

## *CFO Report*

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*Sustainable growth in a  
challenging economic  
environment.*

## Robust financial performance

### 27% return on equity

Capitec has proven its ability to manage the impact of economic pressures while maintaining conservatism in our unsecured lending book, liquidity and capital. The annual GDP growth of South Africa slowed to 1.3% for 2015, while other challenges faced by the country during the year included power shortages, student fee protests, falling commodity prices, political issues and currency weakness. All of these put constraints on the retail credit market; however, Capitec continued to grow and reported a return on equity of 27%.

### 26% increase in earnings

Regardless of the economic challenges faced by the South African economy, Capitec remained on target. Headline earnings per share increased by 26% from 2 209 cents to 2 787 cents per share. Earnings and headline earnings attributed to R3.2 billion compared to R2.5 billion in 2015. The total dividend paid of 1 055 cents in 2016 mirrored the 26% growth (2015: 836 cents).

The compound annual growth rates (CAGR) are as follows:

	Since listing in 2002 (%)	Last 10 years (%)	Last 5 years (%)	Last 3 years (%)	2015 (%)
Headline earnings	35	39	38	27	26
Headline earnings per share	29	33	30	22	26
Dividend	29	37	29	22	26
Share price	54	31	24	36	123

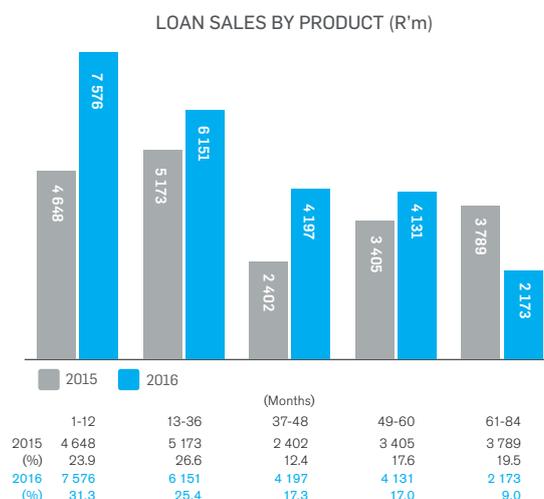
### Loans advanced (sales)

#### Enhancing our credit granting model

Capitec Bank's credit model is reviewed and adjusted continuously so that the credit offer meets the requirements and trends in the market, while performing within the credit risk appetite. We continued to refine the precision of the credit granting model throughout the year to enable us to achieve loan sales totalling R24.2 billion for the year (2015: R19.4 billion). While the value of loans increased by 25%, the number of loans increased by 31%. During the 2016 financial year the maximum loan offer increased to R250 000 (2015: R200 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.

In November 2015 the updated granting model included the launch of a credit facility, which replaced the multi loan. We further updated the affordability assessment in the model, resulting in an improved offer to higher quality and higher income clients, through increasing the maximum allowable repayment to income ratios for these clients.

In the highly competitive short-term category of 1 to 12 months, we saw a 63% rise in the value of loans sales, mainly by refining our pricing for risk model, and expanding access to affordable short term credit. The number of loans in this category increased by 35% to 3.2 million loans. On medium and long-term loans we continued to enhance our risk model, reducing the maximum term available to average risk clients, resulting in strong year-on-year growth in the 37 to 48 month and 49 to 60 month categories of 75% and 21% respectively. The value of loans in the maximum category of 61 to 84 month decreased by 43%. Below is a graph detailing the sales by product:



### National Credit Regulator (NCR)

Recent regulatory developments, including the NCA Affordability Regulations which became effective on 14 September 2015, Regulations on Review of Limitations on Fees and Interest Rates, and the proposed Credit Life Insurance Regulations, will lead to a reduction in the market supply of unsecured credit. This coupled with household expense pressures may lead to marginal consumers defaulting. Over the longer term these regulatory developments will result in a more stable unsecured lending market. We believe we are well positioned to operate within these guidelines and regulations.

### Negative industry growth of 2%

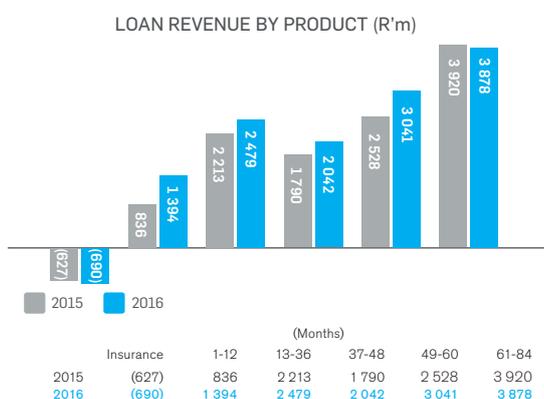
As per NCR statistics, the unsecured lending industry experienced negative growth for the first three calendar quarters of 2015, declining by 2%<sup>(1)</sup> or R0.9 billion compared to the same period in 2014 when credit declined by 14%. The reduced rate of decline during 2015 is due in part to the return of stability to the unsecured credit market after African Bank was placed in curatorship during August 2014.

