Mercantile Bank Holdings Limited

Reg no. 1989/000164/06
Member of CGD Group

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Mercantile Group

Mercantile Bank Holdings Limited and its subsidiaries (“Mercantile” or “the Group”)

Mercantile Bank Holdings Limited (“the Company”) is a registered bank controlling company and an investment holding company. Its holding company is Caixa Geral de Depósitos S.A. (“CGD”), a company registered in Portugal. Its two principal operating subsidiaries comprise:

Mercantile Bank Limited (“the Bank”) provides a full range of international and domestic banking services. It operates in selected retail, commercial, corporate and alliance banking niches to which it offers banking, financial and investment services. It is a wholly-owned subsidiary of Mercantile Bank Holdings Limited.

Mercantile Insurance Brokers (Proprietary) Limited offers life assurance and short-term broking services to the Group and external parties through third party agreements. Its products encompass the full range available in the market including short-term insurance, pension, health benefits and life assurance. It is a wholly-owned subsidiary of Mercantile Bank Holdings Limited.

Board of directors and administration

at 27 February 2007

Board of directors

J A S de Andrade Campos * ∞	*(Chairman)*
D J Brown #	*(Chief Executive Officer)*
G P de Kock ∞	
M J M Figueira *#	*(resigned effective 28 February 2007)*
L Hyne ∞	
A T Ikalafeng ∞	
J P M Lopes *#	
A M Osman ^+	
S Rapeti ∞	

Administration

Group secretary

R van Rensburg

Transfer secretaries

Computershare Investor Services 2004 (Proprietary) Limited
70 Marshall Street
Johannesburg
2001 South Africa

Postal address

PO Box 61051
Marshalltown
2107 South Africa

Registered office

1st Floor
Mercantile Bank
142 West Street
Sandown
2196

Postal address

PO Box 782699
Sandton
2146

* Portuguese
^ Mozambican
\# Executive
\+ Non-executive
∞ Independent Non-executive

Five-year financial performance

Mercantile Bank Holdings Limited and its subsidiaries

	2002* R'000	2003 R'000	2004 R'000	2005 R'000	**2006 R'000**
ASSETS					
Intangible assets	14 696	12 711	6 801	7 020	**11 551**
Property and equipment	88 723	84 651	85 028	91 305	**94 956**
Investment properties	800	800	770	350	**–**
Taxation	3 396	3 567	3 616	3 698	**29**
Other accounts receivable	127 534	82 430	33 148	14 887	**145 291**
Interest in associated company	1 879	2 951	3 236	3 323	**3 626**
Other investments	7 302	3 965	3 556	2 365	**7 209**
Loans and advances	1 313 292	1 178 788	975 611	1 458 677	**2 066 432**
Derivative financial instruments	8 124	7 610	90 162	36 757	**31 134**
Negotiable securities	155 588	273 090	370 279	379 028	**405 016**
Cash and cash equivalents	454 778	574 930	1 148 861	1 408 972	**1 683 974**
Total assets	2 176 112	2 225 493	2 721 068	3 406 382	**4 449 218**
EQUITY AND LIABILITIES					
Share capital and share premium	866 865	866 865	1 208 642	1 207 032	**1 207 046**
Capital redemption reserve fund	3 788	3 788	3 788	3 788	**3 788**
Share-based payments reserve	–	–	123	847	**3 025**
General reserve	7 478	7 478	7 478	7 478	**7 478**
Property revaluation reserve	20 997	28 376	31 273	36 476	**45 588**
Available-for-sale reserve	–	(742)	(955)	(76)	**5 216**
General credit-risk reserve	–	31 212	31 668	10 835	**13 954**
Accumulated loss	(715 628)	(773 078)	(781 078)	(716 201)	**(618 677)**
Shareholders' equity	183 500	163 899	500 939	550 179	**667 418**
Long-term liabilities	8 335	5 287	–	–	**–**
Deposits	1 912 979	1 946 752	2 112 569	2 636 547	**3 539 147**
Derivative financial instruments	4 001	32 115	35 210	38 531	**29 189**
Provisions	27 404	36 066	39 168	31 647	**38 994**
Other accounts payable	38 387	40 437	33 138	149 478	**174 435**
Taxation	1 506	937	44	–	**35**
Total equity and liabilities	2 176 112	2 225 493	2 721 068	3 406 382	**4 449 218**
Contingent liabilities and commitments	752 668	463 690	191 774	309 270	**291 352**
Attributable profit/(loss) after taxation	167 768**	(58 888)	(213 016)**	66 996	**100 643**
Headline earnings/(loss)	184 350	(56 471)	(213 756)	68 025	**100 643**
Earnings/(Loss) per ordinary share (cents)	19.6	(6.9)	(11.6)	1.71	**2.56**
Headline earnings/(loss) per ordinary share (cents)	21.6	(6.6)	(11.7)	1.73	**2.56**
KEY RATIOS FOR 2005 AND 2006					
(Comparatives for 2002 to 2004 are not shown due to losses incurred in those years)					
Return on average equity (%)				12.7	**16.5**
Return on average assets (%)				2.2	**2.6**
Cost to income (%)				91.0	**71.7**
Net asset value per share (cents)				14.0	**17.0**

* For a nine month period

** In the reporting period December 2002 the attributable profit/(loss) after taxation includes a decrease in credit impairments of R265 million due to guarantees received from CGD. In the reporting year December 2004 these guarantees were cancelled resulting in the raising of credit impairments of R173 million. Excluding these transactions related to the CGD guarantees, the attributable (loss) after taxation would have been (R97) million in December 2002 and (R40) million in December 2004.

