S&P Global Ratings

RatingsDirect®

Research Update:

South Africa-Based Capitec Bank Ltd. 'BB+/B' And 'zaAA/zaA-1+' Ratings Affirmed; Outlook Negative

Primary Credit Analyst:
Matthew Pirnie, Johannesburg (27) 11-214-4862; matthew.pirnie@spglobal.com

Secondary Contact:
Kuziva Murigo, Johannesburg +27 11 214 4866; Kuziva.Murigo@spglobal.com

Table Of Contents

Research Update:

South Africa-Based Capitec Bank Ltd. 'BB+/B' And 'zaAA/zaA-1+' Ratings Affirmed; Outlook Negative

Overview

- Capitec Bank's resilient profitability continues to support strong levels of capitalization, despite some early signs of asset quality deterioration.
- We are therefore affirming our 'BB+/B' global scale and 'zaAA/zaA-1+' South Africa national scale ratings on Capitec Bank.
- The negative outlook reflects the outlook on South Africa, as well as our view that weak economic growth and the persistent credit risk of over-leveraged households increase pressure on Capitec Bank's asset quality.

Rating Action

On Sept. 5, 2017, S&P Global Ratings affirmed its 'BB+/B' long- and short-term counterparty credit ratings on South Africa-based Capitec Bank Ltd. The outlook is negative.

At the same time, we affirmed our 'zaAA/zaA-1+' South Africa national scale ratings on the bank.

Rationale

Capitec's profitability and capitalization continue to demonstrate resilience despite low economic growth and some signs that the bank's asset quality is facing additional pressure.

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 Feb. 28, 2017, net charge-offs accounted for 10.5% of average customer loans (up from 8.1% at the same date a year earlier). Positively, inflation and interest rates appear to have stabilized, which we believe should somewhat support South African households' ability to service debt. Nevertheless, economic growth is flagging and unemployment is rising, which is squeezing the middle and mass markets. Capitec is more exposed to domestic inflationary and employment pressures than to changes in interest rates, as is the case with its peers, largely due to the significant fixed-rate and small and midsize nature of its loan book. As a result, we think that the lower economic activity will add an element of stress to the bank's loan portfolio in 2017-2018. We therefore anticipate that credit losses (new loan loss provisions to average customer loans) and charge-offs (net charge-offs to average customer loans) will increase toward 13.5% and 11.0%, respectively, in 2017-2018, which is just above the normalized averages for the bank.

Despite our expectations of higher risk costs and somewhat depressed margins, caused by a relatively higher proportion of liquid assets in the earnings mix and slowly reducing interest rates, we anticipate that Capitec will continue to enjoy a robust earnings buffer. The bank's long-term average return on equity is over 25%, which compares well with that of its domestic banking peers. Its earnings stability is also good, for a mono-line unsecured consumer lender, benefiting from a large component of non-interest bearing revenues that covers more than 100% of Capitec's operating expenses. This type of revenue, largely from transactional banking and credit life, will be a considerable advantage for the bank in the event of increased credit losses and simultaneous margin erosion.

The bank's robust profitability has also led to very strong capitalization. We expect Capitec to maintain an S&P Global Ratings' risk-adjusted capital ratio of 15.5% over the next couple of years, balancing strong earnings with moderated loan growth and dividends of approximately 40.0% of net income. We also believe the loss cushion (combining total adjusted capital [TAC] for unexpected loss and loan loss reserves for expected loss) is further supported by healthy reserving. At Feb. 28, 2017, loan loss reserves covered 13.14% of the total loan book, which is approximately 100 basis points (bps) above normalized credit losses and 300bps above charge-offs. Combined TAC (South African rand [ZAR]15 billion) and loan loss reserves (ZAR5.9 billion) of ZAR20.9 billion accounted for 46% of gross customer loans at Feb. 28, 2017.

