% compared to the 2011 year. An improvement in the efficiency of the debt review process contributed to the improvement in recoveries but recovery periods continue to lengthen as longer-term, higher-value loans are handed over.



	1 Month	3 Month	6 Month	12 Month	18 Month	24 Month	36 Month	48 Month	60 Month
2011	45	61	38	133	117	203	217	210	64
2012	79	38	46	94	236	275	258	300	454

The gross loan impairment expense (before recoveries) increased by R692 million. This includes an increase of R731 million due to loan book growth. The gross loan impairment expense before book growth decreased by R12 million due to an improvement in default rates and by R27 million due to an increase in the expected future cash flow from handed over loans.

The table below compares the increase in the expense for each period to the immediately preceding period.

	6 months to Aug 2011 *	**6 months to Feb 2012 ****	**12 months to Feb 2012*****
Loan book growth	190	195	731
Default rates	(55)	70	(12)
Expected future cash flows on handed over loans	(21)	5	(27)
	114	**270**	**692**

** 6 months ended August 2011 compared to the 6 months ended February2011*
*** 6 months ended February 2012 compared to the 6 months ended August 2011*
**** 12 months ended February 2012 compared to the 12 months ended February 2011*

The gross loan impairment expense in the second half of the financial year increased by R270 million compared to the first half of the year. The net increase consisted of an increase of R195 million due to loan book growth, an increase of R70 million due to the deterioration in default rates and an increase of R5 million due to a decrease in the expected future cash flows on handed over loans.

The net impairment expense includes higher provisioning on the newer and growing loan books of the 48- and 60-month loan products. Although these products are only extended to lower risk clients and the performance on these books is better than the more mature 36-month loan product, prudent provisioning assumptions are applied. This is because the impact of a missed instalment on a longer-term, higher-value loan is more severe at the beginning of the repayment period, as the full loan amount may be at risk.

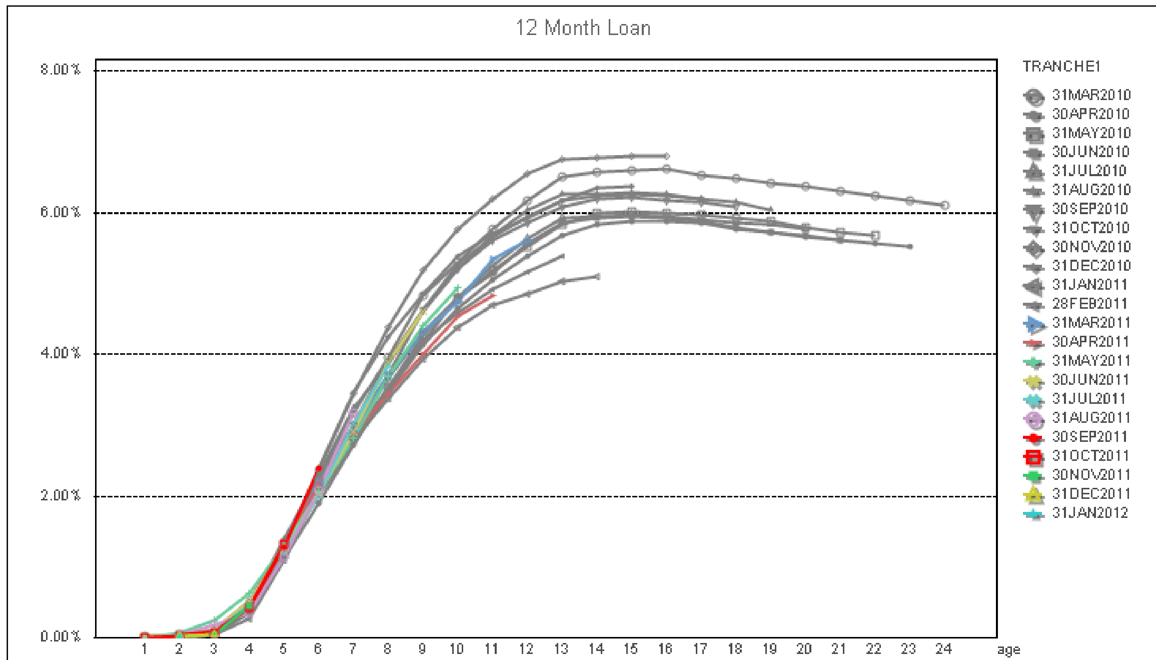
The net loan impairment expense as a percentage of loan revenue has increased to 28% from 26% for the 2011 financial year due to the impact of the higher impairment provision on the 48- and 60-month loan books as explained above and the decreased interest margins. The rate of provisioning on these products exceeds the rate at which income is recognised at the beginning of the term of the loans, which we consider prudent and conservative.

