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Research Update:

South Africa-Based Capitec Bank Ltd. Assigned 'BB+/B' And 'zaA/zaA-1' Ratings; Outlook Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Regulatory Disclosures

Glossary

Research Update:

South Africa-Based Capitec Bank Ltd. Assigned 'BB+/B' And 'zaA/zaA-1' Ratings; Outlook Stable

Overview

- Capitec Bank Ltd. is a modestly sized retail bank operating in South Africa, with a leading position in unsecured lending and a fast-growing transactional banking franchise.
- Due to its unsecured lending focus, the bank has higher credit loss norms than peers, which is mitigated by robust earnings, conservative provisioning, and very strong capital levels.
- We are therefore assigning our 'BB+/B' global scale and 'zaA/zaA-1' South Africa national scale ratings to Capitec.
- The outlook is stable, reflecting our view that over the next 12 months, the bank's business position, asset quality, and capitalization will be resilient to the challenging economic environment and regulatory headwinds in South Africa.

Rating Action

On Oct. 13, 2015, Standard & Poor's Ratings Services assigned its 'BB+/B' long- and short-term counterparty credit ratings to South Africa-based Capitec Bank Ltd. (Capitec). The outlook is stable.

At the same time, we assigned our 'zaA/zaA-1' South Africa national scale ratings to the bank.

Rationale

Capitec is a modestly sized and retail-focused bank, providing unsecured loans and simple savings and transaction products to South Africa's retail segment. It has gained a strong foothold in the transactional retail banking market, increasing its share in personal lending to 19% in 2015 from 17% in 2012. The bank has a 5% share in retail deposits and 6.7 million customers as of Aug. 31, 2015. Its financial performance has been resilient through the recent unsecured lending segment instability and the continued economic and regulatory headwinds the sector continues to face. Capitec has achieved a stable 25% average return on equity over the past three years. Still, we think the bank's lack of business diversity is a weakness that could create greater capital and earnings volatility compared with top-tier domestic peers.

We consider Capitec's capitalization and earnings as "very strong" and a key strength that provides sound loss-absorbing capacity against a higher-than-average normalized loan-loss experience. Over the next 12 months, we expect Capitec's capitalization will slightly improve, with the Standard & Poor's risk adjusted capital (RAC) ratio for the bank climbing above 15% and supported by robust earnings buffers. Our projection balances moderate risk-weighted asset growth alongside strong earnings capacity, achieved through the bank's low-cost platform, solid

margins, and solid transaction income generation. Capitec pays out fairly robust dividends at about 40% of net income.

Our "weak" assessment of Capitec's risk position reflects the bank's predominant focus on unsecured lending, which is tightly managed to extract strong returns from high risk assets. As a result, over the past five years, the bank's cost of risk and net charge-offs have averaged 11.5% and 7.8% respectively, which compares poorly with the more diversified and lower-margin loan books of domestic banks. Over the next 12-18 months, we think cost of risk will normalize to between 10.5% and 11%, balancing a slight improvement in South African consumer leverage, and lower loan competition and growth, with the struggling domestic economy. We regard the bank's provisioning levels, reported at 239% of arrears (excluding rescheduled loans), on Aug. 31, 2015, as strong and a necessary benefit to the current rating levels.

Structurally, Capitec's funding and liquidity compares well with its peers' in the South African banking sector, and the bank is one of the few entities in the 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 largely deposit funded, with little-to-no dependence on short-term wholesale funds. Over the past three years, Capitec has experienced a sharp rise in customer deposits, averaging 45% year-on-year. This has pushed the ratio of core deposits to total funds to 77% in 2015 from 60% in 2012 and lowered the bank's funding costs.

Outlook

The stable outlook 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 the bank's RAC ratio at more than 15% over the next 12 months.

We could lower the ratings on Capitec if its capitalization fails to reach 15% within a 12-18 month period, either through lower earnings or higher dividends than we currently expect, or if asset quality deteriorates beyond our expectations. This could happen if cost of risk rose above 15% or loan loss reserve coverage 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, 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.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Stable/B
SACP	bb+
Anchor	bbb-
Business Position	Moderate (-1)
Capital and Earnings	Very Strong (+2)
Risk Position	Weak (-2)
Funding and Liquidity	Average and Strong (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity - April 27, 2015
- General Criteria: Standard & Poor's National And Regional Scale Mapping Tables - September 30, 2014
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010
- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 04, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria - Financial Institutions - Banks: 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

