



Viceroy comments on SARB statement

Viceroy comments on information available to the South African Reserve Bank regarding Capitec

In response to Viceroy’s recent report on Capitec (JSE:CPI), the South African Reserve Bank (SARB) decided to vouch for Capitec. Indeed, it decided to stake its reputation on the accuracy of the company’s accounts. Below is their statement in full:

“The South African Reserve Bank (SARB) notes a report by a US based fund manager. As part of our mandate, we monitor the safety and soundness of all banks, including Capitec Bank Limited (Capitec). According to all the information available, Capitec is solvent, well capitalised and has adequate liquidity. The bank meets all prudential requirements.”

The South African Reserve Bank makes this statement “according to all the information available”. We understand that the SARB has not yet performed an adequate regulatory inspection of Capitec – and expect they will do so in due course.

For the moment Viceroy will respond to SARB limiting themselves to information contained in the most recent Capitec annual report. This is information readily available to the South African Reserve Bank.

Viceroy’s allegation is that Capitec’s balance sheet, income and solvency numbers are not reliable – and that the mechanism of underrepresenting losses is to pretend that uncollectable loans are collectable and still accruing income.

Viceroy suggests that at least ZAR 10bn of loans fall into this category. Moreover, these loans are largely in the long-dated loans on Capitec’s balance sheet, such as 49-to-60 month and 61 - 84-month month loans.

This table – from page 26 of the last annual report notes that ZAR 10,832m and ZAR 13,689m of gross loans fall into these categories. This is just over half of Capitec’s ZAR 45,135m of gross loans outstanding.

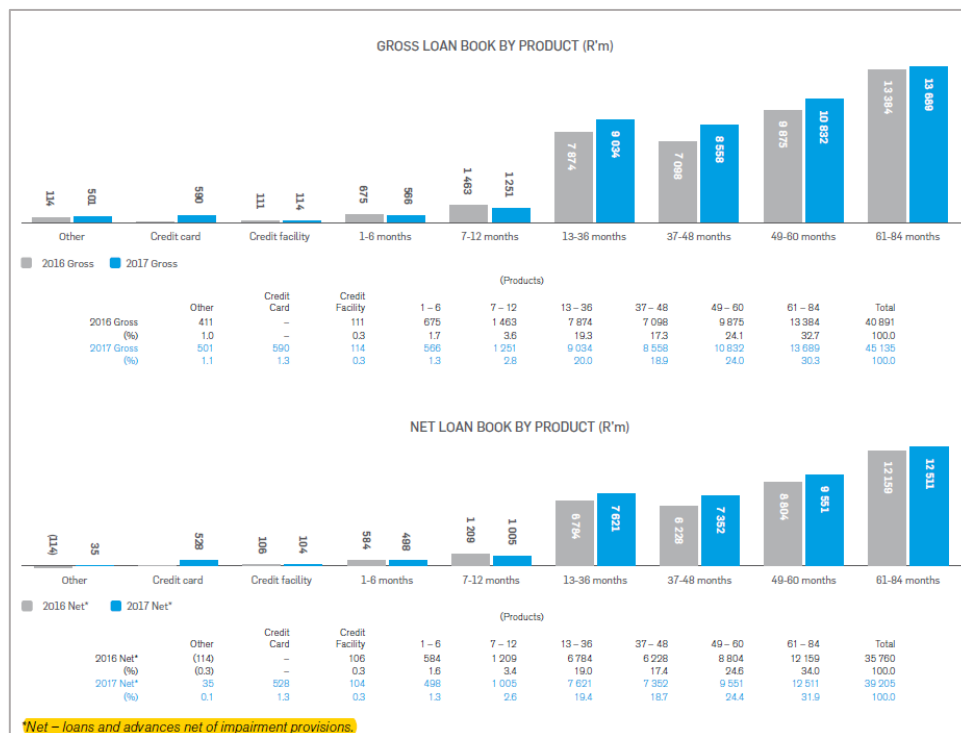


Figure 1 Extract from Capitec Annual Report 2017



Capitec accounts provide enough information to assess the credit worthiness of these long-dated loans.

To simplify the analysis, we will just focus on the ZAR 13,689m of 61 - 84-month month gross loans outstanding.