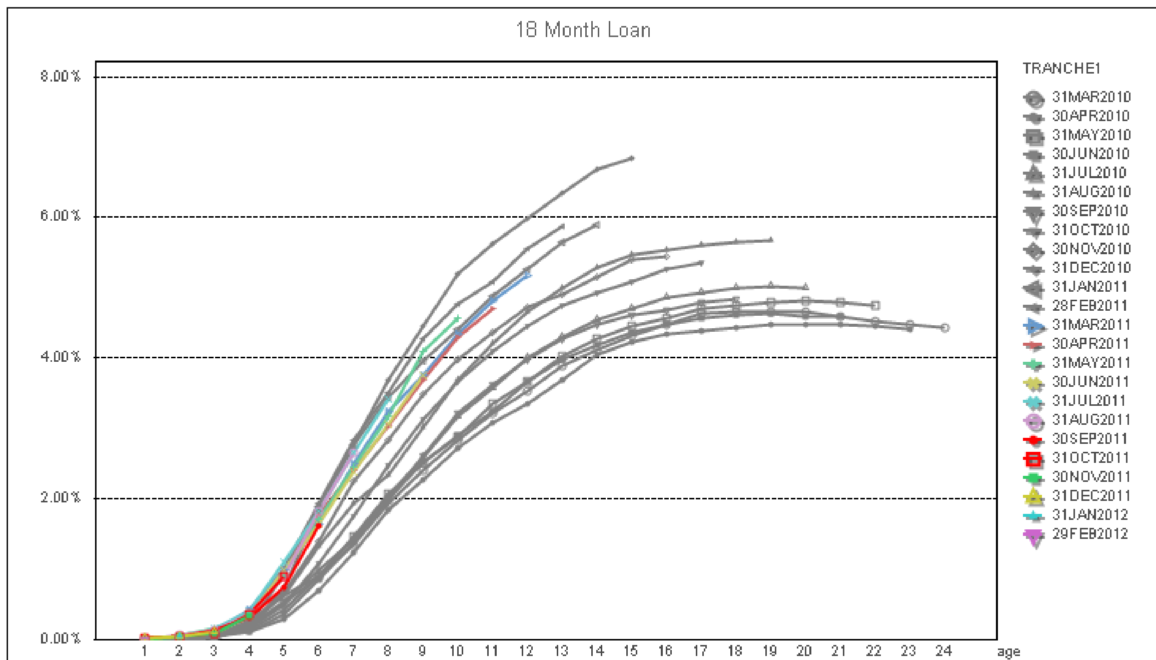
Vintage graph – loan tranches March 2010 to February 2012

