# What is the chief financial officer's view?

2014

*Our strategy of developing a full service bank enables stability in earnings*

# Growing earnings in a downturn

*27% growth in earnings to R2 billion*

Our strategy of developing a full service bank enabled us to report continued earnings growth due to a diversification of revenue streams. We earn income from providing both transacting services and unsecured credit.

Headline earnings for the 2014 financial year amounted to R2 017 million, 27% more than the R1 584 million earned in 2013. Headline earnings per share increased by 15% from 1 519 to 1 752 cents per share. The compound annual growth rates ('CAGR') are as follows:

| | **Since listing in 2002** | **Last 10 years** | **Last 5 years** | **Last 3 years** |
|---|---|---|---|---|
| | % | % | % | % |
| Headline earnings | 37 | 46 | 46 | 47 |
| Headline earnings per share | 29 | 38 | 37 | 32 |
| Dividend | 30 | 42 | 36 | 32 |
| Share price | 52 | 41 | 44 | 5 |

The macro-economic environment over the past year was characterised by annual GDP growth of 1.8%, insufficient job creation, rising cost pressures, greater client indebtedness and increased competition. These developments made it necessary to adopt a more defensive strategy for the lending business. This means being stricter about who we lend to, which resulted in lower loan sales for the year of R18 billion (2013: R25 billion).

*15% growth in headline earnings per share*

The 15% growth in earnings per share is lower than the 27% growth in earnings due to the dilutive effect of the November 2012 rights issue. 2014 earnings per share growth is also lower than the 35% growth in headline earnings per share for the 2013 financial year. The higher number of shares for a full twelve months, lower sales and higher bad debt charges are the main drivers of the lower

per share growth. If the impact of the additional rights issue shares is excluded, earnings per share growth would have been 8% higher. Adjusting earnings for the change from secondary tax on companies to dividend withholding tax would have resulted in a 3% decline in earnings per share. If these adjustments are factored in, the growth in headline earnings per share for 2014 would have been 20%.

*23% return on shareholders' equity*

Our return on equity (ROE) was 23.3%, 1.7% below the 25% that we targeted for the 2014 financial year. The current state of the retail credit markets and economic fundamentals will continue to make it difficult to outperform our target.

## Loans advanced ('sales')

The value of loans advanced declined 28% to R18.2 billion as reflected in the accompanying chart.

*Tighter credit rules slow loan sales*

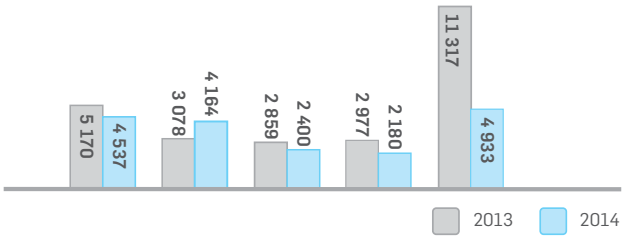
During the 2014 financial year the maximum loan offer remained R230 000. However, we tightened our credit rules (discussed in more detail later in this report), which made it more difficult for clients to qualify for the maximum amount.

The effect of the tightening is also clearly seen in the decline in sales in almost all categories, with only the 13- to 36-month category increasing due to a migration to shorter terms. The category most affected was the 61- to 84-month loan category, where loan sizes are larger and where a lower risk appetite resulted in a decline of 57% in the value of loans sold.

The number of loans sold also decreased by 19% to 3.0 million. Similarly, there was a decrease in the average loan amount to R6 003 compared to R6 756 for the 2013 financial year.

The overall mix of loan sales for terms less than twelve months to loans sold with terms more than twelve months changed from 20:80 for 2013 to 25:75 in 2014.

LOAN SALES BY PRODUCT (R'm)

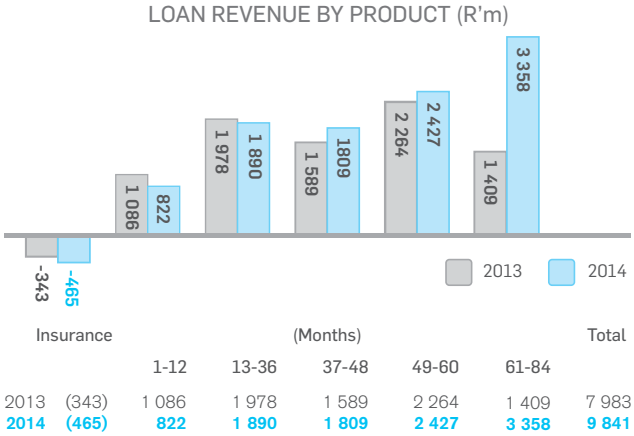



| | (Months) | | | | | Total |
|---|---|---|---|---|---|---|
| | 1-12 | 13-36 | 37-48 | 49-60 | 61-84 | |
| 2013 | 5 170 | 3 078 | 2 859 | 2 977 | 11 317 | 25 401 |
| % | 20 | 12 | 11 | 12 | 45 | 100 |
| **2014** | **4 537** | **4 164** | **2 400** | **2 180** | **4 933** | **18 214** |
| **%** | **25** | **23** | **13** | **12** | **27** | **100** |

*Negative industry growth of 11%*

The reduction in loan sales is in line with the broad trends in the unsecured credit market as reported by the National Credit Regulator (NCR). The growth in unsecured credit was negative, down 11% for the first three calendar quarters of 2013 when compared to the first three calendar quarters of 2012. The industry growth rate for the full year in 2012 compared to 2011 was an increase in growth of 23%, and for the full year 2011 to 2010, an increase of 60%[1].

[1] *Capitec reflects loans advanced net of internal loan consolidations. The NCR reflects credit granted gross of internal and external loan consolidations in its statistics. Credit granted by the market is therefore inflated.*




## Loan revenue

*23% growth in loan revenue*

Loan revenue, which consists of interest, origination fees and monthly administration fees net of insurance expense, grew by 23% to R9.8 billion compared to the 41% growth in 2013, as reflected in the accompanying chart.

The growth in loan revenue is despite the 28% decrease in loan sales. This is due to the annuity effect of loan sales in previous financial years. However, the impact of lower sales is evident in the slower rate of revenue growth.

*Rising costs for clients will continue to affect loan sales*

The interest rates on our loans are fixed which shields our clients from rising interest rates for the duration of their loan. Clients continue to face rising cost pressures, notably electricity and transport costs (due to the impact of Rand depreciation on the price of fuel) as examples. This will continue to exert pressure on sales. Our risk-based loan pricing continues to be refined to ensure that we keep abreast with changes in the credit market.