<sup>(1)</sup> Capitec reflects loans advanced net of internal loan consolidations. The NCR consumer credit reports do not explicitly mention that internal and external loan consolidations are removed from the statistics. Credit granted by the market, as reported therein, may be inflated.

## Loan revenue

### 14% growth in loan revenue

Loan revenue, which consists of interest, origination fees and monthly administration fees net of insurance expense, grew by 14% to R12.1 billion compared to the 8% growth in 2015. This is predominately due to higher margin short term loans. The distribution of revenue by product category is shown in the following graph:



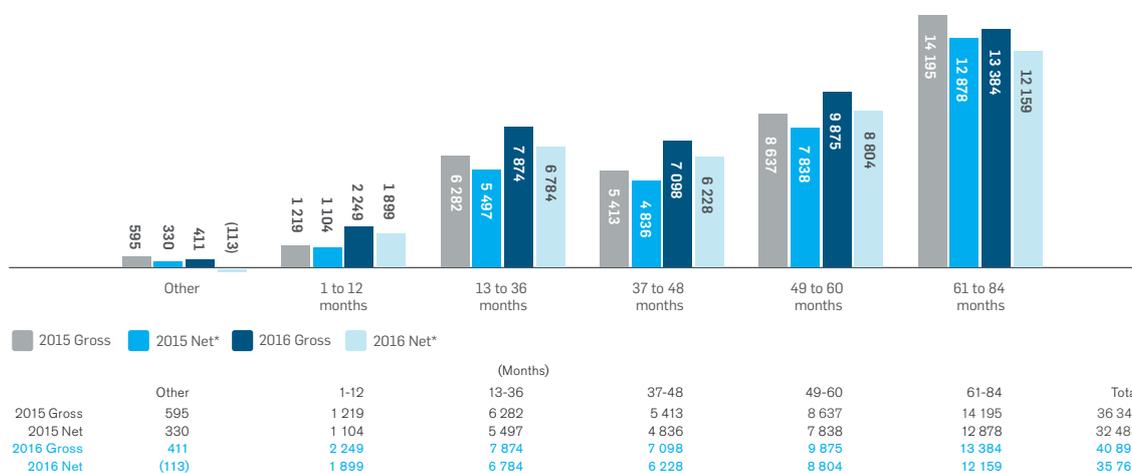
Interest income grew by 16%. In addition to the increased loan sales, the interest income line continued to benefit from the contribution from interest on loans written in previous years (the annuity income effect) and the interest earned on surplus funding and liquidity buffers. Net loan fee income (loan fees net of insurance expenses) increased by 38% to R855 million. The increase in loan fee income of 24% to R1.5 billion was offset by the cost of insuring the book against the death or retrenchment of clients, which increased by 10% to R690 million.

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

We continue to insure our book against events relating to retrenchment (non-government) and the death of all our clients. The full value of any outstanding loan is insured. Insurance cost increased during the year as the book grew and as the rate on retrenchment insurance became more expensive. Insurance premiums cost Capitec Bank R690 million (2015: R627 million).

This insurance protects Capitec from bad debts, but also benefits our clients. When retrenched, our clients have a safety buffer and in the case of death, Capitec does not claim against their deceased estates. We do not currently charge our clients credit life or retrenchment insurance as this is built into the interest rate we charge our clients, but will start to do so from 6 May 2016 when regulations for interest rate limits and fees for credit agreements become effective.

LOAN BOOK BY PRODUCT (R'm)



\* 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.

## Loan book, arrears and provision for doubtful debts

### 13% growth in loans and advances

The retail customers are showing confidence in our simple, transparent and affordable product range. This is reflected in our gross loan book that grew by R4.6 billion to R40.9 billion. This was an increase of 13% compared to the increase of 8% in 2015.

### Tightening of credit granting criteria

During the year we implemented a number of adjustments to our granting parameters, the most significant being in April and November 2015.

The adjustments were intended to widen access to affordable short term credit, reduce the maximum term available to average risk clients, increase offers

to high quality clients, and launch the new credit facility which replaced the multi loan.

At the end of February 2016 the weighted average outstanding term of the loan book was 40 months (2015: 43 months). The average loan size granted decreased from R6 887 to R6 577. The total number of loans granted during the year increased from 2.8 million to 3.7 million. More short-term loans were sold during the year.