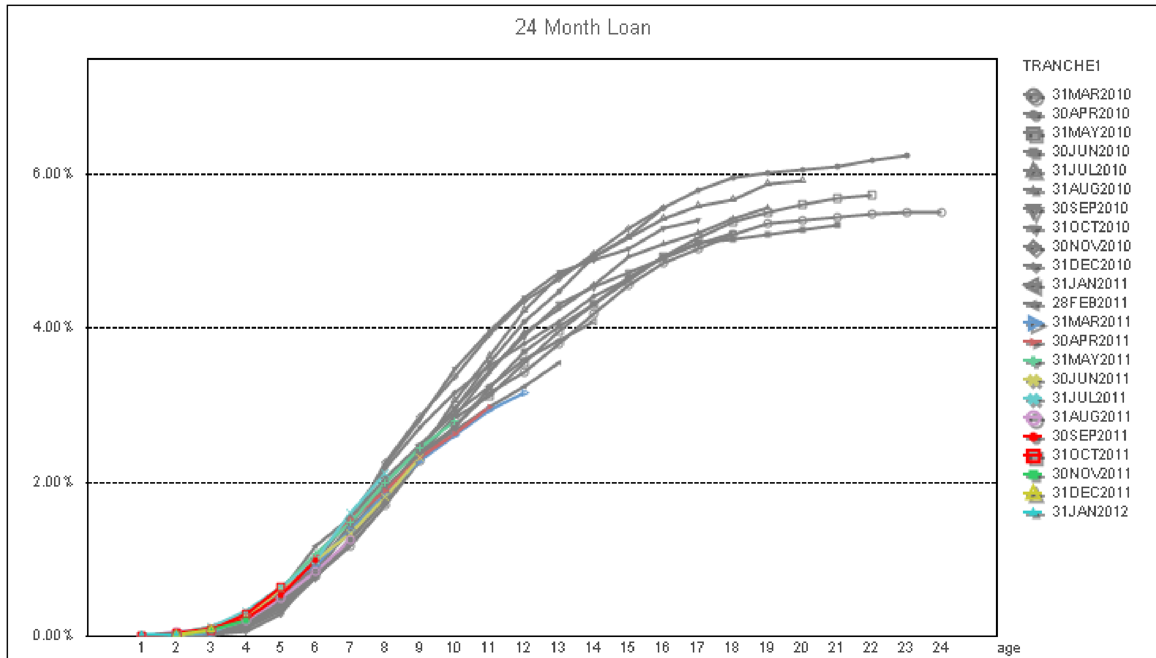
The vintage graphs for the 18- to 48- month loan products reflect the impact of the increase in the 60-month product and the adjustment to credit granting criteria which enabled clients to qualify for longer-term loans.

As some clients were offered more choices they migrated to better priced, longer-term products. The clients that did not qualify for these longer loans and therefore remain in

the shorter-term loan books are higher-risk and therefore the quality of these books is diluted.






24 Month Loan
6.00%
4.00%
2.00%
0.00%
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24
age
TRANCHE1
31MAR2010
30APR2010
31MAY2010
30JUN2010
31JUL2010
31AUG2010
30SEP2010
31OCT2010
30NOV2010
31DEC2010
31JAN2011
28FEB2011
31MAR2011
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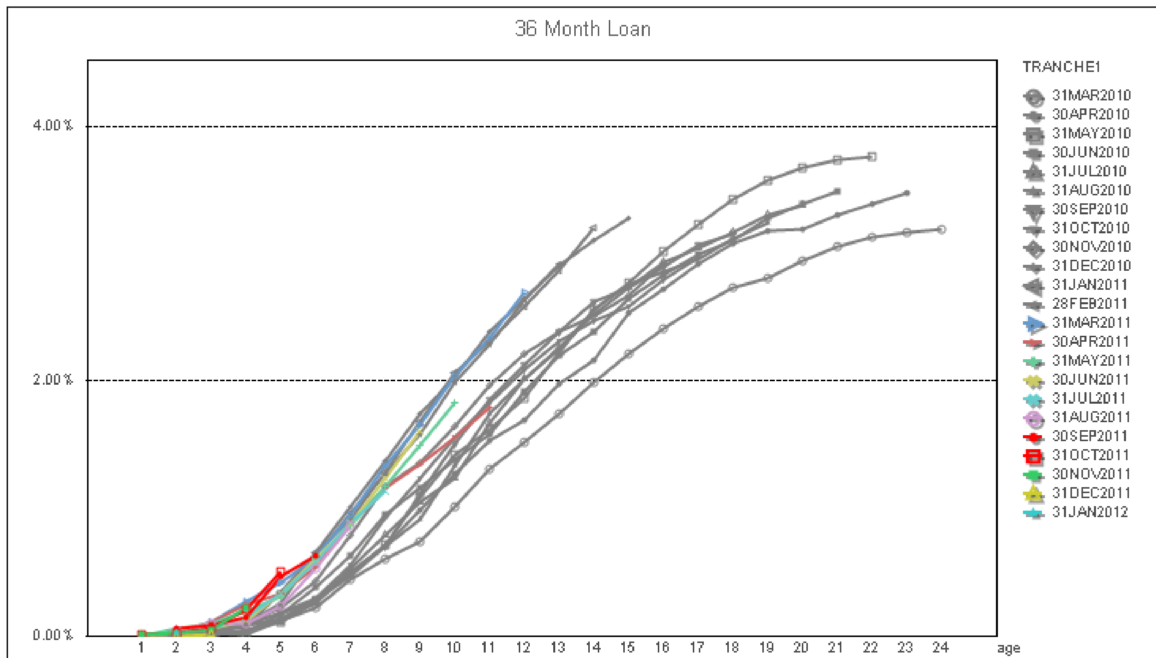
31DEC2011
31JAN2012