*Outstanding loan capital protected from retrenchments and the death of clients*

The cost of credit life and retrenchment insurance offered on loan products with terms of six months and longer is included as a direct cost that we must cover in order to make a profit on each loan sold. This insurance protects Capitec from bad debt losses, but it also benefits our clients as Capitec does not claim against them or their deceased estates. We do not charge our clients an additional insurance premium for this. Consequently this means that we have a lower appetite for risk than most of our competitors, who do charge a premium for credit life and retrenchment insurance, which is an unregulated charge. The insurance premiums we pay for our cover amounted to R465 million (2013: R343 million). We will not be impacted by the NCR's proposed caps on credit insurance.

## Loan book, arrears and provision for doubtful debts

*10% growth in loans and advances*

The gross loan book grew by R3 billion to R33.7 billion. The increase in gross loans and advances was 10%, much less than the 67% experienced in 2013. The slower growth is due to the stricter credit granting criteria which slowed sales and reduced the amounts and terms for new loans. The average term of a loan granted in 2014 was 37 months (2013: 48 months).

Gross loans and advances with terms longer than 12 months continued to comprise most of the book at 96% compared to 97% at February 2013. The 61-month to 84-month loan book accounts for 40% (2013: 35%) of the gross loan book.

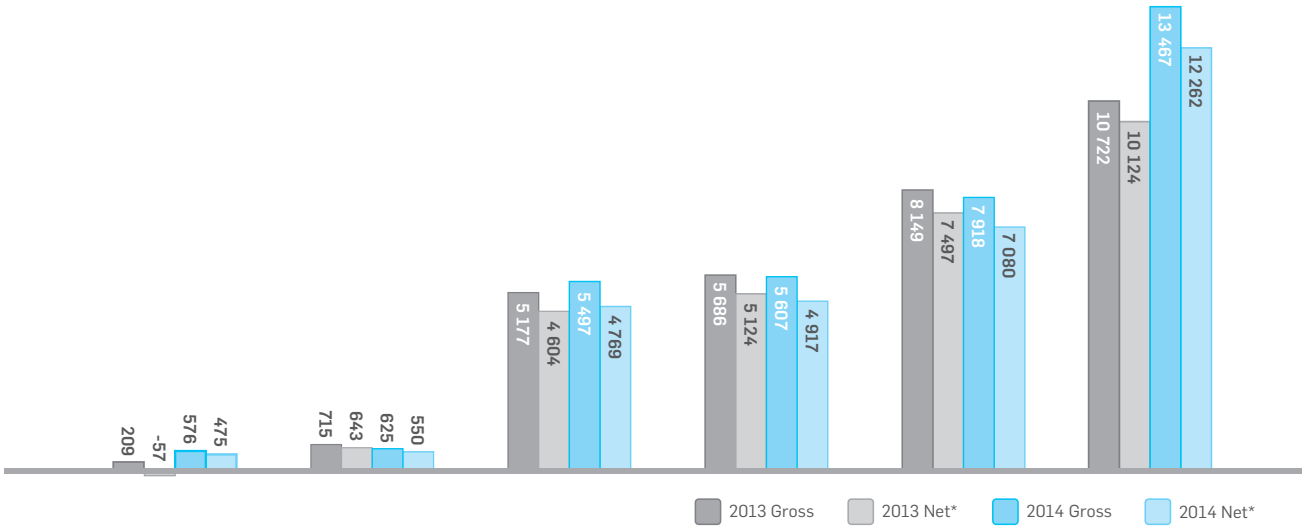
At the end of February 2014 the weighted average outstanding term of the loan book was 45 months (2013: 48 months).

*Arrears disclosed on a client basis*

Arrears are reflected on a client basis. Where a client has multiple loans and one of them becomes past due, the outstanding balances on all the client's loans are included in arrears. Once the client misses their third payment, all their outstanding balances on all loans are written off.

Total arrears grew from R1.8 billion at the end of February 2013 to R2.2 billion, an increase of 22%. Arrears

LOAN BOOK BY PRODUCT (R'm)




| | Other | 1-12 | 13-36 | 37-48 | 49-60 | 61-84 | Total |
|---|---|---|---|---|---|---|---|
| | | | (Months) | | | | |
| 2013 Gross | 209 | 715 | 5 177 | 5 686 | 8 149 | 10 722 | 30 658 |
| 2013 Provision | (266) | (72) | (573) | (562) | (652) | (598) | (2 723) |
| 2013 Net* | (57) | 643 | 4 604 | 5 124 | 7 497 | 10 124 | 27 935 |
| **2014 Gross** | **576** | **625** | **5 497** | **5 607** | **7 918** | **13 467** | **33 690** |
| **2014 Provision** | **(101)** | **(75)** | **(728)** | **(690)** | **(838)** | **(1 205)** | **(3 637)** |
| **2014 Net*** | **475** | **550** | **4 769** | **4 917** | **7 080** | **12 262** | **30 053** |

** 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 half the term.*

as a percentage of gross loans and advances increased from 5.8% at the end of February 2013 to 6.5%. The higher increase in arrears as a percentage of gross loans and advances reflects a deterioration in the quality of the loan book. The deterioration in credit quality has been addressed by tightening lending criteria and through provisioning.

*34% increase in impairment provisions*

Our provisioning remains prudent and our write-off policy remains unchanged. The impairment provision increased 34% to R3.6 billion and represents 10.8% of gross loans and advances compared to 8.9% at the end of February 2013. As with arrears measurement, impairment provisions are calculated on a client level.

Although arrears have increased by 22%, our provisioning has increased to 34% to address the deterioration. The increase in provisions is 3.4 times more than the increase in gross loans and advances and 1.67 times greater than loans in arrears.

The increase in provisions is driven by three factors. The first is that our statistical provisions model automatically factored in the poorer performance history. This results in it projecting a more conservative provisioning requirement. The second is that we have maintained our prudent approach of supplementing the model provision with additional, overlay provisions and have also thirdly, added a new provision supplement to address higher risk rescheduled balances.

| | | Aug 2012 | Feb 2013 | Aug 2013 | Feb 2014 |
|---|---|---|---|---|---|
| Gross loans and advances | R'm | 24 697 | 30 658 | 32 644 | **33 690** |
| Loans past due (arrears) | R'm | 1 075 | 1 777 | 1 799 | **2 174** |
| Arrears to gross loans and advances | % | 4.4 | 5.8 | 5.5 | **6.5** |
| Provision for doubtful debts | R'm | 1 873 | 2 723 | 3 184 | **3 637** |
| Provision for doubtful debts to gross loans and advances | % | 7.6 | 8.9 | 9.8 | **10.8** |
| Provision/arrears coverage ratio[1] | % | 174 | 153 | 177 | **167** |
| Arrears & arrears subsequently rescheduled and now current in the past 6 months[2] | Rm | | 2 402 | 2 634 | **2 921** |
| Arrears & arrears subsequently rescheduled and now current in the past 6 months to gross loans & advances[2] | % | | 7.8 | 8.1 | **8.7** |
| Arrears & arrears subsequently rescheduled and now current in the past 6 months coverage ratio[2] | % | | 113 | 121 | **125** |