Group review

CGD which is wholly owned by the Portuguese state, remains the Group's holding company with a shareholding of 91.75%. CGD is ranked as the world's 112th largest banking institution by assets in a current issue of "The Banker's Almanac". 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
Fitch Ratings	F1+	AA-	September 2006
Moody's	Prime-1	Aa3	September 2006
Standard & Poor's	A-1	A+	July 2006

CA Ratings upgraded the Group's long-term rating from zaA to zaA+ and reconfirmed the short-term rating of zaA1 on 27 February 2007.

Business focus

The Group's strategy remains unchanged, namely:

- to grow enterprise banking business by offering products and services to small and mid-sized businesses across the South African spectrum whilst retaining a key segment focus on Portuguese customers; and

- to grow existing and seek out new opportunities in the alliance banking arena of card and payment products.

Financial review

The Group has grown headline earnings per share by 48.0% for the year under review. The results achieved are largely attributable to:

- an increase in net interest income of 24.4% principally generated by growth in lending (net of impairments) of 41.7% and deposits of 34.2%. Overall total asset growth was 30.6%;

- non-interest income growth of 32.1% mainly in the areas of transactional banking, alliance banking card business and foreign exchange services;

- continued recoveries of impaired and written off legacy debts. Legacy debt with a gross value of R377.4 million was sold during the year under review resulting in a net release of R7.3 million in impairments upon conclusion of the sale (refer to note 9);

- exceptional recoveries of R8.6 million (refer to note 9) being amounts impaired/written off in 2004 following the release of CGD guarantees, which was a condition attached to the recapitalisation of the Group; and

- cost containment in operating expenses – year on year growth of 0.8%.

Group review (continued)

Financial Sector Charter

The Group remains fully committed to achieving the targets (as applicable to the Group's strategy) set out in the charter and plans are in place to deliver on these targets. Progress in this respect will form part of an industry communication being co-ordinated by the Banking Association.

Outlook

With the sale of the bulk of the legacy book during the past year, recoveries on legacy debt will be limited going forward.

Evaluations are still underway for the replacement of our core banking systems at a current estimated cost of approximately R70 – 80 million. The increase in this estimated cost since December 2005 is due to an expanded scope of the project. These cost estimates remain preliminary calculations with a detailed analysis in progress. The project (which is subject to final Board approval) is expected to have a duration of two to three years.

Whilst tighter monetary conditions are expected to slow the rate of credit growth, the improvement in the Group's core performance is expected to continue.

We thank all our staff for their commitment and dedication during the year under review and to our clients and shareholders we convey our appreciation for your trust and support. We also thank the South African Reserve Bank and our professional advisors for their sound guidance.

J A S de Andrade Campos
Chairman
27 February 2007

D J Brown
Chief Executive Officer
27 February 2007

Annual financial statements

Contents

Directors' responsibility

In terms of the Companies Act of South Africa, the Directors are required to maintain adequate accounting records and to prepare annual financial statements that fairly present the financial position at year-end and the results and cash flows for the year of the Company and the Group.

To enable the Board to discharge its responsibilities, management has developed and continues to maintain a system of internal controls. The Board has ultimate responsibility for this system of internal controls and reviews the effectiveness of its operations, primarily through the Group Audit Committee and other risk monitoring committees and functions.

The internal controls include risk-based systems of accounting and administrative controls designed to provide reasonable, but not absolute, assurance that assets are safeguarded and that transactions are executed and recorded in accordance with sound business practices and the Group's written policies and procedures. These controls are implemented by trained and skilled staff, with clearly defined lines of accountability and appropriate segregation of duties. The controls are monitored by management and include a budgeting and reporting system operating within strict deadlines and an appropriate control framework. As part of the system of internal controls the Group's internal audit function conducts inspections, financial and specific audits and co-ordinates audit coverage with the external auditors.

The external auditors are responsible for reporting on the Company and Group annual financial statements.

The Company and Group annual financial statements are prepared in accordance with International Financial Reporting Standards and incorporate responsible disclosures in line with the accounting policies of the Group. The Company and Group annual financial statements are based on appropriate accounting policies consistently applied except as otherwise stated and supported by reasonable and prudent judgements and estimates. The Board believes that the Group will be a going concern in the year ahead. For this reason they continue to adopt the going concern basis in preparing the annual financial statements.

These annual financial statements, set out on page 10 to 53, have been approved by the Board of Mercantile Bank Holdings Limited and are signed on their behalf by:

J A S de Andrade Campos
Chairman
27 February 2007

D J Brown
Chief Executive Officer
27 February 2007

Certificate from the Company Secretary

In terms of section 268G(d) of the Companies Act, 1973, as amended ("the Act"), I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies for the financial year ended 31 December 2006 all such returns as are required of a public company in terms of the Act, and that all such returns are true, correct and up-to-date.