Ratings List

New Rating

Capitec Bank Ltd

Counterparty Credit Rating

Foreign and Local Currency

BB+/Stable/B

South Africa National Scale

zaA/--/zaA-1

Regulatory Disclosures

- Primary credit analyst: Jones Gondo
- Rating committee chairperson: Emmanuel Volland
- Date initial rating assigned: Oct. 13, 2015
- Date of previous review: --

Disclaimers

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

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Glossary

- Adjusted common equity: Common shareholders' equity plus minority interest, minus dividends (not yet distributed), minus revaluation reserves, minus nonservicing intangibles, minus interest only strips, minus tax-loss carryforwards, minus postretirement benefit adjustments.
- Anchor: The starting point for assigning a bank a long-term rating, based on economic and industry risk.
- Asset quality: A key measure of the quality and performance of the assets of a bank.
- Business position: A measure of the strength of a bank's business operations.
- Capital and earnings: A measure of a bank's ability to absorb losses.
- Core deposits: Total deposits minus noncore deposits (such as deposits due to banks and certificates of deposits).
- Cost of funds: Interest expense as a percentage of average interest-bearing

liabilities.

- Counterparty credit rating: A form of issuer credit rating, which is a forward-looking opinion about an obligor's overall creditworthiness.
- Credit losses: Losses arising from credit risk.
- Credit risk: Risk that a borrower will default on its payment obligations.
- Customer loans (gross): Total customer loans before loan loss reserves.
- Customer loans (net) over customer deposits: Gross customer loans net of loan loss reserves, over core deposits.
- Date initial rating assigned: The date Standard & Poor's assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date Standard & Poor's last reviewed the credit rating on the entity.
- Earning capacity: The capacity of a bank to generate sufficient earnings against losses and the primary way that a bank builds or maintains its capitalization.
- Earnings buffer: A measure of the capacity for earnings to absorb normalized losses through the credit cycle.
- Funding and liquidity: A combined assessment of the strength and stability of a bank's funding mix and its ability to manage its liquidity needs in adverse market and economic conditions over an extended period.
- Funding base: Total deposits, plus acceptances, repurchase agreements, and other borrowings (including commercial papers, short- and long-term debt, subordinated debt, and minimal equity content hybrids).
- Government-related entity (GRE) support: An assessment of the likelihood that the government would provide extraordinary support to a bank that is a government-related entity.
- Gross nonperforming assets over customer loans plus other real estate owned over customer loans: Nonaccrual loans, plus restructured loans, plus repossessed assets plus loans 90-days past due; over gross customer loans plus repossessed assets.
- Group support: An assessment of the likelihood that a parent or other group member would provide extraordinary support to a bank within that group.
- Loan loss reserves over gross nonperforming assets: General plus specific reserves, over adjusted nonperforming assets (nonaccrual loans plus restructured loans plus repossessed assets plus 90-day past due loans).
- National scale rating: An opinion of an obligor's creditworthiness or overall capacity to meet specific financial obligations, relative to other issuers and issues in a given country or region.
- Net charge-offs over average customer loans: Gross charge-offs net of recoveries, over average gross customer loans of current period and last fiscal year.
- New loan loss provisions over average customer loans (cost of risk): Credit loss provisions (including specific loan provisions and general and other provisions) minus recoveries, over average gross customer loans of current period and last fiscal year.
- Normalized credit losses: An assessment of the long-term annualized credit-related losses expected through the credit cycle.
- Return on equity: Net income before extraordinary results minus preferred dividends over average common (average between current period and last fiscal period).
- Risk position: Our view of the specific risk characteristics of a particular bank.
- Risk-adjusted capital (RAC) ratio before diversification: This is calculated

according to Standard & Poor's methodology as total adjusted capital over risk-adjusted assets.

- Short-term wholesale funding: Debt securities that mature in less than one year (of commercial papers, debt and senior and subordinated bonds), plus bank deposits that mature in less than one year.
- Sovereign support: An assessment of the likelihood that the government would provide extraordinary support to a bank.
- Stand-alone credit profile (SACP): An interim step in assessing a bank's overall creditworthiness. It includes government support, but not extraordinary government support.
- Total adjusted capital: adjusted common equity plus admissible preferred instruments and hybrids.
- Total wholesale funding: Noncore deposits, plus acceptances, repurchase agreements, other borrowings (including commercial papers, debt and senior and subordinated bonds, minimal equity content hybrids), and total equity, minus minority interest and common shareholders' equity.

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