# Highlights

**Before taxation performance**

- Growth in profit of 56.0%
- Growth in HEPS of 55.3%
- ROE of 26.2%
- ROA of 4.9%
- Improvement in cost to income from 56.4% to 49.0%

**After taxation performance: recognition of deferred taxation**

- Growth in HEPS of 156.8%
- ROE of 39.8%
- ROA of 7.9%

Mercantile Bank Holdings Limited
Member of CGD Group
("Mercantile" or "the Group")
Registration number 1989/000164/06

# Condensed audited results for the year ended 31 December 2008

## FINANCIAL OVERVIEW

### Before taxation performance

The Group has again recorded a strong growth in profit, which increased by 56.0% for the 2008 financial year compared to the 2007 financial year. Headline earnings per share increased by 55.3%. These increases are largely attributable to:

- an increase in net interest income (after credit losses) of 49.8% as a result of the positive endowment effect of higher interest rates, higher capital due to profit retention, growth in lending of 20.9% and growth in deposits of 16.5%;
- growth in gross recurring non-interest income of 47.9% (net of costs growth: 24.6%) from core business activities with a particularly strong contribution from treasury; and
- non-recurring gains of R9.8 million on the disposal of Visa shares as part of that entity's public listing.

Costs increased year on year by 16.7% of which 12.5% relates to increased employee costs. The higher employee costs are largely due to salary package adjustments, increased headcount to support business growth as well as higher performance bonus costs in line with the Group's results. Efficiency continues to improve with the overall cost to income ratio reducing from 56.4% in December 2007 to 49.0%. Expenses (e.g. interchange and broker fees) incurred directly in the generation of fee and commission income, previously included in operating expenditure are now deducted from fee and commission income in determining the cost to income ratio and presented accordingly in the income statement. Comparatives have been adjusted.

In line with market conditions, loans and advances have reflected some stress resulting in non-performing loans and advances as a percentage of total lending increasing to 3.8% as at December 2008 from a level of 2.5% in December 2007.

Return on average equity ("ROE") improved to 26.2% (December 2007: 21.9%) whilst return on average assets ("ROA") was at 4.9% (December 2007: 3.6%).

### After taxation performance: recognition of deferred taxation

In accordance with International Financial Reporting Standards the Group deemed it appropriate to recognise deferred taxation at the end of 2008 mainly in respect of taxation losses incurred in the financial years prior to 2005. The effect of this recognition resulted in a non-recurring taxation credit of R162.2 million for the year ended 31 December 2008.

The impact of this credit on the key performance ratios of the Group was: Headline earnings per share increased year on year by 156.8%, ROE of 39.8% and ROA of 7.9%.

## CREDIT RATINGS

Caixa Geral De Depósitos S.A. ("CGD"), which is wholly owned by the Portuguese state, remains the Group's holding company with a shareholding of 91.75%.

Its short and long-term financial liability ratings were confirmed by the three leading international rating agencies – Fitch Ratings, Moody's and Standard & Poor's as follows:

| | Short term | Long term | Date | Outlook |
|---|---|---|---|---|
| Fitch Ratings | F1+ | AA- | October 2008 | Stable |
| Moody's | P-1 | Aa1 | November 2008 | Stable |
| Standard & Poor's | A-1 | A+ | January 2009 | Stable |

Moody's Investors Service confirmed the following RSA national scale issuer ratings to Mercantile Bank in September 2008:

| | |
|---|---|
| Short term | P-1.za |
| Long term | A2.za |
| Outlook | Stable |

## ACCOUNTING POLICIES

The Group financial results have been prepared on the historical cost basis excluding financial instruments and properties which are fair valued and conform to International Financial Reporting Standards. The accounting policies are consistent with those applied in the annual financial statements for the financial year ended 31 December 2007, except for IFRIC 11-IFRS 2 Group and Treasury transactions, which is effective for annual reporting periods beginning on or after 1 March 2007 and was adopted in 2008. These condensed financial statements have been prepared in terms of IAS 34 – Interim Financial Reporting.

## AUDIT OPINION

The independent auditors, Deloitte & Touche, have issued their unmodified opinion on the Group's financial statements for the year ended 31 December 2008. The audit was conducted in accordance with International Standards on Auditing. A copy of their audit report is available for inspection at Mercantile's registered office. These condensed financial statements have been derived from the Group financial statements and are consistent in all material respects, with the Group financial statements.