R van Rensburg
Company Secretary
27 February 2007

Independent auditor's report

To the members of Mercantile Bank Holdings Limited

Report on the financial statements

We have audited the Company and Group annual financial statements, which comprise the directors' report, the balance sheet and the consolidated balance sheet as at 31 December 2006, the income statement and the consolidated income statement, the statement of changes in equity and the consolidated statement of changes in equity and cash flow statement and the consolidated cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages 10 to 53.

Directors' responsibility for the financial statements

The Company's Directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act of South Africa. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall financial statement presentation. We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company and the Group as at 31 December 2006, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act of South Africa.

Deloitte & Touche

Deloitte & Touche
Per Lito Nunes
Partner
27 February 2007

Address
Building 8
Deloitte Place
The Woodlands
Woodmead Drive
Sandton

National Executive
G G Gelink *Chief Executive*, A E Swiegers *Chief Operating Officer*, G M Pinnock *Audit*, D L Kennedy *Tax*, L Geeringh *Consulting*, M G Crisp *Financial Advisory*, L Bam *Strategy*, C R Beukman *Finance*, T J Brown *Clients and Markets*, S J C Sibisi *Public Sector and Corporate Social Responsibility*, N T Mtoba *Chairman of the Board*, J Rhynes *Deputy Chairman of the Board*

A full list of partners and directors is available on request

Directors' report

for the year ended 31 December 2006

The directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company and the Group for the year ended 31 December 2006.

1. Nature of business

The Company is a registered bank controlling company and an investment holding company incorporated in the Republic of South Africa. Through various subsidiaries, the Company is involved in the full spectrum of domestic and international banking and financial services to the retail, commercial, corporate and alliance banking niche markets.

2. Holding company

The majority shareholder of the Company (91.75%) is CGD, a company registered in Portugal.

3. Financial results

An overview of the financial results is set out in the Group Review commencing on page 5 of the Annual Report. Details of the Company and Group financial results are set out on pages 12 to 53 and in the opinion of the directors require no further comment.

4. Share capital

There were no changes to the authorised and issued share capital of the Company.

The authorised and issued share capital of the Company and Group is detailed in note 13 to the annual financial statements.

5. Directors, Company Secretary and registered addresses

The directors of the Company during the year were as follows:

J A S de Andrade Campos *∞ *(Chairman)*
D J Brown # *(Chief Executive Officer)*
G P de Kock ∞
M J M Figueira *# (resigned effective 28 February 2007)
L Hyne ∞
A T Ikalafeng ∞
J P M Lopes *#
A M Osman ^+
S Rapeti ∞
K B Motshabi ∞ (resigned 10 November 2006)

The Directors of the Company as at 27 February 2007 are shown on page 3.

The Company Secretary is R van Rensburg and the registered addresses are:

Postal	Head office
PO Box 782699	1st Floor
SANDTON	Mercantile Bank
2146	142 West Street
	SANDOWN
	2196

R van Rensburg was appointed as Company Secretary with effect from 23 March 2006 while F V Coelho retired with effect from the same date.

* Portuguese, ^ Mozambican, # Executive,
\+ Non-executive, ∞ Independent non-executive

6. Dividends

No dividend was declared during the year under review (2005: nil).

7. Subsidiary companies

All subsidiary companies are incorporated in South Africa. A register containing details of all non-trading companies is available for inspection at the registered office of the Company.

Aggregate income after taxation earned by subsidiaries amounted to R105.1 million (2005: R70.6 million) and aggregate losses amounted to R3.5 million (2005: R3.0 million).

Directors' report

for the year ended 31 December 2006 (continued)

7. **Subsidiary companies** (continued)

The principal consolidated subsidiary companies are as follows:

Company name	Issued share capital R'000	Effective holding %	Nature of business^	Shares at cost 2006 R'000	Shares at cost 2005 R'000	Owing to subsidiaries 2006 R'000	Owing to subsidiaries 2005 R'000
Lisabank Corporate Finance Limited *	–	–	1	–	15	–	–
LSM (Troyeville) Properties (Pty) Limited	–	100	1	**140**	140	–	–
Mercantile Bank Limited	124 969	100	2	**1 485 448**	1 485 448	**(12 901)**	(13 754)
Mercantile Insurance Brokers (Pty) Limited	250	100	3	**294**	294	–	–
Mercantile Nominees (Pty) Limited	–	100	4	–	–	–	–
Mercantile Registrars Limited	100	100	5	–	–	–	–
Portion 2 of Lot 8 Sandown (Pty) Limited	–	100	1	**8 832**	8 832	–	–
						(12 901)	(13 754)

^Nature of business
1 – Property holding
2 – Banking
3 – Insurance brokers
4 – Nominee company
5 – Investment company

*Sold effective 1 March 2006

8. **Going concern**

The Company and Group annual financial statements have been prepared on the going concern basis.