Gross loans and advances with terms longer than 12 months continued to comprise most of the book at 94% compared to 95% at February 2015. The 61 to 84 month loan book accounts for 33% (2015: 39%) of the gross loan book.

		Aug 2014	Feb 2015	Aug 2015	Feb 2016
Gross loans and advances	R'm	35 086	36 341	37 898	40 891
Loans past due (arrears)	R'm	1 935	1 964	1 781	2 297
Arrears to gross loans and advances	%	5.5	5.4	4.7	5.6
Provision for doubtful debts	R'm	3 763	3 857	4 249	5 131
Provision for doubtful debts to gross loans and advances	%	10.7	10.6	11.2	12.5
Arrears coverage ratio <sup>(1)</sup>	%	194	196	239	223
Arrears and arrears rescheduled in the last six months, now current	R'm	2 680	2 848	2 948	3 839
Arrears and arrears rescheduled within the last six months, now current to gross loans and advances	%	7.6	7.8	7.8	9.4
Arrears and arrears rescheduled within the last six months, now current coverage ratio	%	140	135	144	134

(1) The 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.

### Rescheduled accounts

As a practical collection strategy, rescheduling is still accepted as an effective arrears preventer. Over the past few years we have implemented several rescheduling strategies affecting arrears and continue to closely monitor rescheduled accounts.

Amending a contract does not necessarily remove the risk and hence a higher provision is held on current rescheduled loans than the rest of the current book. During the year our provisioning on the higher risk class of arrears, which were rescheduled in the past six months increased, from 42% in 2015 to 49% at the end of 2016.

The increase in the arrears to gross loans and advances percentage, can partially be attributed to the focussed increase in higher margin/higher arrears short-term loans. This also partially lead to increased arrears rescheduling.

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	2016	(%)	2015	(%)
Gross	35 234		32 363	
Impairment	(2 697)	8	(2 128)	7
<b>Current</b>	<b>32 537</b>		30 235	
Gross	1 818		1 130	
Impairment	(288)	16	(206)	18
<b>Current – rescheduled from current not rehabilitated <sup>(1)</sup></b>	<b>1 530</b>		924	
Gross	1 542		884	
Impairment	(758)	49	(367)	42
<b>Current – rescheduled from arrears not rehabilitated <sup>(2)</sup></b>	<b>784</b>		517	
Gross	2 297		1 964	
Impairment	(1 388)	60	(1 156)	59
<b>Arrears</b>	<b>909</b>		808	
	<b>35 760</b>		32 484	
Total gross	40 891		36 341	
Total impairment	(5 131)		(3 857)	
	<b>35 760</b>		32 484	

(1) Clients are deemed to be rehabilitated once they have made six consecutive payments.

(2) These are loans and advances relating to clients that were in arrears and were subsequently rescheduled in line with approved credit policy rules on forbearance. If these loans are up-to-date six months post rescheduling, they are reclassified to current for impairment allowance purposes.

### 17% increase in arrears

Arrears increased from R2.0 billion at the end of February 2015 to R2.3 billion, an increase of 17%. Arrears as a percentage of gross loans and advances increased slightly from 5.4% at the end of February 2015 to 5.6%. Arrears performed better than target up to November 2015. However, there was a deterioration thereafter which was more pronounced than the trends over the same period in previous years. This can be attributed to the challenging economic factors that put constraints on customers. We addressed this by adjusting our granting strategies and increasing our impairment provisions.

### Continued prudence in provisioning

Our provisioning remains prudent and our write-off policy remains unchanged. We continue to reflect arrears and provisions 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. After 90 days all of the client's outstanding balances on all loans are written off.

### Increase in impairment provisions

With the fluctuations in the macro-economic environment we continued with our conservative provisioning approach. The increase in our provision is driven by three factors. firstly, our statistical model provision increased by 15%, which was more than the 13% increase in the loan book. The second is that we have maintained our prudent approach of supplementing the model provision with the probability that a non-reschedule client will reschedule and thirdly we further analysed economic expectations and indicators and how this will affect our clients. These two supplements combined increased