36 Month Loan
4.00%
2.00%
0.00%
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24
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TRANCHE1
31MAR2010
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31MAY2010
30JUN2010
31JUL2010
31AUG2010
30SEP2010
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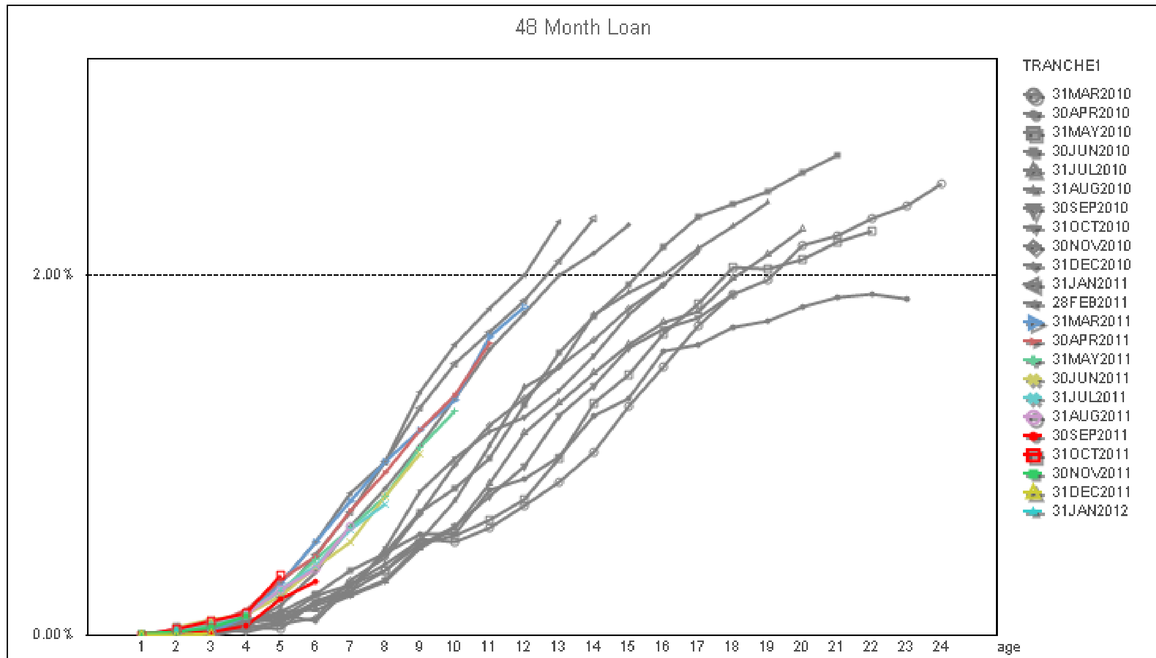