## GOING CONCERN

The financial statements have been prepared on the going concern basis.

## POST BALANCE SHEET EVENTS

No material events have occurred between the accounting date and the date of this report that require adjustment to or disclosure in the annual financial statements.

## DIRECTORATE

Tapiwa Njikizana was appointed as an independent non-executive director on 6 November 2008.

Julio Lopes, an executive director seconded to the Group by CGD had his contract renewed for a further 3 years from 9 November 2008.

Dave Brown, the CEO, was reappointed with effect from 29 March 2009 for a further period of 3 years.

## NEW BANKING SYSTEM

The implementation of the replacement of the core retail banking systems and enhancement/upgrade of current systems architecture is well underway with a go-live date planned for the first quarter of 2010. Expenditure capitalised on this project as at 31 December 2008 is as follows:

- Property and equipment: R21.2 million; and
- Intangible assets: R74.6 million

Following on completion of the process mapping phase of the project in December 2008 which has increased the scope in terms of functionality required, the design of an operational data store as a platform for future management information, tactical and strategic reporting, coupled with the revised plan to implement the system in the first quarter of 2010 (vs. the last quarter of 2009, primarily to accommodate a more recent version of software release), the overall spend on the project is now expected to increase to an estimated R210 million. As previously communicated, the increase in the original estimated cost was mainly due to the expanded scope in terms of upgrading/enhancing the current systems architecture of the Bank.

Most cost estimates have now become firm by way of concluding rand based contracts. The project will be funded from cash resources over the period of the project against agreed deliverables.

The pro forma effect of the transaction on the tangible net asset value per share of the Group at 31 December 2008, based on the above revised cost estimates, is expected to be a decrease of approximately 2.6 cents. The pro forma effect of the transaction has not been reviewed or reported on by the Group's auditors.

The rationale for this project remains the creation of a new systems platform to support the growth of the Group in line with our strategic objectives. The project will result in a more flexible and integrated systems environment enhancing our risk management and controls whilst providing us with greater capacity to compete in the market in the areas of product and service. No profits can be directly attributed to this project but the project drivers outlined above are expected to provide a positive benefit to the Group over time.

## OUTLOOK

The current difficult global economic conditions are expected to have an increasingly negative impact on the South African economy. This, together with the high level of consumer indebtedness on the domestic front will make 2009 an extremely challenging year. In addition, Woolworths Financial Services have advised Mercantile that its card processing agreement will be terminated in the second half of 2009, following the sale of a controlling stake in the business to a competitor bank, which will put pressure on the rate of growth in fee income during the coming year. Similarly, the lower interest rate environment expected to prevail in 2009 will impact negatively on the Group's net interest income (negative endowment) given the structure of the Group's funding sources.

**J A S de Andrade Campos**
**Chairman**

**D J Brown**
**Chief Executive Officer**

Sandton
24 February 2009

**Directors:** J A S de Andrade Campos* ***(Chairman)***, D J Brown ***(Chief Executive Officer)***, J P M Lopes* ***(Executive)***, G P de Kock, L Hyne, A T Ikalafeng, T H Njikizana**, S Rapeti **Portuguese* ***Zimbabwean*

**Group Secretary:** R van Rensburg

**Registered Office:** Mercantile Bank, 142 West Street, Sandown, 2196

**Share code:** MTL **ISIN:** ZAE000064721

**Transfer Secretaries:** Computershare Investor Services (Pty) Limited, 70 Marshall Street, Johannesburg, 2001

**Sponsor:** Bridge Capital Advisors (Pty) Limited, 2nd Floor, 27 Fricker Road, Illovo, 2196

**Sponsor** BRIDGE CAPITAL

Mercantile Bank Holdings Limited
Member of CGD Group
Registration number 1989/000164/06