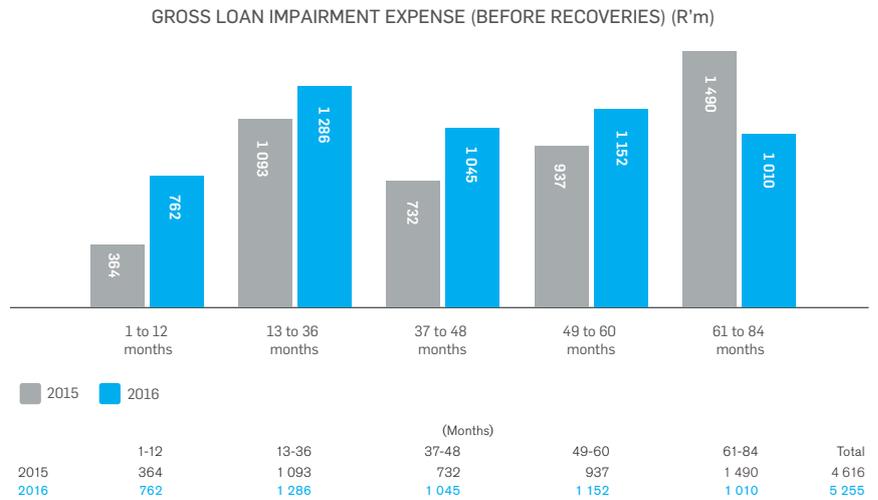
our provision by R372 million. The impairment provision consequently increased by 33% to R5.1 billion and represents 12.5% of gross loans and advances compared to 10.6% at the end of February 2015.

*Loan impairment expense*

The net loan impairment expense was R4.4 billion (2015: R4.0 billion) and is 11.4% of average gross loans and advances. The impairment charge comprises bad debts written off, the movement in provisions for bad debts (impairment allowance) and bad debts recovered. The drop in bad debts written off (excluding provision movements and recoveries) to R4.0 billion (2015: R4.4 billion) was mostly due to rescheduling. The provision charge was R1.3 billion compared to the R220 million in 2015. We continue to improve our collection environment, hence the increase in the bad debt recovered of 42% from 2015.

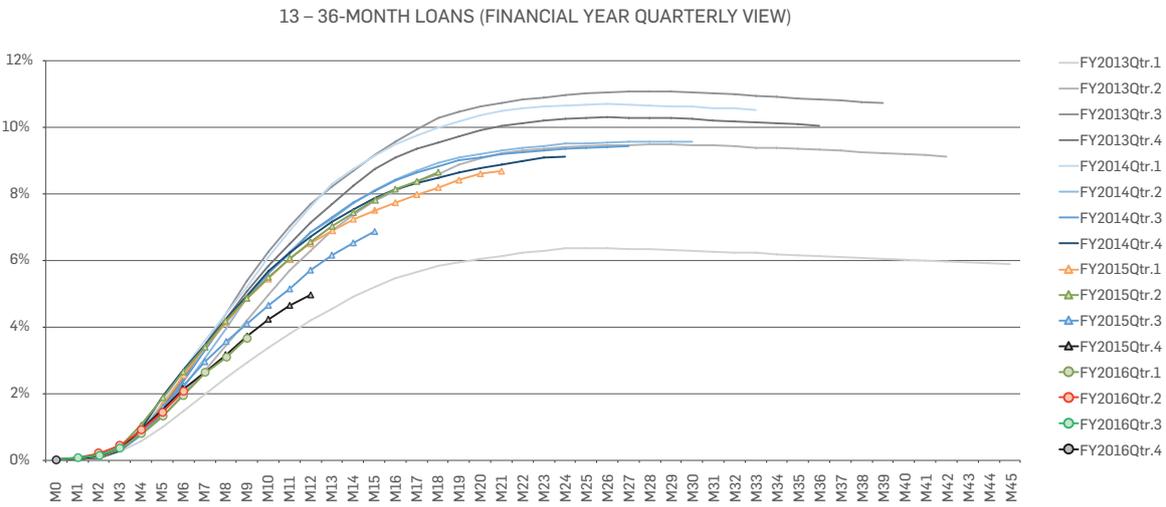
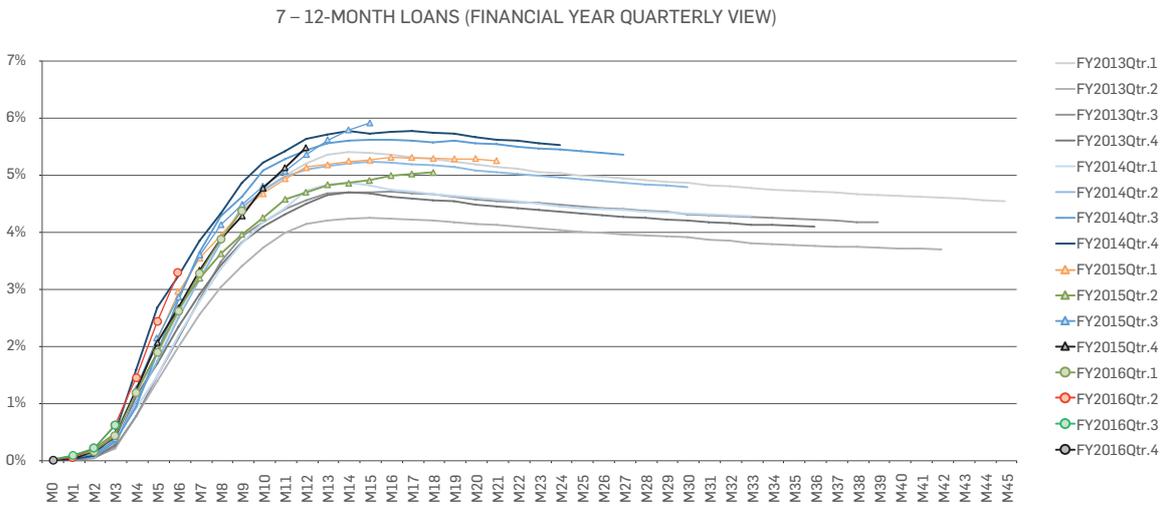
R'm	2016	2015
Bad debts	3 981	4 396
Movement in impairment allowance	1 274	220
Gross loan impairment expense	5 255	4 616
Bad debts recovered	(854)	(602)
Net impairment charge	4 401	4 014