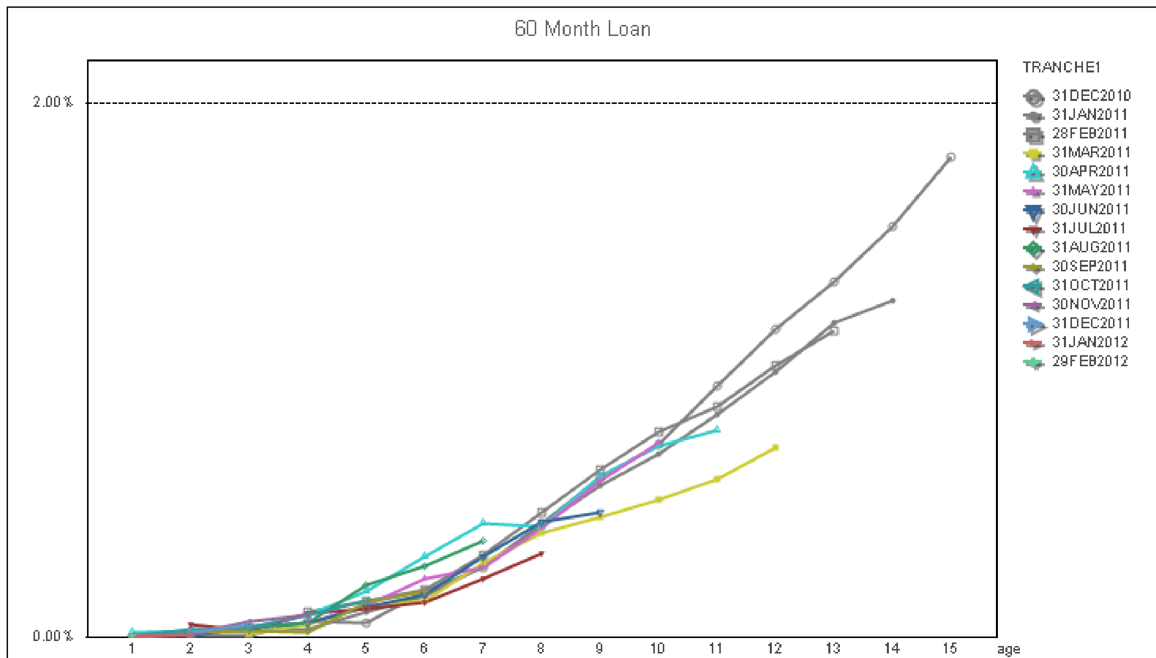

Transacting services

Net transaction fee income grew by 57% to R836 million

Gross transaction fee income grew by 54% to R1.4 billion. Growth in fee income exceeded growth in client numbers despite the fact that Capitec Bank did not increase its fee structure during the 2012 financial year.

The number of clients using stop orders, debit orders and transfers increased and gross fees from these transactions grew by 67% compared to February 2011. The fee income per client utilising these transactions also increased.

Gross acquiring income increased in excess of 100% as the number of POS terminals in operation more than doubled.

Transaction fee expenses grew by 49% to R524 million.

Net transaction fee income covered 34% of banking operating expenses compared to 29% in 2011, making progress towards the target of 40%.

Funding

Total funding grew to R17.5 billion

Retail call savings deposits grew by 61% to R6.3 billion. The increase is largely due to a 49% increase in the number of non-lending, transaction fee clients since February 2011.

Retail fixed savings products, with a maturity of up to 60 months, grew by 73% to R4.0 billion at the end of February 2012. The number of clients with fixed deposit accounts grew by 41% compared to February 2011, while the average balance per client grew by 23%. As at 29 February 2012 retail fixed savings comprised 36% (2011: 37%) of term funding. It remains management's goal to maintain this percentage at about 40% as fixed term retail funding remains attractive due to the lower pricing and lower concentration and refinancing risk. The average maturity of retail fixed savings as at February 2012 was 15 months compared to 13 months at the end of February 2011.

Two bonds totalling R1.3 billion were issued under the Domestic Medium Term Note ("DMTN") programme in May 2011 and bonds in the amount of R490 million that matured were repaid. Subordinated debt funding in the amount of R619 million was procured of which R575 million is listed under the DMTN programme.

Funding instruments with more varied maturities were issued as Capitec's profile became more established in the market and the cost of credit decreased. Funding with terms of 12 months or less in issue increased to R2.5 billion from R842 million in February 2011. The term of funding is matched to the term of the loan book. Total wholesale deposits at the end of February 2012 amounted to R7.2 billion representing growth of 81% since February 2011.

A capital repayment amounting to R90 million in terms of a foreign bilateral funding agreement takes place in March 2012. Bonds totalling R322 million issued in terms of the DMTN programme mature in May 2012. Further amounts will be issued in terms of the registered bond programme at that stage.

Liquidity

Liquidity management remains conservative

Management's liquidity philosophy remains cautious and conservative. The management of liquidity continues to take preference over the optimisation of profits.

Despite difficult economic conditions the bank has not experienced volatility in its retail funding base and Capitec complies with the two new Basel 3 liquidity ratios: the liquidity coverage ratio and the net stable funding ratio.

