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Capitec Bank Ltd

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Capitec Bank Ltd

SACP	bb+

\+

Support	0

\+

Additional Factors	0

Anchor	bbb-	
Business Position	Moderate	-1
Capital and Earnings	Very Strong	+2
Risk Position	Weak	-2
Funding	Average	0
Liquidity	Strong	

GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BB+/Stable/B

Major Rating Factors

Strengths:	Weaknesses:
• Solid risk-adjusted capital buffer, supported by robust internal capital generation. • Balance-sheet liquidity that compares well with that of domestic peers. • Robust operational and credit risk management framework and a conservative provisioning policy.	• Higher normalized loss experience than peers. • Narrow focus on unsecured lending. • Second-tier bank with "low" systemic importance.

Outlook: Stable

Standard & Poor's Ratings Services' stable outlook on South Africa-based Capitec Bank Ltd (Capitec) reflects our expectations that Capitec's normalized credit losses will stabilize at between 10.5% and 11.0% over the next 12 months, loan growth will moderate at about 10%, and profitability will continue to compare well with that of sector peers. In our opinion, internal capital generation will sustain our risk-adjusted capital (RAC) ratio for the bank at more than 15% over the next 12 months.

We could lower our ratings on Capitec if its capitalization failed to reach 15% within a 12-18 month period, either through lower earnings or higher dividends than we currently expect, or if asset quality deteriorated beyond our expectations. This could happen if cost of risk rose above 15% or loan loss reserve coverage (including restructured loans) fell below 100%. We could also lower the ratings if the funding profile exhibited greater wholesale funding concentrations or weaker liquidity. Lastly, if the economic and industry headwinds prevailing in South Africa prompt either a negative sovereign rating action or a downward revision of our Banking Industry Country Risk Assessment (BICRA), we could lower the ratings on the bank.

We currently consider an upgrade of Capitec to be highly unlikely in the next 12 months. Any positive rating action would follow a material transformation of the bank's business mix to diversify business lines and revenues.

Rationale

The ratings on Capitec reflect our 'bb+' assessment of its stand-alone credit profile (SACP), which incorporates our 'bbb-' anchor as the starting point for rating banks operating only in South Africa.

We assess Capitec's business position as "moderate" based on its modest size and narrow focus compared with domestic banking peers. We assess the bank's risk position as "weak" because of its higher-than-average loan loss experience compared with peers' and its concentrated exposure to unsecured lending. However, we think that Capitec's understanding and management of credit risks in this asset class is robust, enabling it to extract high returns on high-risk assets and build up solid earnings and capital buffers to absorb expected credit losses.

As a result, we view Capitec's capital and earnings as "very strong" and over the next 12 months, we expect the bank will sustain our RAC ratio above 15%.

Capitec's funding and liquidity are assessed as "average" and "strong" respectively and compare well with its domestic peers. Capitec is one of the few entities in South Africa's banking system that meets the fully-loaded net stable funding and liquidity coverage ratios required under Basel III. However, due to its small size and focus, the bank could be exposed to additional confidence sensitivity relative to its larger peers. Capitec is mainly deposit funded, with little-to-no dependence on short-term wholesale funds.

We do not include any uplift in the ratings above the SACP because we believe there would be only limited support for senior creditors if the bank fails.

Anchor: 'bbb-' for a bank operating in South Africa

Under our bank criteria, we use our BICRA economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating to a bank. The anchor for a commercial bank operating only in South

Africa is 'bbb-', reflecting our economic risk score of '6' and industry risk score of '4'.

South Africa's economic risk incorporates the wide income disparities and infrastructure gaps that weigh increasingly on the country's growth and social fabric. We also factor in our expectation of the country's ongoing moderate economic and banking sector expansion over the next two years. Our opinion also includes fairly flat industry wide credit losses over the period, based on slight improvement in second-tier unsecured lenders and the upward normalization of credit losses of the top-five banks toward 1%.

We base our industry risk assessment on our opinion that regulation in South Africa is in line with international best practices, the banking system's structurally short-term and concentrated funding, the modest impact of the failure of African Bank Ltd., and the oligopolistic market position of the top-tier banks that creates high barriers to entry and supports their good profitability.

Table 1

Capitec Bank Ltd Key Figures					
		--Year ended Feb. 28--			
(Mil. ZAR)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	58,324.0	53,677.6	45,989.6	38,210.3	23,552.6
Customer loans (gross)	37,898.0	36,341.3	33,690.0	30,658.0	18,408.3
Adjusted common equity	11,486.4	10,279.3	8,725.0	7,660.0	4,561.2
Operating revenues	6,479.0	11,602.2	10,050.5	7,952.8	5,670.7
Noninterest expenses	2,315.0	3,942.9	3,165.3	3,016.8	2,505.0
Core earnings	1,467.0	2,631.9	2,093.4	1,583.6	1,077.5

*Data as of Aug. 31, 2015. ZAR--South African rand.