*[1] 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.*

*[2] Comparitives provided for the periods since Capitec transitioned to client level provisioning.*

*Increased provisioning for rescheduled accounts*

Rescheduling (otherwise known as restructuring or forbearance) refers to arranging a new payment plan for clients who are experiencing difficulty in making their repayments. This is a normal practice of most credit providers with longer-term loans. All our rescheduled loans are managed as a separate group with appropriate sub-segmentation to ensure accurate provisioning calculations. When an arrears loan is rescheduled, a new contract is concluded and the client starts afresh as up-to-date in line with their status as reflected on the credit bureaux. Clients may only ever be rescheduled twice, and then only in certain circumstances. Rescheduling is done in terms of a centralised credit policy and monitored by the credit committee. As concluding a new contract does not necessarily remove the risk, we have always carried a higher provision on current rescheduled loans than the rest of the current book.

During 2014, we increased the provisioning for what we regard as higher risk rescheduled clients, that is those clients who were in arrears but who were rescheduled in the last six months. The six month period is based on statistical data that indicates that if a client is up-to-date six months after being rescheduled they are more likely to be rehabilitated. At February 2014, this meant increasing the provision, for clients that had not yet reached the six month mark, by R103 million. We now separately disclose these balances. At February 2014 the total of such balances was R747 million and the provisions thereon R246 million, a coverage of 33%. At February 2013 the total balances were R625 million with a provision of R64 million thereon, a coverage of 10%. The increase in the coverage ratio on these balances reflects the increased conservatism.

The breakdown of the loan book between current loans, arrears subsequently rescheduled in the past six months and now current and loans in arrears is set out in the table below.

| R'm | 2014 | % | 2013 | % |
|---|---|---|---|---|
| Gross | **30 768 901** | | 28 255 561 | |
| Impairment | **(2 073 214)** | 7% | (1 794 906) | 6% |
| Current | **28 695 687** | | 26 460 655 | |
| | | | | |
| Gross | **747 262** | | 625 073 | |
| Impairment | **(246 292)** | 33% | (64 418) | 10% |
| Current – arrears rescheduled in the past six months | **500 970** | | 560 655 | |
| | | | | |
| Gross | **2 173 863** | | 1 777 034 | |
| Impairment | **(1 317 670)** | 61% | (863 490) | 49% |
| Arrears | **856 193** | | 913 544 | |
| | | | | |
| Total Gross | **33 690 026** | | 30 657 668 | |
| Total Impairment | **(3 637 176)** | | (2 722 814) | |
| Total net | **30 052 850** | | 27 934 854 | |

The impact of a missed instalment on longer-term, higher-value loans is more severe at the beginning of the repayment period, as the full loan amount is then at risk. Consequently, the rate of provisioning on new longer-term loans continues to exceed the rate at which income is recognised in the early stages.

Our conservative provisioning policy has stood us in good stead. We did not need to make any large once-off adjustments. Having taken the difficult conditions into account we believe that we have sufficient provisions to address the risk in the book.

*We tightened our credit rules*

In May 2012 when we began extending longer-term, higher value loans we foresaw the risk of a possible increase in impairments and built safety buffers into our pricing.

When we first saw the credit cycle deteriorate we acknowledged this; progressively tightening our lending rules and lowering our risk appetite. We remain cautious in granting loans.

Our first significant pre-emptive change was in November 2012; we introduced a new behavioural scorecard and a cash quality indicator to improve our risk-based pricing model. We continued to tighten credit criteria early in the 2014 financial year to address what we perceived as continuing deterioration in the credit market due to job losses, slower than expected economic growth, rising indebtedness and slower growth in clients' disposable incomes.

On 26 May 2013, we increased interest rates on new loans advanced by 2% per year. This had the effect of reducing the amount of the loan that a client could get, as more of the monthly repayment must service the increased interest. This also acts as a credit quality rule. Some clients are now granted shorter loans and some clients who might previously have been granted a loan, are now declined. The increase does not immediately result in an increased yield on the book as it only applies to new business.

In March 2013 we reported that we had identified a growing trend of clients with a propensity to over indebt themselves by taking on additional credit at other providers after receiving a loan with us. To address this we implemented significantly tighter rules in June 2013.

*Loan impairment expense*

The net loan impairment expense of R4.0 billion for the year increased by R1.3 billion and represents 12.4% of average gross loans and advances compared to 10.8% in 2013. The impairment charge comprises bad debts written-off, the movement in the provisions for bad debts ('impairment allowance') and bad debts recovered.

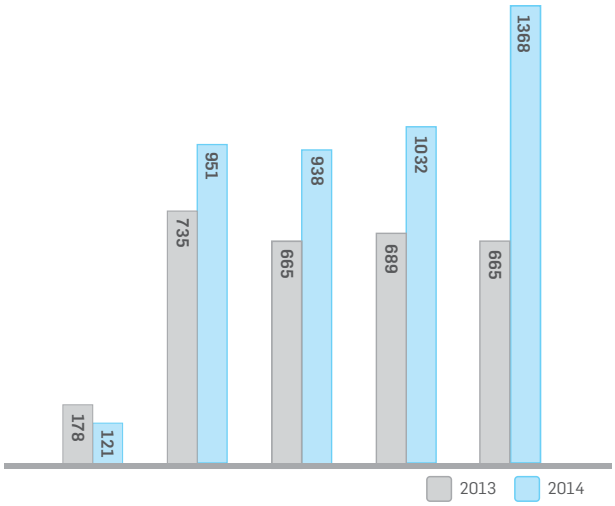
| R'm | 2014 | 2013 |
|---|---|---|
| Bad debts | 3 496 | 1 755 |
| Movement in impairment allowance | 914 | 1 177 |
| Bad debts recovered | (434) | (273) |
| **Net impairment charge** | **3 976** | 2 659 |

The past year has been difficult for unsecured lending. Bad debts written-off (excluding provision movements and recoveries) amounted to R3.5 billion compared to R1.8 billion for the 2013 financial year.

The provisions charge was R914 million compared to R1 177 million in the previous year. This does not mean that we were less conservative in provisioning. Most of the increase in the prior year was driven by the 67% growth in the loans and advances book. The deceleration in the rate of book growth was 57%, whereas the movement in the impairment allowance only reduced by 22%. We have demonstrated in the section on provisioning (see above) that our provisioning remains prudent.