9. **Special resolutions**

There were no special resolutions during the year under review.

10. **Post balance sheet events**

No material events have occurred between the accounting date and the date of this report.

Accounting policies
for the year ended 31 December 2006

The principal accounting policies adopted in the preparation of these annual financial statements are set out below:

1. Basis of presentation

The Company and Group annual financial statements have been prepared in accordance with International Financial Reporting Standards and interpretations ("IFRS") issued by the International Accounting Standards Board, using the historical cost convention as modified by the revaluation of certain financial assets, liabilities and properties.

2. Group accounts

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

3. Recognition of assets and liabilities

3.1. Assets

The Group recognises assets when it obtains control of a resource as a result of past events and from which future economic benefits are expected to flow to the Group.

3.2 Liabilities

The Group recognises liabilities when it has a present obligation as a result of past events and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

3.3 Contingent liabilities

The Group discloses a contingent liability where it has a possible obligation as a result of past events, the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, or it is possible that an outflow of resources will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability.

4. Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group has become a party to the contractual provisions of that instrument. Regular way purchases or sales of financial assets are recognised using settlement date accounting. Initial recognition is at cost, including transaction costs.

The Group derecognises a financial asset when:

- the contractual rights to the cash flows arising from the financial assets have expired or been forfeited by the Group; or
- it transfers the financial asset including substantially all the risks and rewards of ownership of the asset; or
- it transfers the financial asset, neither retaining nor transferring substantially all the risks and rewards of ownership of the asset, but no longer retains control of the asset.

A financial liability is derecognised when and only when the liability is extinguished, that is, when the obligation specified in the contract is discharged, cancelled or has expired.

The difference between the carrying amount of a financial liability (or part thereof) extinguished or transferred to another party and consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in income.

Accounting policies

for the year ended 31 December 2006 (continued)

4. **Financial instruments** (continued)

4.1 Derivative financial instruments

Derivative financial assets and liabilities are classified as held-for-trading.

The Group uses the following derivative financial instruments to reduce its underlying financial risks:

- forward exchange contracts;
- foreign currency swaps; and
- interest rate swaps.

Derivative financial instruments are not entered into for trading or speculative purposes. All derivatives are recognised on the balance sheet. Derivative financial instruments are initially recorded at cost and are remeasured to fair value at each subsequent reporting date. Changes in the fair value of derivatives are recognised in income.

Embedded derivatives are separated from the host contract and accounted for as a separate derivative when:

- the embedded derivative's economic characteristics and risks are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the combined instrument is not measured at fair value with changes in fair value reported in income.

A derivative's notional principal reflects the value of the Group's investment in derivative financial instruments and represents the amount to which a rate or price is applied to calculate the exchange of cash flows.

4.2 Financial assets

The Group's principal financial assets are cash and cash equivalents, loans and advances, investments, and other accounts receivable.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held by the Group with the South African Reserve Bank, domestic banks and foreign banks as well as resale agreements. These financial assets have been designated as loans and receivables and are measured at amortised cost.

Investments

Investments comprise negotiable securities and other investments. Negotiable securities consist of government stock, Treasury bills, Landbank bills, corporate bonds and debentures while other investments consist of unlisted equity investments.

Negotiable securities for which there is no active secondary market are classified as loans and receivables and are carried at amortised cost subject to impairment.

Negotiable securities for which an active secondary market exists are designated as fair value through profit and loss.

Other investments have been designated as available-for-sale. These assets are measured at fair value, at each reporting date with the resultant gains or losses being recognised in equity until the financial asset is sold, or otherwise disposed of, or found to be impaired. At that time the cumulative gains or losses previously recognised in equity are included in income.

Accounting policies

for the year ended 31 December 2006 (continued)

4. Financial instruments (continued)

4.2 Financial assets (continued)

Loans and advances

Loans and advances principally comprise amounts advanced to third parties in terms of certain products.

Fixed rate loans and advances have been designated as fair value through profit and loss with resultant gains and losses being included in income. Variable rate loans and advances have been designated as loans and receivables and are measured at amortised cost.

Other accounts receivable

Other accounts receivable comprise items in transit, prepayments and deposits and other receivables. These assets have been designated as loans and receivables and are measured at amortised cost.

4.3 Financial liabilities

The Group's financial liabilities include deposits and other accounts payable consisting of repurchase agreements, accruals, product related credits and sundry creditors. All financial liabilities, other than liabilities designated at fair value and derivative instruments, are measured at amortised cost. Financial liabilities designated at fair value and derivative instruments are measured at fair value, and the resultant gains and losses are included in income.

4.4 Fair value estimation

The fair value of publicly traded derivatives, securities and investments is based on quoted market values at the balance sheet date. In the case of an asset held by the Group, the current bid price is used as a measure of fair value. In the case of a liability held, the current offer or asking price is used as a measure of fair value. Mid-market prices are used as a measure of fair value where there are matching asset and liability positions.

In assessing the fair value of non-traded derivatives and other financial instruments, the Group uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. Quoted market prices or dealer quotes for the same or similar instruments are used for the majority of securities, long-term investments and long-term debt. Other techniques, such as option pricing models, estimated discounted value of future cash flows, replacement cost and termination cost are used to determine fair value for all remaining financial instruments.