Business position:"Moderate," reflecting the bank's modest size and position in the second-tier of the South African banking sector

Capitec is a midsize, retail-focused bank operating in the second-tier of South Africa's banking sector, with total assets of about South African rand (ZAR) 59 billion (approximately USD4.4 billion) and ZAR45 billion (USD3.4 billion) in total reported deposits as of Aug. 31, 2015.

Retail banking in South Africa is a highly competitive segment in the banking system. We understand Capitec's strategy aims to position the bank as the leading retail franchise in South Africa by delivering a low-cost alternative to traditional banks and providing simple savings and loan products, with transparent and affordable pricing and convenient, customer-centric services. This strategy has been very successful to date, in our opinion, enabling Capitec to garner a strong foothold in transactional retail banking over the past few years. Capitec has increased its share of the transactional retail client base to approximately 19% in 2015 from 8% in 2012, while also experiencing rapid growth in retail customer deposits, averaging 45% per year over the past three years. Capitec has also emerged as the market leader in unsecured lending with a 19% market share in 2015. At the same time, Capitec continues to expand its commercial network gradually, investing in new branches, staff, ATMs, and alternative channels including mobile, internet, and retail partnerships.

However, Capitec's monoline focus translates into a lack of business diversity compared with traditional top-tier South

African banks, which exposes the bank to cyclicality, adds additional regulatory risks (due to the unsecured lending asset class focus), and limits revenue diversification. We expect the bank will slowly expand its offering to include credit cards and mortgages (launched with SA Home Loans as the underwriter), principally as a strategy to retain customers rather than a revenue diversification drive. Nevertheless, the bank has performed well throughout the instability in the unsecured lending space over the past few years. Revenue stability has been underpinned by a good mix between net interest income and fee income (approximately a 70/30 percent split), good operating efficiency with a cost-to-income ratio of 34% in 2015, and return on equity of 25%, which compares well with domestic banking sector peers.

Table 2

Capitec Bank Ltd Business Position					
		--Year ended Feb. 28--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Return on equity	24.9	24.2	22.4	24.0	26.5

*Data as of Aug. 31, 2015.

Capital and earnings: "Very strong" capitalization supported by strong earnings capacity and solid earnings buffers

Our assessment of Capitec's capital and earnings as "very strong" reflects our expectation that our RAC ratio for the bank will climb sustainably above 15% over the next 12 months, balancing slower risk-weighted asset growth with faster-paced internal capital generation through retained earnings. On Aug. 31, 2015, the bank's Basel III regulatory capital adequacy ratio (RCAR) was 35%, compared with the Basel III regulatory minimum ratio of 10% in South Africa. Tier 1 capital accounts for approximately 85% of qualifying regulatory capital and includes Common Equity Tier 1 (CET1) capital and a small portion (1.3%) of Alternative Tier 1 (AT1) capital, in the form of perpetual preference shares. Tier 2 capital is 15% of the capital base and is made up of 80% subordinated debt and 20% risk reserves. Both the subordinated debt and perpetual preference shares are subject to phasing-out, in line with Basel III's new loss absorbency requirements, at a rate of 10% per year, since Jan. 1, 2013. In our calculation of the RAC ratio, we exclude Tier 2 capital due to its relatively lower loss-absorbing quality compared with Tier 1 capital.

In our opinion, Capitec's capitalization is further strengthened by solid earnings buffers, after covering normalized credit losses and distributions. Capitec's earnings have shown resilience through the market turbulence in the unsecured lending segment over the past few years. This is due to the superior net interest margins achievable in this asset class, although margins have contracted due to competition and regulatory pressures. Earnings have also been supported by the bank's maintenance of a low operating cost base, reduced credit losses compared with previous years, alongside stronger bad debt recoveries over the period.

Our forecast RAC for Capitec also considers the following over the next 12 months:

- Moderate loan growth of about 10%.
- Narrowing in net interest margins, to between 16% and 17%, incorporating our expectations of stricter regulatory caps on interest rates and fairly stable funding costs.
- An unchanging revenue mix dominated by net interest income (70% of operating revenues) and fees (30%). We expect that the new limits on card processing fees between banks and merchants will have a muted impact on

Capitec because we think it will make up the difference through increasing transaction volumes.

- A cost-to-income ratio of about 35%, with net transaction income accounting for 65%-70% of expenses;
- Stable asset quality metrics even though households remain under mild financial strain. We expect nonperforming assets (including loans 90 days past due and restructured loans) at approximately 7% of total loans, net-charge offs at about 10% of average customer loans, and a normalized cost of risk averaging 10.5-11.0%.
- Maintenance of a robust annual dividend pay-out ratio to net income at around 40%.