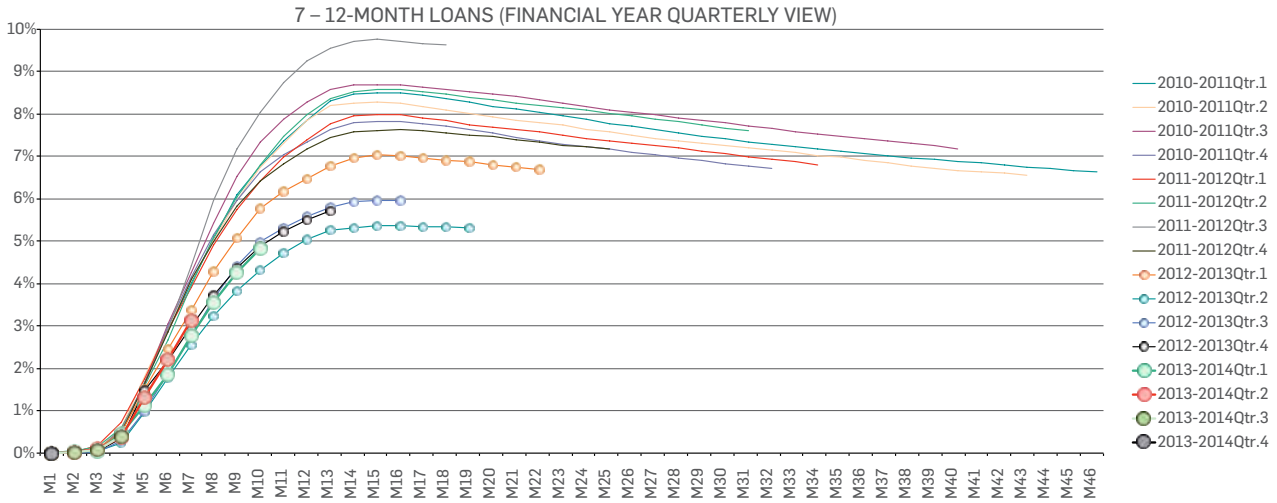
Our bad debt recoveries grew from R273 million to R434 million. The performance of the panel of collection agencies has stabilised and central, internal collections are now performing to satisfaction. Centralising our collections has not been without growing pains. We had to address some people, systems and process matters to optimise collections. As one example, configuration issues with our predictive dialler negatively impacted recoveries. We also appointed more personnel, invested in training and recalibrated the performance measurement systems. These measures together with new strategies, including the sale of part of the handed over book improved recoveries in 2014. Better collection experience had a positive impact on the valuation of the handed-over book. We value our handed over book at the contractual all in rate. None of the loans valued and identified for collection have prescribed.

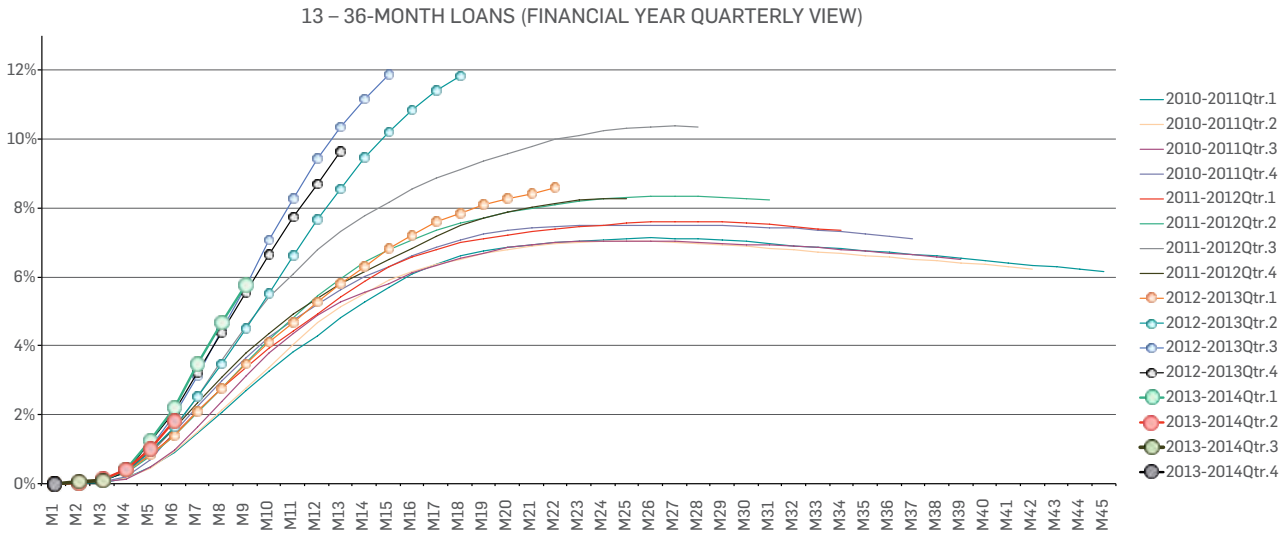
GROSS LOAN IMPAIRMENT EXPENSE
(BEFORE RECOVERIES) (R'm)