On page 30 of their 2017 annual report Capitec provides a gross cumulative loss curve for various vintages of these loans:

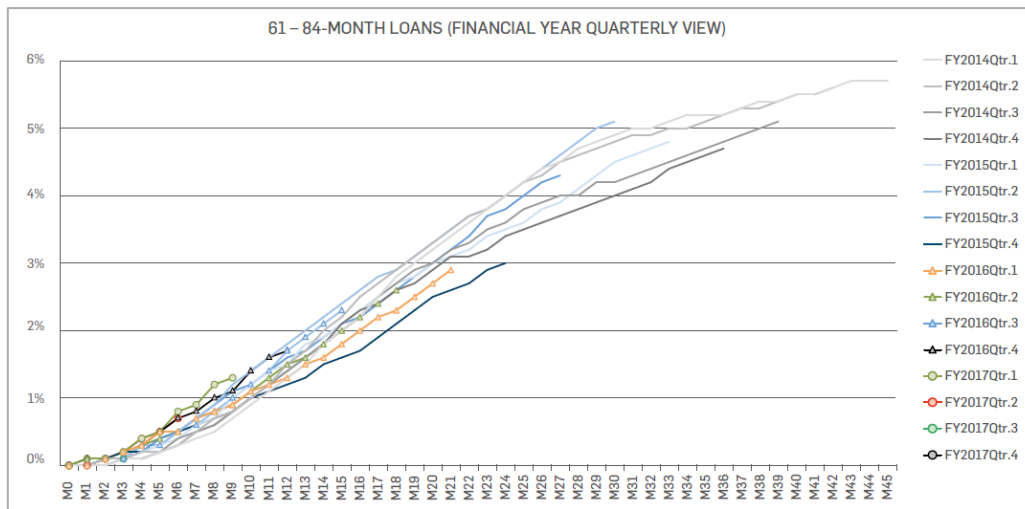


Figure 2 Extract from Capitec Annual Report 2017

This is easy to read. It shows the cumulative loss (net of recoveries) as a percentage of the pool for loans originated in various quarters. The performance for these loans is – according to Capitec – following roughly similar paths irrespective of the pool.

At M12 – i.e. after one year – roughly 1.5% of the loans have been written off.

At M24 – i.e. after two years – roughly 3% of the loans have been written off.

At M36 – i.e. after three years – roughly 4.5% of the loans are written off.

You could of course extend this and follows that after 4 years about 6% of the loans will be written off.

The loss rate on these pools is – as you can see – roughly 1.5% per annum.

This is based on the numbers that Capitec provide us in their annual report. It is not hearsay from Viceroy. These are Capitec’s numbers. These numbers are astonishingly low. 1.5% is below the loss rate on US prime credit cards. Below is the summary consumer loss disclosures from Bank of America’s last annual reports:

(Dollars in millions)	Net Charge-offs ⁽¹⁾		Net Charge-off Ratios ^(1,2)	
	2016	2015	2016	2015
Residential mortgage	\$ 131	\$ 473	0.07%	0.24%
Home equity	405	636	0.57	0.79
U.S. credit card	2,269	2,314	2.58	2.62
Non-U.S. credit card	175	188	1.83	1.86
Direct/Indirect consumer	134	112	0.15	0.13
Other consumer	205	193	8.95	9.96
Total	\$ 3,319	\$ 3,916	0.74	0.84

Figure 3 Extract from Bank of America annual report 2016



Bank of America loses roughly 2.5% per annum on their US credit card business. Capitec is reporting losses on their book substantially below Bank of America's US Prime Loan losses. Citigroup's credit card business has similar losses per annum compared to Bank of America's. Capitec's long-dated unsecured lending business in South Africa is (on Capitec's numbers) has lower losses than Citigroup's prime credit card business.

Capitec's claims for the excellence of their long-dated lending business extend further than this. Capitec have an admirable formulaic provisioning policy. It is stated multiple times in the annual report and we will repeat it here from page 14 of the 2017 annual report:

We provide 8% on current loans, 43% on loans one instalment behind, 81% for two instalments and 92% for three instalments, all statistically calculated. We provide on average 52% on clients that rescheduled any of their loans whilst in arrears within the last 6 months even though they are current in terms of their new agreement. For clients who rescheduled any of their loans whilst current we provide 15%. All provisions are based on the probability of default. All outstanding balances of clients who are 90 days in arrears on any loan are substantially provided for or written off.

Figure 4 Extract from Capitec Annual Report 2017

Capitec in the table on page 26 provide us gross and net loans by term of the loan. We repeat this data here:

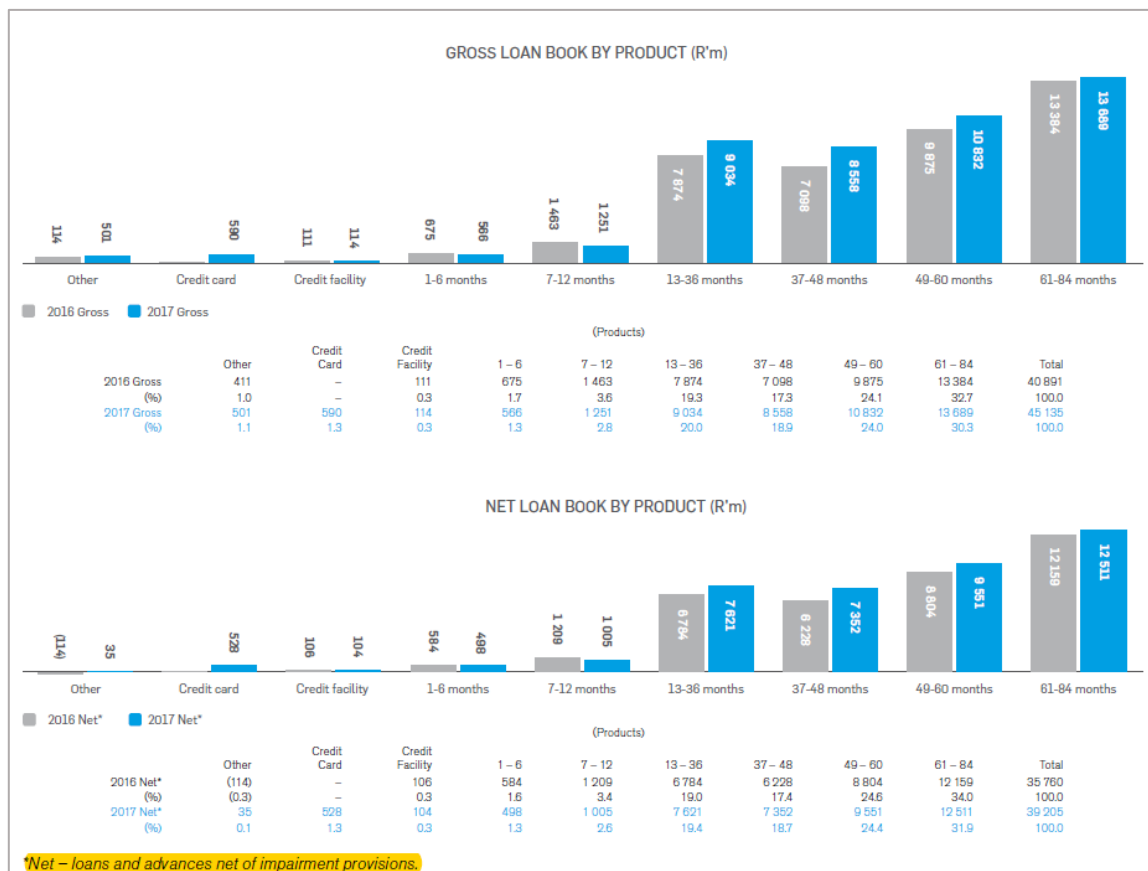


Figure 5 Extract from Capitec Annual Report 2017



Note that there are ZAR 13,689m of **gross** 61 – 84-month loans outstanding at the end of the 2017 year. There are ZAR 12,511m of **net** 61 – 84-month loans outstanding. The provision is the difference – ZAR 1,178m.

That provision is only 8.6% of outstanding gross 61 - 84-month loans.

Recall that according to Capitec's provision policy they provide 8% of current loans – thus their provision for delinquent or rescheduled long-dated loans is 0.6% of outstanding 61 – 84-month loans. According to the formula they can have at most a 1.3% delinquency on these loans.

Again, this number is astonishingly low. This delinquency is far below the delinquency rate of US prime loans. Indeed, the delinquency rate implied by Capitec on their unsecured loans is below the serious delinquency rate US prime mortgages.

It seems – on the numbers provided by Capitec – the 61 - 84-month month book of loans is perhaps the best performing set of unsecured personal loans in the world. There is almost no delinquency and astonishingly low charge offs.

Now SARB say – and we quote again:

“According to all the information available, Capitec is solvent, well capitalised and has adequate liquidity.”

The information includes loan pools Capitec claims perform better than the best unsecured credit pools in developed countries. They are – based on Capitec's data – much better than prime. They are “*superprime*”.

Capitec categorically state that not many of these loans have been restructured or deferred. If they were deferred Capitec – according to its own rules – must draw a large provision against them and no such provision is drawn.

Viceroy has collected considerable anecdotal evidence that staff regularly roll these loans or restructure them so that no delinquency or losses are recorded. Indeed, Viceroy believes that is by far the best explanation for the astonishing performance of the long-dated Capitec loans.

If Capitec's loans are not in fact better than American prime credit cards then Capitec is misrepresenting in the information that it provides the market and in the information provided to the South African Reserve Bank. This seems to us the more likely outcome and is consistent with reams of anecdotal data we have collected on rolling loans.

The South African Reserve Bank has a responsibility to determine whether the information provided to them – and on which they base their regulatory decisions is accurate. We do not think it is.

The SARB has, at this point, a responsibility to perform a full regulatory inspection of Capitec. Viceroy remains firm in its belief that this will result in SARB placing Capitec into curatorship.



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