Table 3

Capitec Bank Ltd Capital And Earnings

		--Year ended Feb. 28--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	30.0	29.9	31.1	30.2	28.9
Adjusted common equity/total adjusted capital	98.4	98.0	97.1	96.7	94.6
Net interest income/operating revenues	72.0	72.0	72.6	68.2	58.6
Fee income/operating revenues	28.0	27.8	27.5	31.5	40.7
Noninterest expenses/operating revenues	35.7	34.0	31.5	37.9	44.2
Preprovision operating income/average assets	14.8	15.3	16.3	15.9	16.6
Core earnings/average managed assets	5.2	5.3	5.0	5.1	5.7

*Data as of Aug. 31, 2015.

Table 4

Capitec Bank Ltd Risk-Adjusted Capital Framework Data

(Mil. ZAR)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	5,695	0	0	1,869	33
Institutions	8,319	3,440	41	3,952	48
Corporate	2,087	1,960	94	2,619	125
Retail	34,466	25,630	74	41,757	121
Of which mortgage	0	0	0	0	0
Securitization§	0	0	0	0	0
Other assets	2,173	2,180	100	3,935	181
Total credit risk	52,740	33,210	63	54,131	103
Market risk					
Equity in the banking book†	0	0	0	0	0
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	0	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	2,530	--	18,213	--

Table 4

Capitec Bank Ltd Risk-Adjusted Capital Framework Data (cont.)

(Mil. ZAR)	Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA
Diversification adjustments				
RWA before diversification	35,740		72,344	100
Total Diversification/Concentration Adjustments	--		12,114	17
RWA after diversification	35,740		84,458	117
(Mil. ZAR)	**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	10,810	30.2	10,486	14.5
Capital ratio after adjustments‡	10,810	29.9	10,486	12.4

*Exposure at default. §Securitization exposure includes the securitzsation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. ZAR--South Africa Rand. Sources: Company data as of Feb. 28, 2015, Standard & Poor's.

Risk position: High normalized credit losses, reflecting prudent provisioning and robust risk management.

Our assessment of Capitec's risk position as "weak" incorporates the bank's high normalized credit losses, which we do not fully capture in our RAC framework. We also factor in the concentrated nature of the loan book, with strong provisioning and a robust enterprise risk management framework.

Capitec specializes in providing fixed rate, medium-term, and small-size unsecured loans in South Africa. The weighted average outstanding term of the loan book is about 43 months, with an average size of ZAR6,887. Due to this focus, the bank's loan loss experience is considerably higher than that of South African banking peers, which operate with more diversified, lower loss, and lower-margin loan products. We consider net charge-offs to be the most reliable indicator of Capitec's underlying asset quality because loans are written-off at 90 days past due. On Aug. 31, 2015, net charge-offs accounted for 9.3% (10.8% at Feb.28, 2015) of average customer loans.

Due to stress in South Africa's unsecured lending market, the bank has raised its credit loss provisioning, to reflect the now higher expected losses in its loan book. When the bank books a new loan, it immediately raises an expected loss provision of 7%, raising this to 46% on one missed payment, 74% on two payments, and 88% on three missed payments. After this, it considers the loan as bad and writes it off. Consequently, Capitec's cost of risk was 11.4%, with loan loss provisions covering 144% of nonperforming assets (loans less than 90 days past due and restructured loans) on Aug. 31, 2015.

South African households face ongoing moderate household inflation, gradual interest rates rises, and elevated debt levels, which are eroding disposable incomes and reducing affordability. A steep rise in unemployment and higher-than-expected inflation could cause an unexpected shock, but we think that the bank's strong risk management of this asset class should stop the build-up of higher risk exposures, given that Capitec's credit granting scorecards are more conservative than the affordability guidelines the regulator proposes. As such, the credit quality of new loans is improving, and the bank maintains additional collective portfolio provisions beyond its model-specific provisioning indicators, to take into account heightened economic risks in South Africa.

We consider reputational, operational, and regulatory risks to be other key considerations for any monoline unsecured lender operating in South Africa, especially since the failure of African Bank and the regulator's focus on the lending class. Capitec currently provides credit life cover free-of-charge to its customers; however, this could change on the back of regulatory reform proposals on prescribed consumer credit affordability criteria, which include pricing caps on interest and credit life insurance. We think that Capitec's simple and transparent pricing regime is already broadly in line with these proposals and has been an important differentiator between the bank and other suppliers of unsecured credit.

Capitec is structurally exposed to interest rate risk due to maximum pricing on loans, imposed by the Department of Trade and Industry's interest rate cap. This pricing formula determines that if there is a 100 basis-point change in the South African Reserve bank repo rate (up or down), there should be a 170 basis-point change (in the same direction) in maximum interest per loan.