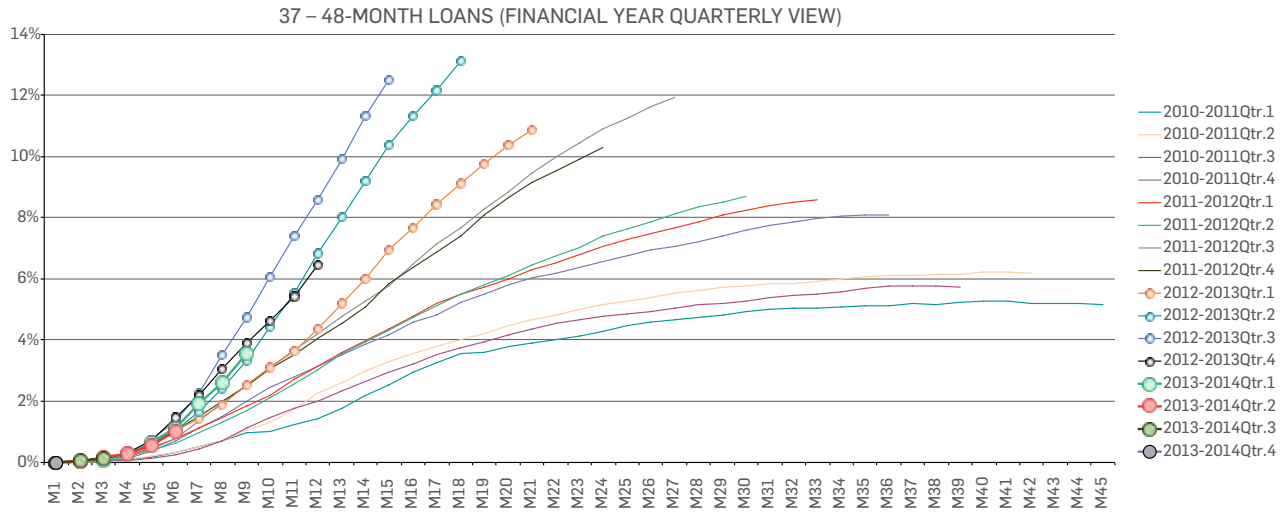


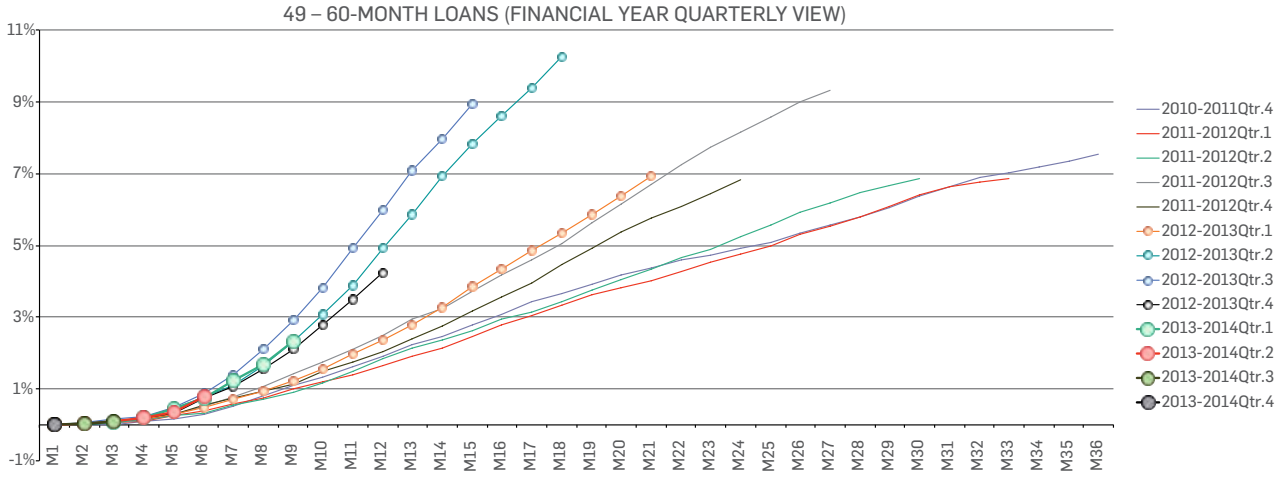

| | (Months) | | | | | Total |
|---|---|---|---|---|---|---|
| | 1-12 | 13-36 | 37-48 | 49-60 | 61-84 | |
| 2013 | 178 | 735 | 665 | 689 | 665 | 2 932 |
| 2014 | 121 | 951 | 938 | 1 032 | 1 368 | 4 410 |

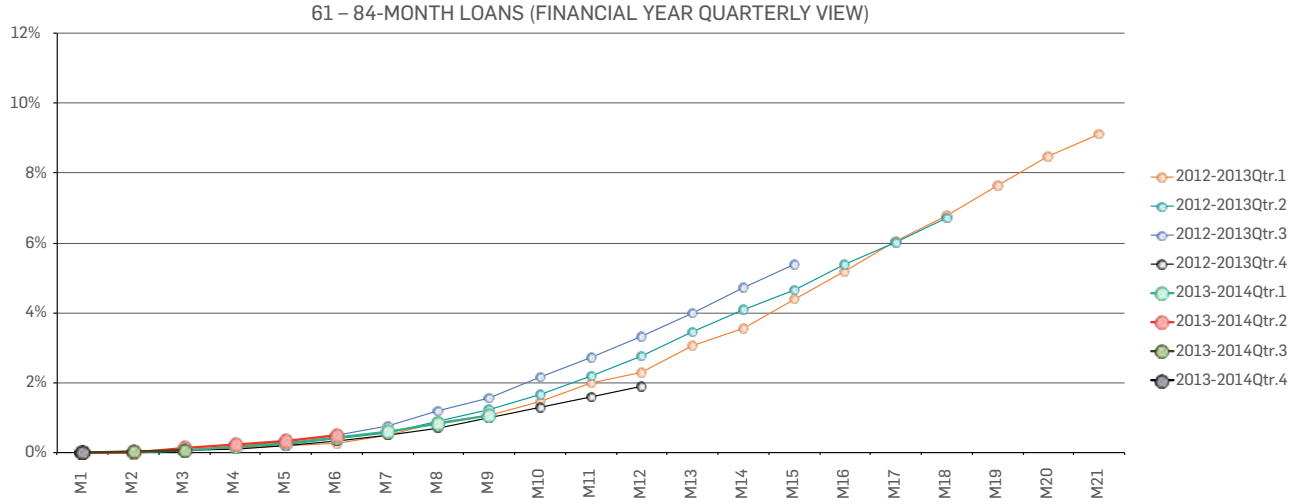
# Vintage graphs




37 – 48-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
14%
12%
10%
8%
6%
4%
2%
0%
M1 M2 M3 M4 M5 M6 M7 M8 M9 M10 M11 M12 M13 M14 M15 M16 M17 M18 M19 M20 M21 M22 M23 M24 M25 M26 M27 M28 M29 M30 M31 M32 M33 M34 M35 M36 M37 M38 M39 M40 M41 M42 M43 M44 M45
2010-2011Qtr.1
2010-2011Qtr.2
2010-2011Qtr.3
2010-2011Qtr.4
2011-2012Qtr.1
2011-2012Qtr.2
2011-2012Qtr.3
2011-2012Qtr.4
2012-2013Qtr.1
2012-2013Qtr.2
2012-2013Qtr.3
2012-2013Qtr.4
2013-2014Qtr.1
2013-2014Qtr.2
2013-2014Qtr.3
2013-2014Qtr.4


49 – 60-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
11%
9%
7%
5%
3%
1%
-1%
M1 M2 M3 M4 M5 M6 M7 M8 M9 M10 M11 M12 M13 M14 M15 M16 M17 M18 M19 M20 M21 M22 M23 M24 M25 M26 M27 M28 M29 M30 M31 M32 M33 M34 M35 M36
2010-2011Qtr.4
2011-2012Qtr.1
2011-2012Qtr.2
2011-2012Qtr.3
2011-2012Qtr.4
2012-2013Qtr.1
2012-2013Qtr.2
2012-2013Qtr.3
2012-2013Qtr.4
2013-2014Qtr.1
2013-2014Qtr.2
2013-2014Qtr.3
2013-2014Qtr.4


61 – 84-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
12%
10%
8%
6%
4%
2%
0%
M1 M2 M3 M4 M5 M6 M7 M8 M9 M10 M11 M12 M13 M14 M15 M16 M17 M18 M19 M20 M21
2012-2013Qtr.1
2012-2013Qtr.2
2012-2013Qtr.3
2012-2013Qtr.4
2013-2014Qtr.1
2013-2014Qtr.2
2013-2014Qtr.3
2013-2014Qtr.4

## Transacting

*Net transaction fee income of R1.9 billion.*

Net transaction fee income grew by 43% to R1.9 billion compared to R1.3 billion in the 2013 financial year.