The loan impairment expense is shown per product category above right, and approximately reflects the sales growth in these product categories.

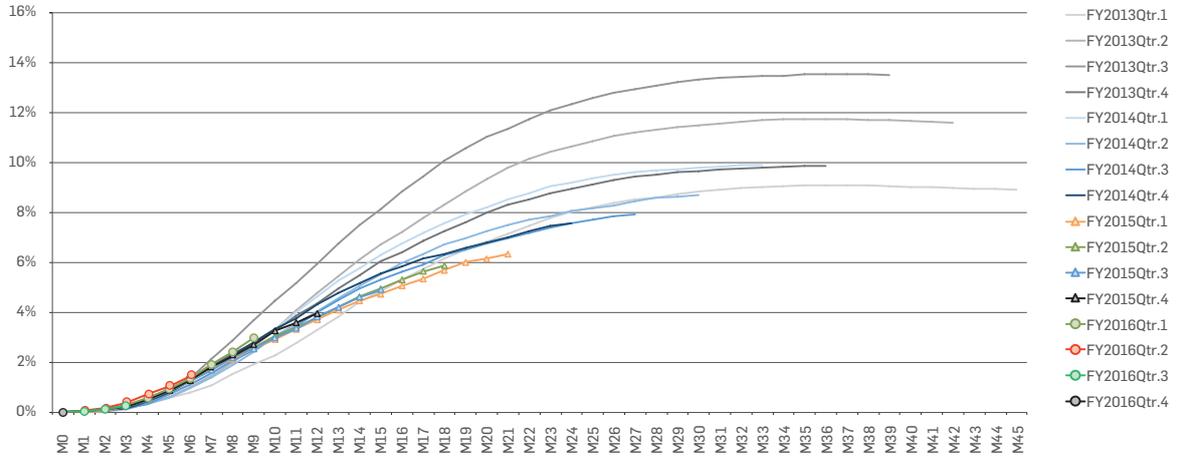


## Vintage graphs

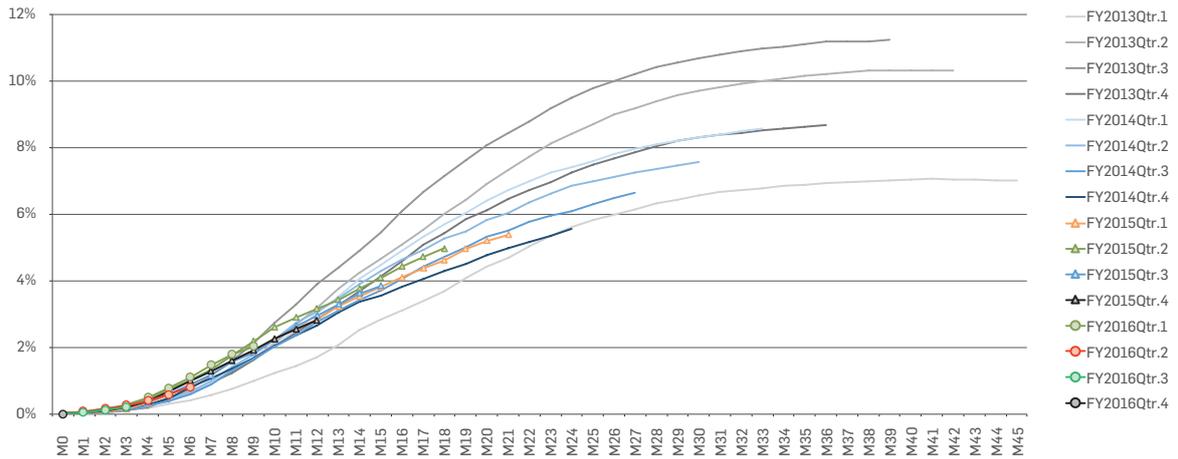
These vintage graphs express the balance at risk at time of write-off as a percentage of the total original planned instalments for the loans granted in a given quarter.