4.5 Amortised cost

Amortised cost is determined using the effective interest rate method. The effective interest rate method is a way of calculating amortisation using the effective interest rate of a financial asset or financial liability. It is the rate that discounts the expected stream of future cash flows through maturity or the next market-based revaluation date to the current net carrying amount of the financial asset or financial liability.

4.6 Impairments

Specific impairments are made against identified doubtful advances. Portfolio impairments are maintained to cover potential losses, which although not specifically identified, may be present in the advances portfolio.

Advances which are deemed uncollectible, are written off against the specific impairments. Loans previously written off which subsequently become fully performing are reincorporated in the advances portfolio. Both the specific and portfolio impairments raised during the year less the recoveries of advances previously written off, are charged to income.

Accounting policies

for the year ended 31 December 2006 (continued)

4. **Financial instruments** (continued)

4.6 **Impairments** (continued)

The Group reviews the carrying amounts of its advances to determine whether there is any indication that those advances have suffered an impairment loss. Where it is not possible to estimate the recoverable amount of an individual advance, the Group estimates the recoverable amount on a portfolio basis for a group of similar financial assets.

The recoverable amount is the sum of the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects the portfolio of advances' original effective interest rate.

If the recoverable amount of the advance is estimated to be less than the carrying amount, the carrying amount of the advance is reduced to its recoverable amount by raising a specific impairment which is recognised as an expense in income.

Where the impairment loss subsequently reverses, the carrying amount of the advance is increased to the revised estimate of its recoverable amount, subject to the increased carrying amount not exceeding the carrying amount that would have been determined had no impairment loss been recognised for the advance in prior years. A reversal of an impairment loss is recognised as income immediately.

5. **Foreign currency transactions**

Transactions in foreign currencies are converted into the functional currency at prevailing exchange rates on the transaction date. Monetary assets, liabilities and commitments in foreign currencies are translated into the functional currency using the rates of exchange ruling at each reporting date. Gains and losses on foreign exchange are included in income.

6. **Subsidiaries**

Investments in subsidiaries in the Company's annual financial statements are designated as available-for-sale assets and are recognised at fair value. Fair value is estimated as the net asset value. All gains and losses on the sale of subsidiaries are recognised in income.

7. **Associated companies**

Associated companies are those companies in which the Group exercises significant influence, but not control or joint control, over their financial and operating policies and holds between 20% and 50% interest therein.

The carrying values of investments in associated companies represent the aggregate of the cost of the investments plus post-acquisition equity accounted income and reserves. These investments are accounted for using the equity method in the Group annual financial statements. This method is applied from the effective date on which the enterprise became an associated company, up to the date on which it ceases to be an associated company.

8. **Investment properties**

Investment properties are held to earn rentals and/or for capital appreciation. The Group carries investment properties in the balance sheet at open-market fair value based on regular valuations by independent registered professional valuators. The open-market fair value is based on the open market net rentals for each property.

Fair value movements are included in income in the year in which they arise.

Accounting policies

for the year ended 31 December 2006 (continued)

9. Property and equipment

9.1 Owner-occupied properties

Owner-occupied properties are held for use in the supply of services or for administrative purposes and are stated in the balance sheet at open-market fair value on the basis of their existing use at the date of revaluation, less any subsequent accumulated depreciation calculated using the straight-line method and subsequent accumulated impairment losses. The open-market fair value is based on the open market net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

Any revaluation increase, arising on the revaluation of owner-occupied properties, is credited to the non-distributable reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense. The increase is credited to income to the extent that an expense was previously charged to income. A decrease in carrying amount arising on the revaluation of owner-occupied properties is charged as an expense to the extent that it exceeds the balance, if any, held in the non-distributable reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued property, the revaluation surplus, relating to that property, in the non-distributable reserve is transferred to distributable reserves. The properties' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

9.2 Equipment

All equipment is stated at historical cost less accumulated depreciation and subsequent accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to income as they are incurred.

Depreciation on equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Leasehold improvements are depreciated over the period of the lease or over such lesser period as is considered appropriate. The equipments' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

The estimated useful lives of property and equipment are as follows:

	Years
Leasehold improvements	5 – 10
Computer equipment	3 – 5
Furniture and fittings	10
Office equipment	5 – 10
Motor vehicles	5
Owner-occupied properties	50

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying amount and are recognised in income.

Accounting policies

for the year ended 31 December 2006 (continued)

10. Intangible assets

Computer software

Costs associated with developing or maintaining computer software programs and the acquisition of software licenses are recognised as an expense as incurred. Costs that are directly associated with an identifiable and unique system controlled by the Group, and are expected to generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include external software development and consultancy fees.

Direct computer software development costs recognised as intangible assets are amortised on the straight-line basis at rates appropriate to the expected useful lives of the assets, which is usually between three and five years, but where appropriate over a maximum of ten years and are carried at cost less any accumulated amortisation and any accumulated impairment losses. The carrying amount of capitalised computer software is reviewed annually for indication of impairment and is written down when the carrying amount exceeds the recoverable amount.