Table 5

Capitec Bank Ltd Risk Position

		--Year ended Feb. 28--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	8.6	7.9	9.9	66.5	68.6
Total managed assets/adjusted common equity (x)	5.1	5.2	5.3	5.0	5.2
New loan loss provisions/average customer loans	11.4	11.5	12.4	10.8	10.9
Net charge-offs/average customer loans	9.3	10.8	9.5	6.0	6.2
Gross nonperforming assets/customer loans + other real estate owned §	7.8	7.8	8.7	7.8	5.1
Loan loss reserves/gross nonperforming assets	144.1	135.4	124.5	113.4	165.8

*Data as of Aug. 31, 2015. §Gross nonperforming assets are calculated as loans less than 90 days past due and restructured loans. Loans more than 90 days past due are written-off as part of the bank's financial policy.

Funding and liquidity: Structurally superior funding and liquidity profiles, but exposed to additional confidence sensitivity than larger peers

We assess an "average" funding profile and "strong" liquidity for Capitec, which results in a combined "adequate" assessment.

Structurally, Capitec's funding and liquidity compares well with that of South African banking sector peers. Capitec is one of the few banks in South Africa that meets the fully-loaded net stable funding and liquidity coverage ratios required under Basel III. However, due to its small size and focus, the bank could be exposed to additional confidence sensitivity relative to its large peers--causing potential funding flight should the bank face significant capital or asset quality erosion. However, this risk may alleviate somewhat if and when retail deposits become guaranteed by the South African Reserve Bank. On Aug. 31, 2015, retail customer deposits (including retail call and fixed deposits) were 77% of the bank's total reported deposits, with no reliance on short-term wholesale funding. Wholesale funds include long-term senior and subordinated debts, unlisted negotiable instruments, and bilateral wholesale deposits.

Similar to peers, Capitec's wholesale funding is fairly concentrated, with the top-five counterparties accounting for about 60% of wholesale funds. Prudently, Capitec only takes fixed-term wholesale deposits, and floating-rate fixed-income instruments are typically swapped to fixed rates. We believe that the structure of funds somewhat mitigates a surge in wholesale deposit calls in case of market liquidity stress. We think that Capitec will likely maintain higher-than-average cost of funds of about 6.5%-6.6% as it competes for stable funds.

The bank's "strong" liquidity position reflects its sizable cash cushion, where our calculation of broad liquid assets accounted for approximately 20% of total assets and covered 32% of funds maturing in less than 12 months, as of Feb. 28, 2015. The bank's investment portfolio mainly consists of short-dated government securities and is funded primarily by retail call deposits, as the bank aims to limit any asset-liability mismatches that could strain liquidity.

Table 6

Capitec Bank Ltd Funding And Liquidity

		--Year ended Feb. 28--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	76.1	72.0	65.2	56.7	55.3
Customer loans (net)/customer deposits	101.3	113.1	135.1	180.4	186.0
Long-term funding ratio	94.3	93.3	91.7	90.1	88.4
Stable funding ratio	124.5	112.5	102.0	94.2	90.4
Short-term wholesale funding/funding base	4.1	5.4	6.7	6.7	7.3
Broad liquid assets/short-term wholesale funding (x)	8.9	5.2	2.8	2.2	2.1
Net broad liquid assets/short-term customer deposits	45.0	32.2	19.4	14.1	11.4
Short-term wholesale funding/total wholesale funding	16.9	18.9	18.9	15.1	15.7

*Data as of Aug. 31.

External support: No additional support factored into our ratings

The ratings on Capitec reflect its SACP at 'bb+'. We do not incorporate any extraordinary government support in our rating on the bank, even though we consider the South African government to be "supportive" toward the domestic banking sector. We view Capitec as having "low" systemic importance, reflecting our opinion that a loss in confidence in the bank is unlikely to lead to a loss in confidence in South Africa's entire financial system, when compared with its large and complex top-tier peers.

Additional rating factors: None

There are no additional factors affecting the ratings on Capitec.

Related Criteria And Research

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Standard & Poor's National and Regional Scale Mapping Tables, Sept. 30, 2014
- National and Regional Scale Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Banking Industry Country Risk Assessment Update: October 2015, Oct. 7, 2015
- South African Banks: Regulation Takes Center Stage In 2015, Feb. 5, 2015

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	**6**	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	**bbb-**	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of November 5, 2015)

Capitec Bank Ltd	
Counterparty Credit Rating	BB+/Stable/B
South Africa National Scale	zaA/--/zaA-1
Counterparty Credit Ratings History	
13-Oct-2015	BB+/Stable/B
13-Oct-2015 *South Africa National Scale*	zaA/--/zaA-1
Sovereign Rating	
South Africa (Republic of)	
Foreign Currency	BBB-/Stable/A-3
Local Currency	BBB+/Stable/A-2
South Africa National Scale	zaAAA/--/zaA-1

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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