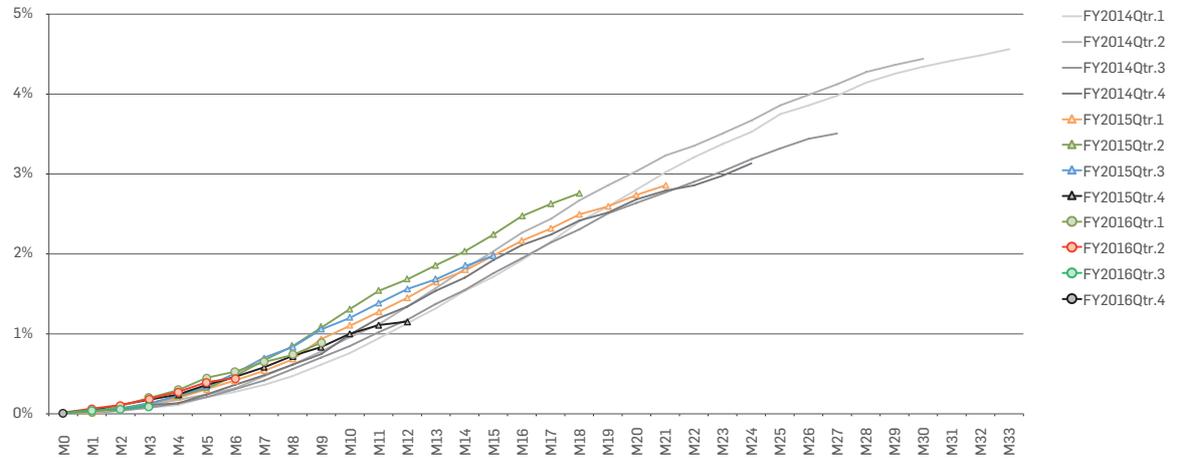
37 – 48-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)



49 – 60-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)



61 – 84-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)



## Transacting

### *Net transaction fee income of R3.0 billion*

Net transaction fee income grew by 16% to R3.0 billion compared to R2.6 billion in the 2015 financial year despite the impact of the reduction in card processing fees that became effective on 17 March 2015. The target for net transaction fee income as a percentage of banking expenses was 55% for 2016 and the actual percentage for 2016 was 66% (2015: 65%). Net transaction fee income amounted to 33% of net banking income after impairment charges, down from 34% for the 2015 financial year.

Growth was driven by a continued increase in clients and the expansion of Capitec's distribution network and access to digital channels. Our clients increased by 1.1 million from 6.2 million in 2015 to 7.3 million for the year. The branch network was expanded by opening new branches and increasing the capacity of existing branches. Gross transaction fee income amounted to R4.3 billion (2015: R3.7 billion) and increased by 16% (2015: 32%) while transaction fee expenses, which consist of interchange charges from other banks and service providers, grew by 23% (2015: 24%) to R1.3 billion (2015: R1.1 billion).

A total of 7.3 million active clients access Capitec's money management solutions through the Capitec network, which grew to 720 branches (2015: 668) countrywide; a total of 3 705 own and partnership ATMs (2015: 3 418); 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 own POS devices; a network of national and international POS devices of other financial institutions and cash withdrawals and money transfers at retail partners. Mobile clients grew to 4.2 million (2015: 3.4 million).

## Funding

### *Debt-to-equity ratio of 3.6:1*

The debt-to-equity ratio remained fairly consistent at 3.6:1 slightly down from 3.7:1 in 2015. Total deposit funding increased by R6.8 billion (2015: R5.8 billion) to R47.9 billion. Retail deposits increased 26% or R7.8 billion to R37.8 billion. Wholesale funding declined by a net R1.0 billion.

### *Retail call deposits grew strongly*

Retail call savings grew by 25% from R19.3 billion to R24.2 billion. Continued brand awareness among higher net worth individuals has broadened the access to retail deposits.

### *Retail fixed savings now 57% of term funding*

Retail fixed term savings grew to R13.6 billion, a growth of 27%. The contribution to the fixed-term funding mix is now 57% (2015: 50%) as Capitec has not needed to aggressively grow wholesale term funding since 2013. The weighted average maturity of retail fixed funding was 17 months at the end of February 2016 (2015: 17 months).