11. Provisions

Provisions are recognised when the Group has a present legal or constructive obligation, as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

12. Deferred income taxes

Deferred income tax is provided, using the balance sheet liability method, for all temporary differences arising between the tax values of assets and liabilities and their carrying values for financial reporting purposes. Expected tax rates are used to determine deferred income tax. Deferred tax assets relating to the carry forward of unused tax losses are recognised to the extent that it is probable that future taxable income will be available against which the unused tax losses can be utilised.

13. Sale and repurchase agreements and lending of securities

Securities sold subject to linked repurchase agreements (“repos”) are reflected in the annual financial statements as cash and cash equivalents, when the transferee has the right to sell or repledge the collateral, and the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits, or deposits due to customers, as appropriate. Securities purchased under agreements to resell (“reverse repos”) are recorded as cash and cash equivalents. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective interest method. Securities lent to counterparties are also retained in the annual financial statements.

Securities borrowed are not recognised in the annual financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss being included in income. The obligation to return them is recorded at fair value in other accounts payable.

14. Instalment sales and leases

14.1 The Group as the lessee

The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to income on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Accounting policies

for the year ended 31 December 2006 (continued)

14. Instalment sales and leases (continued)

14.2 The Group as the lessor

Leases and instalment sale agreements are regarded as financing transactions with rentals and instalments receivable, less unearned finance charges, being included in advances. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

15. Interest income and interest expense

Interest income and expense are recognised in income for all interest-bearing instruments measured at amortised cost using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

16. Fee, commission and dividend income

Fees and commissions are recognised on an accrual basis. Dividend income from investments is recognised when the shareholder's rights to receive payment have been established.

17. Retirement funds

The Group operates defined contribution funds, the assets of which are held in a separate trustee-administered fund. The retirement funds are funded by payments from employees and by the relevant Group companies. The Group contributions to the retirement funds are based on a percentage of the payroll and are charged to income as accrued.

18. Post-retirement medical benefits

The Group provides for post-retirement medical benefits to certain retired employees. These benefits are only applicable to employees who were members of the Group's medical aid scheme prior to May 2000 and who elected to retain the benefits in 2005 and are based on these employees remaining in service up to retirement age. The Group provides for the present value of the obligations in excess of the fair value of the plan assets which are intended to offset the expected costs relating to the post-retirement medical benefits. The costs of the defined benefit plan are assessed using the projected unit credit method. Under this method, the cost of providing post-retirement medical benefits is charged to income so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the plans at least every three years.

Actuarial gains and losses, the effect of settlements on the liability and plan assets and the curtailment gain due to the change in the post-retirement subsidy of in-service members are recognised immediately. The Group's contributions to the post-retirement healthcare policy are charged to income in the year to which they relate.

19. Equity compensation plans

Share options in the Company are granted to employees of the Bank at the discretion of the Group Remuneration Committee and approved by the Board of the Company. The Share Incentive Trust's financial position and results are consolidated. The Group has applied the requirements of IFRS 2 to share-based payments.

The equity-settled share-based payments are measured at fair value at the grant date and expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

Fair value is measured by use of a Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Accounting policies
for the year ended 31 December 2006 (continued)

20. Segment information

A business segment is a distinguishable component of the Group that is engaged in providing specific products or services whilst a geographical segment provides products or services in a particular economic environment.

21. General credit-risk reserve

Banks Act circular 21/2004 requires that a general credit-risk reserve be recognised within Shareholders' equity for any shortfall between total impairments raised in terms of IAS 39 and the provisions required in terms of Regulation 28 of the Regulations relating to Banks. Such reserve is maintained through an appropriation of distributable reserves to a general credit-risk reserve.

22. Critical accounting estimates and judgements

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

22.1 Impairment losses on loans and advances

The Group reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

22.2 Fair value of derivatives

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk, volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

22.3 Impairment of available-for-sale equity investments

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates among other factors, the normal volatility in share price. In addition impairment may be appropriate when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Accounting policies
for the year ended 31 December 2006 (continued)

22. Critical accounting estimates and judgements (continued)

22.4 Income taxes

There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

23. Comparative figures

Where necessary, comparative figures are restated to be consistent with the disclosure in the current year. Details of restatements are provided in note 30.

24. Recent accounting developments

There are standards and interpretations in issue that are not yet effective. These include the following standards and interpretations that are applicable to the business of the Group and may have an impact on future financial statements. The impact of initial application has not been assessed as at the date of authorisation of the annual financial statements.

IFRS 7 (Financial Instruments: Disclosures) was issued during June 2005 but is only effective for annual periods beginning on or after 1 January 2007. The Group is subject to IFRS 7 as this standard supersedes IAS 30 (Disclosures in the Financial Statements of Banks and Similar Financial Institutions) and supplements the principles of IAS 32 and IAS 39. The Group will apply IFRS 7 from the year ending 31 December 2007.

IFRS 8 (Operating segments) was issued during November 2006 but is only effective for annual periods beginning on or after 1 January 2009. The Group will apply IFRS 8 from the year ending 31 December 2009.