Net transaction fee income amounted to 32% of net banking income after impairment charges, up from 26% for the 2013 financial year. The 55% target for net transaction fee income as a percentage of banking operating expenses by 2016 was exceeded at 59%. Management maintains its target of 55% for the next three years.

Gross transaction fee income amounted to R2.8 billion and increased by 33% while transaction fee expenses, which consist of interchange charges from other banks and service providers, grew by 14% to R860 million.

Growth was driven by a continued increase in clients and the expansion of Capitec's distribution network. A total of 5.4 million active clients access Capitec's money management solutions through a branch network that grew to 629 branches (2013: 560) countrywide, a total of 2 918 own and partnership ATMs (2013: 2 554), a network of national (Saswitch) and international ATMs of other financial institutions, mobile branches, internet banking, mobile banking that can be used to purchase airtime and electricity, purchases at 24 329 own POS devices (2013: 19 955), a network of national and international POS devices of other financial institutions and cash withdrawals and money transfers at retail partners.

## Funding

*Conservative debt to equity ratio maintained*

The debt to equity ratio increased marginally to 3.6:1 from 3.5:1 due to continued strong growth in retail deposits. Total deposit funding increased by R6.4 billion to R35.4 billion. The growth in deposit funding was driven by retail deposits which increased 37% to R23.6 billion.

*Strong retail deposit growth continues*

Retail call savings grew by 41% and totalled R14.6 billion. The number of savings accounts increased by 20% and the average balance per account increased by 18% when compared to the end of February 2013.

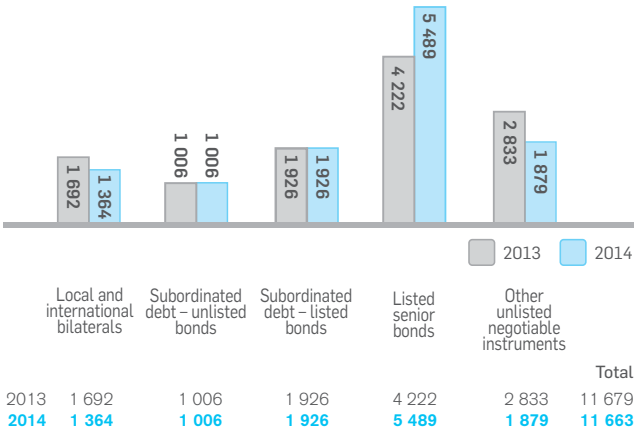
*Retail fixed savings now 43% of term funding*

Retail fixed savings amounted to R9 billion, a growth of 31%. The weighted average maturity of retail fixed funding was 18 months at the end of February 2014 (2013: 18 months). The number of accounts grew by 27% and the average balance per account grew by 3% compared to February 2013. Retail fixed savings grew to 43% of total term funding (2013: 37%) surpassing the target of 40% set at the end of the previous year. Management maintains a preference for fixed-term retail funding due to the lower average pricing, lower concentration and lower refinancing risks.

*Reduced demand for wholesale funding*

The value of wholesale deposits remained the same as the previous year at R11.7 billion. We successfully rolled and extended a wholesale bond of R1.3 billion on the domestic medium term note program (DMTN) in May 2013. Slower loan sales mean less demand for funding and the growth in retail deposits was sufficient to meet this need. Consequently, no additional bond funding was issued on the DMTN program. The weighted average maturity of wholesale funding was 36 months (2013: 42 months). The composition of wholesale funding by funding instrument is as illustrated in the following chart.

WHOLESALE FUNDING BY NATURE (R'm)



## Liquidity

*Conservative liquidity policy maintained*

There has been no change in our liquidity policy over the past year. The management of liquidity continues to take preference over the optimisation of profits. Management's liquidity philosophy remains cautious and conservative. This conservatism at times results in the holding of cash in excess of immediate operational requirements.

*Early compliance with new Basel 3 ratios*

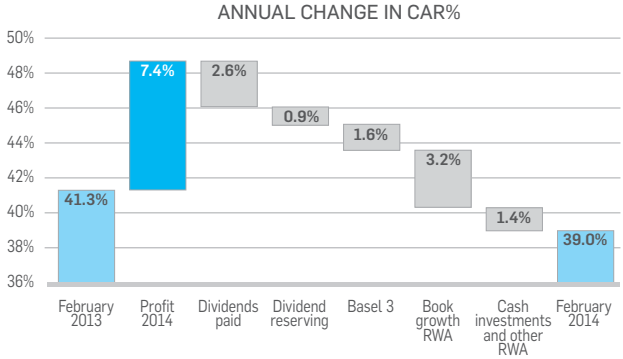
Despite difficult economic conditions the bank has not experienced volatility in its retail funding base and Capitec comfortably complies with the two new Basel 3 liquidity ratios, the liquidity coverage ratio and the net stable funding ratio, in advance of the 2018 and 2019 implementation dates, respectively.

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.

*31% of balance sheet assets invested in cash and highly liquid instruments*

Surplus funding and liquidity buffers are invested in highly liquid and high quality, interest-bearing instruments, selected to minimise the net carrying cost of surplus funds. 31% of the balance sheet is invested in these assets. Instruments with maturities greater than three months but less than twelve months from the date of acquisition are included in investments designated at fair value and comprise treasury bills (97%) issued by the South African National Treasury and negotiable certificates of deposit (3%) issued by a large South African Bank.

The contractual liquidity position as at 28 February 2014 is set out in Annexure 1 to this report.




## Capital

*No need for additional capital*

Capitec remains well capitalised with a capital adequacy ratio of 39% (2013: 41%). Low loan growth has meant that there has only been a moderate demand for capital. As illustrated in the graph above the profitability of the bank is funding the capital demand after paying and reserving for dividends.