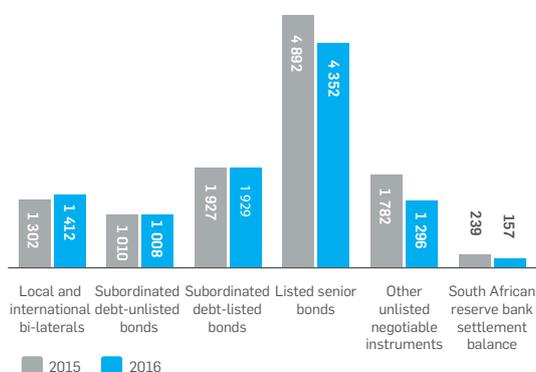
### *Wholesale funding*

The value of wholesale deposits declined from R11.2 billion in 2015 to R10.2 billion as instruments matured and were only partially refinanced. The amount of wholesale funding sourced was moderate due to strong profit and retail fixed deposit growth against muted loan book growth. Bond auctions were well subscribed with broad support from a number of investors. Capitec maintained its conservative liquidity policy, retaining long-term funding to match against longer term assets. Retail call deposits are not used to finance long term loans. The average term of wholesale funding at year-end was 26 months (2015: 27 months).

### *Interest rate exposure on wholesale funding hedged*

At February 2016, the bank had R1 567 billion unhedged wholesale floating rate funding. The interest rate risk at bank level remains low with a 2% shock to base rates resulting in a R18.3 million post taxation movement in profit (2015: R3.9 million).

WHOLESALE FUNDING BY NATURE (R'm)



#### 40% of balance sheet assets invested in cash and highly liquid instruments

Surplus funding is invested in liquid and high-quality, interest-bearing instruments. These cash assets are funded primarily by retail call deposits and provide a positive return. A total of 40% of the balance sheet is invested in these assets (2015: 37%) which comprise operational cash items (cash in ATMs and in drop safes), and an investment portfolio of bank call and fixed deposits, investments in national treasury bills and SARB debentures (that contribute to the management of prudential requirements) as well as money market unit trusts where the underlying assets are only high-quality banks paper.

The weighted average remaining maturity of the cash portfolio at 29 February 2016 was 91 days (28 February 2015: 78 days). The balance sheet categorisation for cash and cash equivalents is based on whether instruments have an original contractual maturity of less than three months. None of the longer-term investments have an original contractual maturity of longer than one year which assists in the management of interest rate risk.

#### Liquidity

##### *Conservative liquidity policy maintained*

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

to ensure that all obligations can be met as they become due.

##### *Compliance with new Basel 3 liquidity ratios*

Capitec continues to comfortably comply with the two new Basel 3 liquidity ratios, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). Compliance with the LCR came into effect on 1 January 2015, with a minimum required ratio of 60%, increasing to 100% by 2019. The group LCR was 1 040% (2015: 1 210%). The decrease is due to increased deemed outflows as a result of large growth in retail savings balances. Compliance with a NSFR of 100% is required from 2018. The group NSFR was 145% (2015: 138%). The increase is due to the strong retail deposit growth, which has a high contribution percentage to the stable funding part of the ratio.

#### Capital

##### *Capital is strong*

Capitec remains well capitalised with a capital adequacy ratio of 34.9% (2015: 35.7%). The appropriation of retained earnings is adequately funding the growth in the retail lending book. The growth in the retail loan book decreased the capital adequacy ratio by 2.5% and retained earnings (2016 profit less dividends paid and reserved for) increased the capital adequacy ratio by 5.2%. The investment made in cash and short-term investments (which offer better yields for surplus cash) decreased the capital adequacy ratio by 1.9%.

A total of R33 million of non-qualifying perpetual preference shares were redeemed during the year. Lack of clarity in the market regarding the most appropriate terms and conditions for issuing new Basel 3 compliant preference share and subordinated debt instruments remains. Therefore, we maintain a conservative capital position as non-qualifying Basel 3 preference share and subordinated debt instruments continue to be phased out. The core equity ratio is 30.1% (2015: 29.4%).

The capital conservation buffer came into effect on 1 January 2016, and will be phased in until 2019 where it will be 2.5%.