IRFIC 8 (Scope of IRFS 2) was issued during January 2006 but is only effective for annual periods beginning on or after 1 May 2006. The Group will apply IFRIC 8 from the year ending 31 December 2007.

IFRIC 9 (Reassessment of embedded derivatives) was issued during March 2006 but is only effective for annual periods beginning on or after 1 June 2006. The Group will apply IFRIC 9 from the year ending 31 December 2007.

IFRIC 10 (Interim financial reporting and impairment) was issued during July 2006 but is only effective for annual periods beginning on or after 1 November 2006. The Group will apply IFRIC 10 from the year ending 31 December 2007.

IFRIC 11 (Interim financial reporting and impairment) was issued during November 2006 but is only effective for annual periods beginning on or after 1 March 2007. The Group will apply IFRIC 11 from the year ending 31 December 2008.

Balance sheets

at 31 December 2006

		Group		Company	
		2006	2005	2006	2005
	Note	R'000	R'000	R'000	R'000
ASSETS					
Intangible assets	1	11 551	7 020	–	–
Property and equipment	2	94 956	91 305	–	–
Investment properties	3	–	350	–	–
Taxation	4	29	3 698	29	29
Other accounts receivable	5	145 291	14 887	4	3
Interest in subsidiaries	6	–	–	670 355	553 448
Interest in associated company	7	3 626	3 323	–	–
Other investments	8	7 209	2 365	20	20
Loans and advances	9	2 066 432	1 458 677	–	–
Derivative financial instruments	10	31 134	36 757	–	–
Negotiable securities	11	405 016	379 028	–	–
Cash and cash equivalents	12	1 683 974	1 408 972	138	87
Total assets		4 449 218	3 406 382	670 546	553 587
EQUITY AND LIABILITIES					
Shareholders' equity		667 418	550 179	670 515	553 290
Share capital and share premium	13	1 207 046	1 207 032	1 210 143	1 210 143
Capital redemption reserve fund		3 788	3 788	3 788	3 788
Share-based payments reserve		3 025	847	3 025	847
General reserve		7 478	7 478	–	–
Property revaluation reserve		45 588	36 476	–	–
Available-for-sale reserve		5 216	(76)	106 011	(10 043)
General credit-risk reserve		13 954	10 835	–	–
Accumulated loss		(618 677)	(716 201)	(652 452)	(651 445)
Liabilities		3 781 800	2 856 203	31	297
Deposits	14	3 539 147	2 636 547	–	–
Derivative financial instruments	10	29 189	38 531	–	–
Provisions	15	38 994	31 647	–	–
Other accounts payable	17	174 435	149 478	31	297
Taxation	4	35	–	–	–
Total equity and liabilities		4 449 218	3 406 382	670 546	553 587

Income statements

for the year ended 31 December 2006

		Group		Company	
		2006	2005	**2006**	2005
	Note	**R'000**	R'000 (restated)	**R'000**	R'000
Interest income	20	**357 163**	248 290	**–**	–
Interest expenditure	21	**(189 044)**	(113 144)	**–**	–
Net interest income before recoveries		**168 119**	135 146	**–**	–
Net recovery of credit losses	9	**1 520**	21 287	**–**	–
Net interest income after recoveries		**169 639**	156 433	**–**	–
Net loss on disposal and revaluation of investments		**(347)**	(498)	**–**	527
Non-interest income	22	**147 520**	111 712	**266**	–
Net interest and non-interest income		**316 812**	267 647	**266**	527
Operating expenditure	23	**(226 040)**	(224 286)	**(1 273)**	(1 088)
Operating profit before exceptional item		**90 772**	43 361	**(1 007)**	(561)
Recovery of amounts previously written off in respect of the release of the CGD guarantee	9	**8 602**	23 119	**–**	–
Operating profit		**99 374**	66 480	**(1 007)**	(561)
Share of income from associated company		**1 269**	516	**–**	–
Profit/(Loss) before taxation		**100 643**	66 996	**(1 007)**	(561)
Taxation	24	**–**	–	**–**	–
Attributable profit/(loss) after taxation		**100 643**	66 996	**(1 007)**	(561)
Earnings per ordinary share (cents)	25.1	**2.56**	1.71		
Diluted earnings per ordinary share (cents)	25.2	**2.56**	1.70		
Dividends per share (cents)		**–**	–		

