

# Portfolio Watch

September 2024

## CAPITEC: RETHINK BANKING

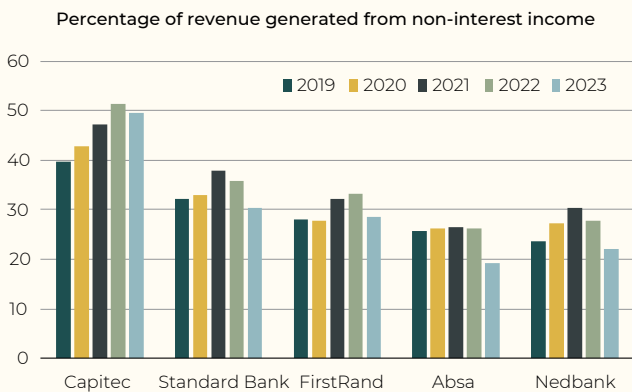
Traditionally, banks generate most of their revenue through net interest income i.e. the difference between interest earned on loans and interest paid on deposits. However, after the Global Financial Crisis, interest rates fell rapidly and remained structurally lower. In response, banks worldwide diversified their revenue streams, expanding into adjacent financial services such as insurance, wealth management and trading.

Locally, non-interest revenue now accounts for 20% - 30% of total revenue across the “traditional” Big Four banks (Standard Bank, FirstRand, Absa and Nedbank). Capitec, by contrast, generates half of its revenue from non-interest income sources, making it far less sensitive to interest rate changes. This diversified income base ultimately supports the bank’s higher, more stable profitability and its premium valuation.

### THE OUTCOME OF A DIFFERENTIATED STRATEGY

While the Big Four banks focused on growing their balance sheets, Capitec adopted a different strategy. In 2000, CEO,

Graph 1: Unlike “peers”, Capitec generates half of its revenue from non-interest income



Sources: Bloomberg, Company Reports

TASNEEM SAMODIEN

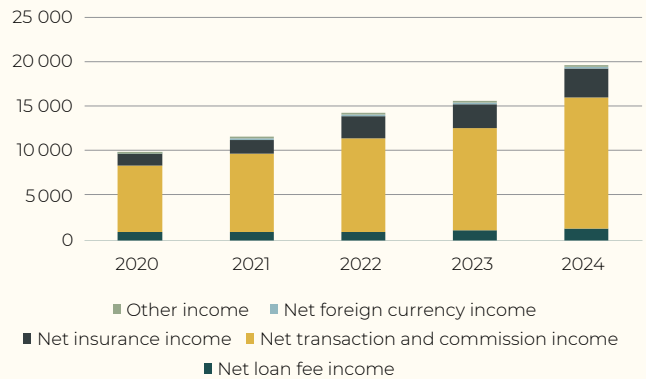
Research Analyst at  
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Gerrie Fourie set an ambitious goal: to bank 95% of all South Africans, with a strong emphasis on the unbanked population and improving access to financial services. Capitec’s model emphasised simplicity (one account and equal treatment for all), affordability (low, transparent fees) and accessibility (retail outlets, ATMs, branches and a digital app).

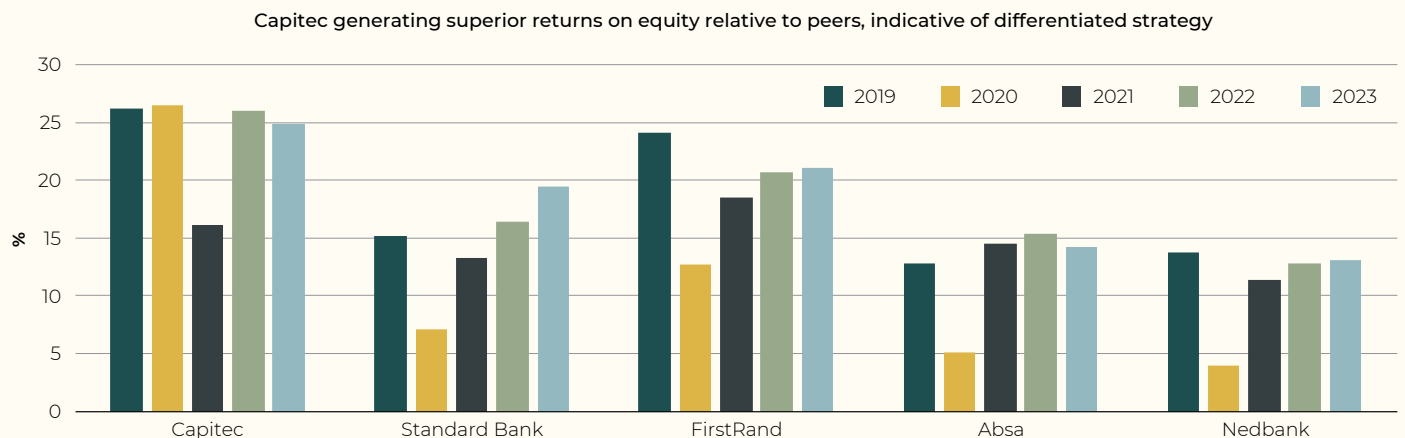
Over the past two decades, Capitec has emerged as one of SA’s most innovative and successful banks. Today, the bank boasts 22.2 million active clients (as at 29 February 2024), generating billions (9.9bn) of transactions that attract diverse sources of non-interest income. This includes fees on transactions executed in branches via ATMs and digital banking, commission income on the sale of lottery tickets and electricity, value added service income related to the sale of mobile data, renewal of vehicle license disks and cash remittances, income related to the sale of credit life insurance and funeral policies as well as fees related to loans granted.

Graph 2: Capitec’s sources of non-interest revenue



Source: Company Reports

Graph 3: Capitec's differentiation evident in higher and more consistent profitability



Sources: Bloomberg, Company Reports

Capitec's focus on broadening access to financial services gave it the flexibility to explore various growth opportunities. Its large customer base provides valuable data insights, which drive new innovations like Capitec Connect and Capitec Pay – services that enhance customer engagement and deepen their integration into the bank's ecosystem.

Beyond value-added services, Capitec is expanding into life insurance, business banking, and international markets. The bank also plans to introduce secured retail products, including vehicle finance and mortgages, further diversifying its offering and revenue streams.

\* 2020/2021 reporting periods coincides with the initial impact of the COVID-19 pandemic

## PRICE IS WHAT YOU PAY, VALUE IS WHAT YOU GET

Capitec's strong and capable management team, innovative culture and diversified revenue streams position it well for significant future value creation. While its forward P/E of 24.5x is higher than Standard Bank and FirstRand (at 8x and 11x, respectively), a direct comparison with traditional banks is not entirely appropriate.

Capitec's earnings are far less cyclical due to its lower sensitivity to interest rate fluctuations and its balance sheet and earnings composition. The bank's higher-margin revenue sources drive superior profitability, as reflected in its strong return on equity (as shown in graph 3). Unlike the Big Four banks, which have historically tied their growth prospects to economic growth (both locally and across the rest of Africa), Capitec's innovative approach and flexibility provide much greater growth potential. In fact, its pioneering role in increasing banking penetration has reshaped the market and forced competitors to rethink their strategies.

We maintain a high level of conviction in Capitec's management's ability to execute on their strategy and view the company as one of the top-quality, high-growth investment opportunities available in the local market.

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