## Condensed Group Balance Sheet

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| **ASSETS** | | |
| Intangible assets | 76 894 | 23 569 |
| Property and equipment | 128 672 | 96 969 |
| Other accounts receivable | 39 273 | 23 639 |
| Interest in associated company | – | 4 251 |
| Other investments | 12 315 | 228 |
| Deferred taxation assets | 157 275 | – |
| Non-current assets held for sale | 5 289 | – |
| Loans and advances | 3 403 789 | 2 814 743 |
| Derivative financial instruments | 56 873 | 43 814 |
| Negotiable securities | 247 141 | 275 577 |
| Bank term deposits [1] | 324 295 | 170 618 |
| Cash and cash equivalents [1] | 1 464 959 | 1 252 376 |
| **Total assets** | **5 916 775** | 4 705 784 |
| **EQUITY AND LIABILITIES** | | |
| **Shareholders' equity** | **1 269 030** | 839 914 |
| Share capital and share premium | 1 202 571 | 1 207 422 |
| Capital redemption reserve fund | 3 788 | 3 788 |
| Share-based payments reserve [2] | 4 650 | 7 019 |
| General reserve | 7 478 | 7 478 |
| Property revaluation reserve | 46 364 | 53 705 |
| Available-for-sale reserve | 13 036 | (48) |
| General credit-risk reserve [3] | – | 19 403 |
| Accumulated loss | (8 857) | (458 853) |
| **Non-current liability** | | |
| Deferred taxation liabilities | 15 259 | – |
| **Liabilities** | **4 632 486** | 3 865 870 |
| Deposits | 4 389 347 | 3 768 183 |
| Derivative financial instruments | 95 091 | 15 356 |
| Provisions | 48 596 | 42 435 |
| Other accounts payable | 98 958 | 39 780 |
| Taxation | 494 | 116 |
| **Total equity and liabilities** | **5 916 775** | 4 705 784 |

## Condensed Group Income Statement

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| Interest income | 661 776 | 467 247 |
| Interest expense | (337 813) | (250 012) |
| **Net interest income** | **323 963** | 217 235 |
| Net charge for credit losses | (6 618) | (5 358) |
| **Net interest income after credit losses** | **317 345** | 211 877 |
| Net gain on disposal and revaluation of available-for-sale investments | 9 837 | 5 602 |
| Non-interest income | 260 003 | 190 871 |
| Recurring | 260 003 | 175 796 |
| Non-recurring | – | 15 075 |
| Fee and commission expenditure [4] | (76 968) | (28 841) |
| **Net interest and non-interest income** | **510 217** | 379 509 |
| Operating expenditure [4] | (253 154) | (216 978) |
| **Operating profit** | **257 063** | 162 531 |
| Share of income from associated company | 735 | 2 771 |
| **Profit before taxation** | **257 798** | 165 302 |
| Taxation | 162 175 | (29) |
| **Profit after taxation** | **419 973** | 165 273 |
| Earnings per ordinary share after taxation (cents) | 10.70 | 4.21 |
| Earnings per ordinary share before taxation (cents) | 6.57 | 4.21 |
| Diluted earnings per ordinary share after taxation (cents) | 10.70 | 4.21 |
| Diluted earnings per ordinary share before taxation (cents) | 6.57 | 4.21 |
| Dividend per share (cents) | – | – |
| **Reconciliation between profit before taxation and headline earnings** | | |
| Profit before taxation | 257 798 | 165 302 |
| *Adjustment for:* | | |
| Realisation of available-for-sale reserve on disposal of investments | (9 837) | (5 602) |
| (Profit)/Loss on disposal of property and equipment | (29) | 13 |
| **Headline earnings before taxation** | **247 932** | 159 713 |
| Taxation | 162 175 | (29) |
| **Headline earnings after taxation** | **410 107** | 159 684 |
| Headline earnings per ordinary share after taxation (cents) | 10.45 | 4.07 |
| Headline earnings per ordinary share before taxation (cents) | 6.32 | 4.07 |
| Diluted headline earnings per ordinary share after taxation (cents) | 10.45 | 4.07 |
| Diluted headline earnings per ordinary share before taxation (cents) | 6.32 | 4.07 |

## Financial Statistics

| | 2008 Audited | 2007 Audited |
|---|---|---|
| Number of ordinary shares in issue: | | |
| – end of year ('000) | 3 911 114 | 3 926 538 |
| – weighted average ('000) | 3 924 414 | 3 925 485 |
| – weighted average – diluted ('000) | 3 924 414 | 3 925 485 |
| Return on average equity after taxation (%) | 39.8 | 21.9 |
| Return on average equity before taxation (%) | 26.2 | 21.9 |
| Return on average assets after taxation (%) | 7.9 | 3.6 |
| Return on average assets before taxation (%) | 4.9 | 3.6 |
| Cost to income (%) | 49.0 | 56.4 |
| Net asset value per ordinary share (cents) | 32.4 | 21.4 |
| Tangible net asset value per ordinary share (cents) | 30.5 | 20.8 |