## Credit rating

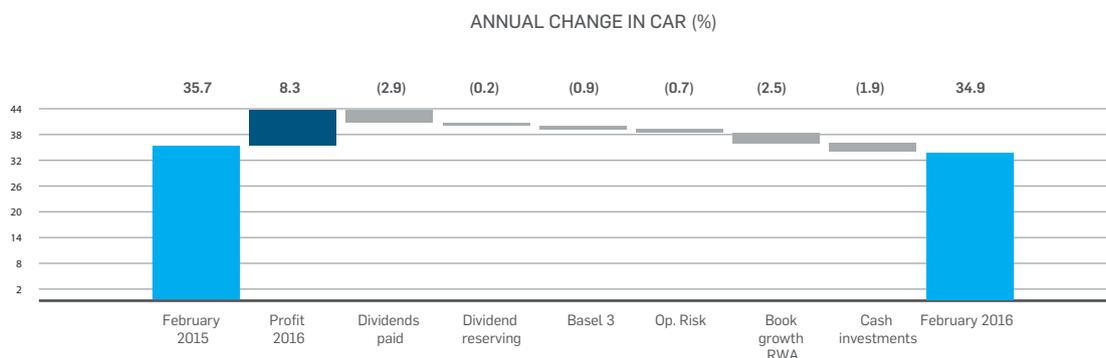
The credit ratings services supplied by Moody's Investor Services were terminated in December 2015. Currently, Capitec Bank Limited is only rated by Standard and Poor's (S&P) and carries the following ratings:

Global scale ratings	- "BB+" long-term rating
	- "B" short-term rating
National ratings	- "A" long-term rating
	- "A-2" short-term rating

The global scale long-term ratings have a negative outlook. This outlook was changed from stable in December 2015 due to the sovereign's outlook being downgraded. The South African sovereign credit ratings are scheduled to be updated in June 2016 and the risk remains real that a downgrade may occur. This will place pressure on Capitec's ratings, along with other financial institutions which could impact the volume and cost of funds to be sourced in the market.

The growth in branches has led to an increase in related premises expenses, depreciation, consumables and staff costs. Our total number of employees increased from 10 261 for 2015 to 11 440 for 2016. Basic employee salary costs increased by R302 million and variable performance-based incentive costs decreased by R17 million. The total reduction in incentive costs comprised R31 million increase for bonuses, R10 million increase for equity-settled method share options and R58 million decrease for share appreciation rights. An additional R10 million was spent on training costs this year as more staff went through our induction programmes to meet the service demand in branches.

Based on the average number of income-generating outlets for each year, the operating expense per outlet for the 2016 financial year amounted to R6.4 million compared to R6.2 million for the 2015 financial year.



## Cost structure

The cost-to-income ratio decreased slightly from 35% for 2015 to 34% in 2016. Income from banking operations increased by 16%, while operating expenses increased by 14%. The growth in income from banking operations is dealt with in the sections on loan revenue and transacting. Total banking operating expenses increased to R4.6 billion from R4.0 billion.

We have made banking more accessible to communities by opening 52 additional branches, bringing the Capitec branch network to 720.

Capital expenditure increased 70% from R414 million to R704 million due to growing ATM and branch network and purchase of land and property.

Expenses remained within predefined limits and cost control within the company remains strong.

## Regulation

Regulatory change continues to be significant. The table below summarises the status of these developments and their impact on Capitec Bank.

Regulator	Development	Impact
SARB	Changes have been made to card interchange fees	Transaction fee revenues were impacted in 2016, but the growth in business volume offset this.
SARB	Review of non-authenticated early debit order collections environment	Capitec is involved in the working groups that are part of developing a revised solution for the NAEDO environment. The impact of any changes will be addressed in our processes.
SARB	<ul style="list-style-type: none"> <li>Review of the various methods used for calculating the capital requirements for credit risk</li> <li>Introduction of a method for holding capital on interest rate risk positions</li> </ul>	Capitec is involved in the working groups that are part of assessing these developments and any changes will be addressed in our processes.
DTI and NCR	The DTI invited comment on the draft regulations regarding the capping of costs 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
DTI and NCR	Review of limitations on fees and interest rates	The DTI published the final regulations for the limitation of fees and interest rates which will become effective from 6 May 2016.
NCR	Emolument Attachment Orders (EAOs)	The use of EAOs is being tested in the Constitutional Court. We monitor developments and will factor any developments into our plans.
DTI and NCR	National Credit regulations including affordability assessment regulations	New regulations dealing with the assessment of affordability under the National Credit Act, 2005, were published on 13 March 2015. The regulations came into effect on date of publication, but were suspended until 13 September 2015. We support proper regulation enhancing sustainability of the credit industry.
DTI and NCR	National Credit amendment act	The National Credit amendment act, commenced on 13 March 2015. It deals with issues such as the automatic removal of adverse consumer credit information, required procedures before debt enforcement and the registration and deregistration of alternative dispute resolution agents.

## 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 has been 2.6.



**André du Plessis**  
Chief financial officer