Capitec's funding structure--and, in turn, its liquidity--continues to compare well with that of its peers in the South African banking sector. On Feb. 28, 2017, the bank had an S&P Global Ratings' stable funding ratio of 1.4x compared with a sector average of below 1.0x.

Unlike top-tier banks in South Africa, Capitec meets the fully loaded net stable funding ratio, required under Basel III, before the recent national discretion provided by the South Africa Reserve Bank. This strength reflects the medium-term nature of the loan book and the increasingly strong retail deposit franchise. Over the past few years the bank has been growing its retail customer deposits rapidly, especially compared with the sector average, and it now accounts for 86% of total funding at Feb. 28, 2017, versus 79% one year earlier. This is a key differentiator to top-tier banks, which are exposed to concentrations from non-bank financial institutions.

Outlook

The negative outlook reflects that on South Africa, as well as our view that weak economic growth and the persistent credit risk of over-leveraged households increase pressure on Capitec's asset quality.

Slow economic growth, weak state-owned enterprises, and political instability are constraining South Africa's creditworthiness, in our opinion. A downgrade of South Africa would cause a similar action on Capitec. Furthermore, we could take a negative rating action on the bank if we observe a weakening in households' debt serviceability or in the stability of the wider banking system.

Additional ratings downside could arise if the bank's risk-adjusted capital ratio falls protractedly below 15%, either from greater-than-anticipated credit losses, higher dividends, or lower revenues. Moreover, if Capitec's asset quality deteriorates (cost of risk above 15% or loan loss reserve coverage below 100% of nonperforming loans) or the bank became more exposed to wholesale funding concentrations, we could lower the rating.

We currently consider an upgrade of Capitec to be highly unlikely in the next 12 months. Such a scenario would rely on marked improvements in South Africa's credit profile.

Ratings Score Snapshot

	To
Issuer Credit Rating	BB+/Negative/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
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14, 2017
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- 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: 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
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Banking Industry Country Risk Assessment: South Africa - July 19, 2017
- South African Bank Outlooks Remain Negative But The Pressure Is Easing - February 08, 2017

Ratings List

	Rating	
	To	From
Capitec Bank Ltd.		
Counterparty Credit Rating		
Foreign and Local Currency	BB+/Negative/B	BB+/Negative/B
South Africa National Scale	zaAA/--/zaA-1+	zaAA/--/zaA-1+

Regulatory Disclosures

- Primary Credit Analyst: Matthew Pirnie, Director
- Rating Committee Chairperson: Nigel Greenwood
- Date initial rating assigned: Oct. 13, 2015
- Date of previous review: Aug. 7, 2017

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 S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

This credit rating is solicited. The rated entity did participate in the credit rating process. S&P Global Ratings did have access to the accounts, financial records and other relevant internal, non-public documents of the rated entity or a related third party. S&P Global Ratings has used information from sources believed to be reliable but does not guarantee the accuracy, adequacy, or completeness of any information used.

Glossary

- 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.

1910052 | 302443158

- 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).
- Core earnings over average managed assets: Annualized core earnings, over average assets of current period and last fiscal year.
- 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.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings 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.
- 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).
- 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.
- 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: 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.
- Operating revenues: Net interest income, plus operating non-interest income (that mainly includes fees and commissions and trading gains).
- 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 S&P Global Ratings' methodology as total adjusted capital over risk-adjusted assets.
- Stable funding needs: Restricted cash and reserves at the central bank, plus interbank deposits, plus loans to banks (net of maturities within one year), plus

reverse repurchase agreements, plus gross customer loans net of loan-loss reserves, plus securities, minus total liquid securities, plus equity participations in nonfinancial entities, plus fixed assets, plus other assets (considering foreclosed assets, tax loss carryforwards, and deferred assets).

- Stable funding ratio: Available stable funding over stable funding needs.
- 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.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Additional Contact:
Financial Institutions Ratings Europe; FIG_Europe@spglobal.com