## Condensed Group Contingent Liabilities and Commitments

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| Guarantees, letters of credit and committed undrawn facilities | 670 100 | 634 861 |
| Operating lease commitments | 12 302 | 7 593 |
| Capital commitments | 93 018 | – |

## Condensed Group Statement of Changes in Equity

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| Balance at beginning of the year | 839 914 | 667 418 |
| Movements in reserves | (16 029) | 12 296 |
| Revaluation of owner-occupied properties | 10 689 | 8 117 |
| Transfer from revaluation surplus to deferred taxation liability | (18 030) | – |
| Transfer (from) share-based payments reserve [2] | (7 019) | – |
| Share-based payments expense [2] | 4 650 | 3 994 |
| Transfer (from)/to general credit-risk reserve [3] | (19 403) | 5 449 |
| Net transfer to/(from) available-for-sale reserve | 13 084 | (5 264) |
| Movements in accumulated loss | 449 996 | 159 824 |
| Profit after taxation | 419 973 | 165 273 |
| Transfer from share-based payments reserve [2] | 7 019 | – |
| Share-based payments expense [2] | 3 601 | – |
| Transfer from/(to) general credit-risk reserve [3] | 19 403 | (5 449) |
| Movement in share capital and share premium | | |
| (Increase)/Reduction of treasury shares held within the Group | (4 851) | 376 |
| Balance at end of the year | 1 269 030 | 839 914 |

## Condensed Group Cash Flow Statement

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| Net cash inflow/(outflow) from operating activities | 291 296 | (7 861) |
| Net cash (outflow) from investing activities | (78 713) | (10 482) |
| **Net cash inflow/(outflow) for the year** | **212 583** | (18 343) |
| Cash and cash equivalents at beginning of the year [1] | 1 252 376 | 1 270 719 |
| **Cash and cash equivalents at end of the year [1]** | **1 464 959** | 1 252 376 |

## Condensed Group Segmental Information

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| **Segment revenue net of fee and commission expenditure [4]** | | |
| Retail and Commercial banking [5] | 347 155 | 241 602 |
| Treasury | 59 612 | 40 046 |
| Alliance banking, MBL credit card and electronic banking [5] | 53 799 | 53 316 |
| Other services [6] | 56 269 | 49 903 |
| | 516 835 | 384 867 |
| **Profit after taxation** | | |
| Retail and Commercial banking [5] [7] | 268 249 | 183 740 |
| Treasury [7] | 41 638 | 23 686 |
| Alliance banking, MBL credit card and electronic banking [5] [7] | 30 801 | 19 231 |
| Other services [8] | 79 285 | (61 384) |
| | 419 973 | 165 273 |

## Material Related Party Balances and Transactions

| | 2008 R'000 Audited | 2007 R'000 Audited |
|---|---|---|
| Net balances with CGD | 1 345 707 | 897 792 |
| Interest received from CGD | 41 063 | 73 105 |

## Explanatory notes:

(1) Bank term deposits with a residual maturity greater than three months from reporting date are now presented separately in the Balance Sheet.
Comparatives for the year ended 31 December 2007 have been reclassified accordingly.

(2) With the adoption of IFRIC 11 – IFRS 2 Group and Treasury transactions, a share-based payments reserve in respect of the Mercantile Share Option Scheme is not required. This reserve has therefore been transferred to accumulated loss and share-based payments expense for this scheme are processed to accumulated loss with effect from 1 January 2008.
In the case of the Mercantile Conditional Share Plan introduced in 2008, a share-based payments reserve has been created to separate the effects of this plan from other classes of reserves for management purposes.

(3) The new Bank Regulations, effective 1 January 2008, no longer require general credit-risk reserves.
The balance of this reserve as at 31 December 2007 was transferred to accumulated loss in 2008.

(4) Expenditure directly attributable to fee and commission income, previously included under operating expenditure is now presented separately in the income statement.
Comparatives for the year ended 31 December 2007 have been reclassified accordingly.

(5) Certain term loans previously included with Alliance Banking, MBL credit card and electronic banking are now presented as part of Retail and Commercial banking.
Comparatives for the year ended 31 December 2007 have been reclassified accordingly.

(6) "Other services" includes support divisions, surplus capital, insurance brokers, taxation and inter-group eliminations.

(7) Excludes the allocation of attributable support costs.

(8) "Other services" includes support divisions, surplus capital, insurance brokers, taxation, inter-group eliminations and associate income.