The decline in the ratio is mainly driven by Basel 3 adjustments which are phasing out existing preference shares and subordinated debt instruments which do not have so-called 'bail-in' or 'loss absorbency' clauses. The impact of the Basel 3 phase-out changes in 2014 was 1.6% on the capital adequacy ratio. There is a lack of clarity in the market regarding the most appropriate terms and conditions for new Basel 3 compliant instruments, validating our decision to have done a rights issue to ensure that we are well capitalised during this period of market adjustment.

## Credit rating

On 19 December 2013, Moody's affirmed Capitec Bank Limited's Baa3/P-3 international issuer ratings and A2.za/P-1.za national-scale issuer ratings, with an outlook of stable. The ratings continued to recognise Capitec Bank's strong loss absorption capacity and comprehensive provisioning policy. The outlook factored in the challenging operating conditions in unsecured lending which were likely to result in higher loan arrears and provisioning. There was cognisance of the

growing retail deposit base which has reduced funding concentrations and broadened the bank's funding profile, robust profitability and solid capitalisation levels.

## Cost structure

*Cost-to-income ratio down to 32%*

The cost-to-income ratio of banking activities improved from 38% for the 2013 financial year to 32% for the 2014 financial year.

Income from banking operations increased by 27%, while operating expenses increased by 8%, mainly due to growth in the branch network and corresponding growth in the number of employees. The increase in operating expenses amounted to R225 million. Variable remuneration costs at R76 million were 65% lower than the previous year. Employment costs represent 48% of total operating expenses compared to 51% in 2013. Capitec currently employs 9 070 people compared to 8 308 at the end of February 2013.

Fraud declined 49% to R38 million mainly as a result of the migration of clients to the chip and pin based debit MasterCard.

The Capitec branch network grew to 629 branches, an increase of 69 branches. Based on the average number of income generating outlets for each year, the operating expense per outlet for the 2014 financial year amounted to R5.5 million compared to R5.6 million for the 2013 financial year. This is a decrease of 2%.

Depreciation and amortisation comprised 10% of total banking expenses and increased 31% to R325 million, as investment in branch and IT infrastructure continued. Advertising and marketing, communications and consumables all increased between 11% to 13%. Together they comprise 12% of total banking expenses and amount to R401 million. Operating lease costs increased 17% to R242 million due to the increase in branches and our strategy to site more branches in malls where rentals are costly.

An analysis of expenses is set out in Annexure 2 to this report.

## Regulation

2014 has been a year of significant activity on the regulatory front. The National Credit Act has been in a process of review and a number of changes are imminent on this front and the South African Reserve Bank has been reviewing fees in the banking industry. The table on the following page summarises the status of these developments and their impact on Capitec Bank.

EMPLOYMENT COSTS

| | | Strategic management | Senior management | Other employees | Total |
|---|---|---|---|---|---|
| **Employees** | Number | 10 | 82 | 8 978 | 9 070 |
| **Remuneration** | | | | | |
| **Fixed cash remuneration** | R'm | 41 | 87 | 1 288 | 1 416 |
| Cash staff performance bonus | R'm | – | – | 8 | 8 |
| Cash bonus bank | R'm | – | 4 | – | 4 |
| Share options | R'm | 5 | 3 | – | 8 |
| Share appreciation rights | R'm | 46 | 11 | – | 57 |
| **Variable remuneration** | R'm | 51 | 18 | 8 | 77 |

| Regulator | Development | Impact |
|---|---|---|
| SARB | Changes have been made to ATM interchange fees. | There is no material impact on Capitec. |
| SARB | Changes to card interchange fees | The outcome of this investigation will soon be made public. Interchange fees will reduce but growing business volumes will offset this. |
| NCR | Capping of fees on credit life and retrenchment insurance | Capitec does not charge credit life or retrenchment insurance. The impact will be beneficial for Capitec as this will result in many credit providers revising their risk appetites lower. It will become more difficult for clients with existing debt to over-indebt themselves. |
| NCR | Removal of adverse data from credit bureaux | We have made appropriate arrangements to ensure our credit granting standards are not compromised. |
| NCR | Review of interest and fees | Parliament has indicated that a review should be done of the current levels of interest and fees. There are no further developments at this time. |
| NCR | Development of affordability guidelines | This will have a positive benefit on Capitec as it may result in more uniform and lower risk appetites for credit providers across the industry. It will become more difficult for clients with existing debt to over-indebt themselves. We support this initiative. |
| NCR | Prescription and sales of handed over debt. | This has no impact on Capitec as we have no debt on our books that has prescribed. |

## Dividends

The board of directors considers the capital and funding requirements of the business before declaring dividends. The dividend cover for the past five years ranged from 2.6 to 2.5.

**André du Plessis**
*Chief financial officer*

# Annexure 1

## Group contractual liquidity position

| Maturities of financial assets and financial liabilities (discounted cash flows) R'000 | Notes | Demand to one month | One to three months | Three months to one year | More than one year | Adjustment[4] | Total |
|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | |
| **Undiscounted assets** | | | | | | | |
| Cash and cash equivalents – sovereigns | 5 | 715 825 | – | – | – | – | 715 825 |
| Cash and cash equivalents – banks | 5 | 7 714 844 | 1 246 239 | – | – | – | 8 961 083 |
| Money markets unit trusts | 5 | 2 278 | – | – | – | – | 2 278 |
| Investments at fair value through profit or loss – sovereigns | 6 | 695 330 | 285 000 | 3 791 580 | – | – | 4 771 910 |
| Loans and advances to clients – retail personal | 7 | 2 201 252 | 3 059 347 | 12 798 287 | 39 901 710 | (368 304) | 57 592 292 |
| Loans and advances to clients – retail other | 7 | 5 307 | – | – | – | – | 5 307 |
| Loans and advances to clients – corporate other | 7 | 14 466 | – | – | – | – | 14 466 |
| Other receivables | 8 | 118 464 | 51 | – | 2 197 | – | 120 712 |
| Derivative assets | 9 | – | (3 251) | 17 932 | 230 057 | – | 244 738 |
| Current income tax assets | | – | – | 22 529 | – | – | 22 529 |
| Undiscounted assets | | 11 467 766 | 4 587 386 | 16 630 328 | 40 133 964 | (368 304) | 72 451 140 |
| Adjustments for undiscounted assets | | (839 285) | (1 466 995) | (6 591 606) | (15 095 506) | – | (23 993 392) |
| **Discounted assets** | | | | | | | |
| Loan impairment provision | 7 | (317 583) | (134 230) | (568 546) | (2 616 817) | – | (3 637 176) |
| **Total discounted assets** | | 10 310 898 | 2 986 161 | 9 470 176 | 22 421 641 | (368 304) | 44 820 572 |
| **Undiscounted liabilities** | | | | | | | |
| Deposits and bonds at amortised cost | 14 | 15 315 786 | 1 739 300 | 5 137 338 | 18 217 404 | – | 40 409 828 |
| Trade and other payables | 15 | 385 846 | 118 914 | 32 762 | 92 348 | 118 863 | 748 733 |
| Current income tax liabilities | | – | – | – | – | – | – |
| Provisions | 16 | – | – | – | 11 451 | – | 11 451 |
| Undiscounted liabilities | | 15 701 632 | 1 858 214 | 5 170 100 | 18 321 203 | 118 863 | 41 170 012 |
| Adjustments for undiscounted liabilities to depositors | | (24 714) | (191 151) | (920 600) | (3 824 685) | – | (4 961 150) |
| **Total discounted liabilities** | | 15 676 918 | 1 667 063 | 4 249 500 | 14 496 518 | 118 863 | 36 208 862 |
| **Net liquidity excess/(shortfall)[2]** | | (5 366 020) | 1 319 098 | 5 220 676 | 7 925 123 | (487 167) | 8 611 710 |
| **Cumulative liquidity (shortfall)/excess** | | (5 366 020) | (4 046 922) | 1 173 754 | 9 098 877 | 8 611 710 | 8 611 710 |