Funding that is surplus to operational requirements is managed in terms of the liquidity philosophy to ensure that obligations can be met as they become due.

Surplus funding is invested in interest-bearing instruments and instruments are selected to minimise the net carrying cost of surplus funds.

Instruments with maturities greater than three months from the date of acquisition are included in investments and comprise treasury bills issued by the South African National Treasury.

The liquidity position as at 29 February 2012 is set in note 27.6 to the annual financial statements.

Capital

Successful private placement raised R787 million in ordinary share capital

In order to optimise the group's capital base, R787 million in ordinary share capital was raised in November 2011 by means of a private placement. This capital together with the subordinated debt procured during the year enabled the group to maintain a risk-weighted capital adequacy ratio of 39% (2011: 41%) while continuing to grow the loan book and expand the branch network.

The capital adequacy calculations incorporate a calculation change in line with standard Basel practice. The risk-weighted asset equivalent for operational risk included in the divisor is now determined as per the Alternative Standardised Approach calculation for retail banking. The comparative has been restated.

The return on ordinary shareholders' equity was 29% (2011: 34%) despite the increase in ordinary share capital of R1.1 billion from the rights issue that took place in January 2011 and the increase of R787 million from the private placement mentioned above. The strong return was achieved by growing earnings by 68% to R1.1 billion. The return remained comfortably above the target of 25%.

Credit rating

Outlook is positive

The long-term and short-term national scale credit ratings for Capitec Bank Limited determined by Moody's Investors Services remain unchanged at A2.za and P-1.za respectively but the outlook for these ratings was amended to positive.

The long-term rating reflects a good long-term credit quality and the short-term rating a superior ability to repay short-term debt obligations.

Cost structure

Cost-to-income ratio of banking activities improved from 48% to 44%

Capitec's branch network expanded from 455 branches at the end of February 2011 to 507 branches at the end of February 2012 and the ATM network has grown to 2 076 from 1 661 at February 2011.

Capital expenditure for the year grew to R381 million compared to R235 million in 2011 and is expected to increase in line with plans for expansion of the branch network by 55 branches during 2013. Capital expenditure planned for the 2013 financial year totals R673 million.

Banking operating expenses grew by 37% to R2.5 billion mainly due to growth in the branch network and corresponding growth in the number of employees. This represents an increase of R673 million.

The group currently employs 7 194 people, an increase of 35% on 2011. The growth in the number of employees exceeded the growth in the number of branches due to the continued implementation of a centralised collections function and the expansion of information technology support structures. Employment costs, including training and incentives, comprise 53% of operating expenses and contributed R352 million to the increase in operating expenses.

An incentive for all Capitec Bank employees in terms of schemes based on growth in headline earnings per share is included in employment costs. Senior management (excluding strategic management) qualify for a cash-settled performance bonus scheme. This scheme rewards managers based on the growth in headline earnings per share and to foster a long-term approach by management the amount is paid out over a three year period. Strategic management are incentivised by means of share options which are equity-settled and share appreciation rights which are cash-settled.

The Remuneration report contains an analysis of these bonus schemes.

Training costs increased by 46% to R40 million and comprise 13% of employment costs. Training costs include in-house training of all new employees that are deployed into the branch network and support structures as well as various in-house leadership and other training programmes. Investment in the training of employees is considered crucial to the success of the bank.

The business focuses on cost analysis and management and this approach reflects in the cost-to-income ratio which decreased to 44% from 48%.

Taxation

The total tax contributions paid over to government for the year amounted to R1.2 billion compared to R698 million in 2011. This includes normal tax, value added tax, secondary tax on companies, unemployment insurance, skills development levies, property rates and taxes as well as employees' tax. The tax contribution as a percentage of profit available for distribution to ordinary shareholders is 59% (2011: 60%). For further detail refer to the statement of economic value added.

The group's business model, as well as the products and services offered are not complex and complex tax structuring does not form part of the philosophy of Capitec Bank.

Dividends

The board of directors considers the capital and funding requirements of the business before declaring dividends. The dividend cover for the past four years ranged from 2.6 to 2.5. The dividend of 300 cents per share declared on 1 March 2012 equates to a dividend cover of 2.6 and is the last dividend to be declared in terms of the Secondary Tax on Companies rules.

André du Plessis
Financial Director