# *Annexure 1 (continued)*

## Group contractual liquidity position

| Maturities of financial assets and financial liabilities (discounted cash flows) R'000 | Notes | Demand to one month | One to three months | Three months to one year | More than one year | Adjustment[4] | Total |
|---|---|---|---|---|---|---|---|
| **2013** | | | | | | | |
| **Undiscounted assets** | | | | | | | |
| Cash and cash equivalents – sovereigns | 5 | 1 854 283 | – | – | – | – | 1 854 283 |
| Cash and cash equivalents – banks | 5 | 4 588 013 | – | – | – | – | 4 588 013 |
| Money markets unit trusts | 5 | 702 492 | – | – | – | – | 702 492 |
| Investments at fair value through profit or loss – sovereigns | 6 | 270 900 | 211 260 | 1 584 400 | – | – | 2 066 560 |
| Loans and advances to clients – retail personal | 7 | 2 003 556 | 2 688 862 | 11 103 896 | 37 720 055 | (458 634) | 53 057 735 |
| Loans and advances to clients – retail other | 7 | 1 027 | – | – | – | – | 1 027 |
| Loans and advances to clients – corporate other | 7 | 19 509 | – | – | – | – | 19 509 |
| Other receivables | 8 | 79 218 | (375) | (1 429) | 7 347 | – | 84 761 |
| Current income tax assets | | – | – | – | – | – | – |
| Undiscounted assets | | 9 518 998 | 2 899 747 | 12 686 867 | 37 727 402 | (458 634) | 62 374 380 |
| Adjustments for undiscounted assets | | (852 915) | (1 461 231) | (5 892 875) | (14 258 931) | – | (22 465 952) |
| **Discounted assets** | | | | | | | |
| Loan impairment provision | 7 | (189 472) | (89 537) | (352 590) | (2 091 215) | – | (2 722 814) |
| **Total discounted assets** | | 8 476 611 | 1 348 979 | 6 441 402 | 21 377 256 | (458 634) | 37 185 614 |
| **Undiscounted liabilities** | | | | | | | |
| Deposits and bonds at amortised cost | 14 | 11 062 854 | 1 078 056 | 4 927 845 | 16 875 837 | – | 33 944 592 |
| Trade and other payables | 15 | 302 633 | 193 101 | 31 562 | 132 927 | 98 860 | 759 083 |
| Current income tax liabilities | | – | – | 46 007 | – | – | 46 007 |
| Provisions | 16 | – | – | – | 28 449 | – | 28 449 |
| Undiscounted liabilities | | 11 365 487 | 1 271 157 | 5 005 414 | 17 037 213 | 98 860 | 34 778 131 |
| Adjustments for undiscounted liabilities to depositors | | (9 452) | (138 937) | (761 177) | (4 034 835) | – | (4 944 401) |
| **Total discounted liabilities** | | 11 356 035 | 1 132 220 | 4 244 237 | 13 002 378 | 98 860 | 29 833 730 |
| **Net liquidity (shortfall)/excess[2]** | | (2 879 424) | 216 759 | 2 197 165 | 8 374 878 | (557 494) | 7 351 884 |
| **Cumulative liquidity (shortfall)/excess** | | (2 879 424) | (2 662 665) | (465 500) | 7 909 378 | 7 351 884 | 7 351 884 |

*[1]The contractual maturity of the financial assets and liabilities of the company are all on demand to one month.*

*[2]Much of the liquidity shortfall in the demand to three-month categories results from the investment of excess cash in treasury bills and SARB debentures with maturities in excess of three months. These instruments are highly liquid and can be converted into cash should the need arise.*

*[3]The definitions of sovereign, corporate and retail are aligned with the Banks Act Regulations.*

*[4]The adjustments relate to deferred initiation fees, leave pay provision, deferred income and straight-lining of lease accruals.*

# Annexure 2

## Operating profit before tax

The following items have been included in arriving at operating profit before tax:

| | GROUP 2014 | 2013 |
|---|---|---|
| Loss/(Profit) on disposal of equipment | **80** | (358) |
| Loss on scrapping of intangibles | **–** | 19 |
| Depreciation on fixed assets | **248 794** | 196 108 |
| Amortisation of computer software | **76 164** | 51 070 |
| Gain on disposal of investment in subsidiary | **–** | (58) |
| | **325 038** | 246 781 |
| Advertising and marketing | **152 514** | 136 263 |
| Bank charges | **182 546** | 184 354 |
| Consumables | **114 594** | 102 850 |
| Communications | **133 590** | 118 535 |
| Operating lease rentals | | |
| Land and buildings | **239 162** | 204 271 |
| Office equipment | **2 964** | 3 415 |
| | **242 126** | 207 686 |
| Income from subletting | **(3 861)** | (2 872) |
| Auditors' remuneration | | |
| Audit fees - current year | **3 320** | 3 245 |
| Other services | **674** | 2 636 |
| Less: Other services accounted for in equity | **–** | (2 100) |
| | **3 994** | 3 781 |
| Employee costs (including directors' remuneration)[2] | | |
| Salaries and wages | **1 427 587** | 1 360 965 |
| Equity-settled share-based payment | **8 398** | 9 037 |
| Cash-settled share appreciation rights | **56 104** | 93 066 |
| Social security cost | **34 315** | 31 794 |
| Training cost | **35 015** | 44 376 |
| Training refund | **(10 232)** | (3 183) |
| | **1 551 187** | 1 536 055 |

*[1] Excludes change in fair value of financial assets through profit or loss as per note 6.*

*[2] Refer note 30 for details of directors' remuneration.*