Statements of changes in equity
for the year ended 31 December 2006

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Share-based payments reserve R'000	General reserve R'000	Property re-valuation reserve R'000	Available -for-sale reserve R'000	General credit-risk reserve R'000	Accu-mulated loss R'000	Total R'000
Group									
Shareholders' equity at 1 January 2005	**1 208 642**	**3 788**	**123**	**7 478**	**31 273**	**(955)**	**31 668**	**(781 078)**	**500 939**
Net movement for the year	**(1 610)**	**–**	**724**	**–**	**5 203**	**879**	**(20 833)**	**64 877**	**49 240**
Change in accounting policy – IAS 32 and 39 credit risk impairments	–	–	–	–	–	–	–	(22 952)	(22 952)
Release of general credit-risk reserve on adoption of IFRS in respect of credit risk impairments	–	–	–	–	–	–	(22 952)	22 952	–
Revaluation of owner-occupied property	–	–	–	–	5 203	–	–	–	5 203
Gains and losses on remeasurement to fair value	–	–	–	–	–	(6)	–	–	(6)
Release to income on disposal of available-for-sale financial assets	–	–	–	–	–	885	–	–	885
Increase in general credit-risk reserve	–	–	–	–	–	–	2 119	(2 119)	–
Treasury shares on consolidation of share incentive trust	(1 610)	–	–	–	–	–	–	–	(1 610)
Share-based payments expense	–	–	724	–	–	–	–	–	724
Attributable profit after taxation	–	–	–	–	–	–	–	66 996	66 996
Shareholders' equity at 31 December 2005	**1 207 032**	**3 788**	**847**	**7 478**	**36 476**	**(76)**	**10 835**	**(716 201)**	**550 179**
Net movement for the year	**14**	**–**	**2 178**	**–**	**9 112**	**5 292**	**3 119**	**97 524**	**117 239**
Revaluation of owner-occupied property	–	–	–	–	9 112	–	–	–	9 112
Gains and losses on remeasurement to fair value	–	–	–	–	–	5 294	–	–	5 294
Release to income on disposal of available-for-sale financial assets	–	–	–	–	–	(2)	–	–	(2)
Increase in general credit-risk reserve	–	–	–	–	–	–	3 119	(3 119)	–
Treasury shares on consolidation of share incentive trust	14	–	–	–	–	–	–	–	14
Share-based payments expense	–	–	2 178	–	–	–	–	–	2 178
Attributable profit after taxation	–	–	–	–	–	–	–	100 643	100 643
Shareholders' equity at 31 December 2006	**1 207 046**	**3 788**	**3 025**	**7 478**	**45 588**	**5 216**	**13 954**	**(618 677)**	**667 418**

Statements of changes in equity

for the year ended 31 December 2006 (continued)

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Share-based payments reserve R'000	Available-for-sale reserve R'000	Accu-mulated loss R'000	Total R'000
Company						
Shareholders' equity at 1 January 2005	**1 210 143**	**3 788**	**123**	**(60 607)**	**(650 884)**	**502 563**
Net movement for the year	**–**	**–**	**724**	**50 564**	**(561)**	**50 727**
Gains and losses on remeasurement to fair value	–	–	–	50 995	–	50 995
Release to income on disposal of available-for-sale financial assets	–	–	–	(431)	–	(431)
Share-based payments expense	–	–	724	–	–	724
Attributable loss after taxation	–	–	–	–	(561)	(561)
Shareholders' equity at 31 December 2005	**1 210 143**	**3 788**	**847**	**(10 043)**	**(651 445)**	**553 290**
Net movement for the year	**–**	**–**	**2 178**	**116 054**	**(1 007)**	**117 225**
Gains and losses on remeasurement to fair value	–	–	–	116 054	–	116 054
Share-based payments expense	–	–	2 178	–	–	2 178
Attributable loss after taxation	–	–	–	–	(1 007)	(1 007)
Shareholders' equity at 31 December 2006	**1 210 143**	**3 788**	**3 025**	**106 011**	**(652 452)**	**670 515**

Cash flow statements

for the year ended 31 December 2006

	Note	Group 2006 R'000	Group 2005 R'000 (restated)	Company 2006 R'000	Company 2005 R'000
Operating activities					
Cash receipts from customers	26.1	**518 278**	393 699	**266**	–
Cash paid to suppliers and employees	26.2	**(391 429)**	(327 252)	**(1 273)**	(1 088)
Dividends received		**7**	80	–	–
Taxation received/(paid)	26.3	**3 704**	(126)	–	–
Net increase in income earning assets	26.4	**(640 942)**	(506 888)	–	–
Net increase in deposits and other accounts	26.5	**797 517**	716 861	**1 058**	195
Net cash inflow/(outflow) from operating activities		**287 135**	276 374	**51**	(893)
Investing activities					
Purchase of property, equipment and intangible assets		**(13 239)**	(18 652)	–	–
Proceeds on sale of property, equipment and intangible assets		**39**	384	–	–
Proceeds on disposal of investments		**101**	1 576	–	644
Decrease in associated company		**966**	429	–	–
Net cash (outflow)/inflow from investing activities		**(12 133)**	(16 263)	–	644
Net cash inflow/(outflow) for year		**275 002**	260 111	**51**	(249)
Cash and cash equivalents at beginning of year		**1 408 972**	1 148 861	**87**	336
Cash and cash equivalents at end of year	12	**1 683 974**	1 408 972	**138**	87

Notes to the annual financial statements
for the year ended 31 December 2006

	Group 2006 R'000	Group 2005 R'000
1. Intangible assets		
Computer software		
Cost at beginning of year	44 068	39 051
Additions	7 648	5 017
Disposals	(42)	–
Cost at end of year	51 674	44 068
Accumulated amortisation and impairment losses at beginning of year	(37 048)	(32 250)
Amortisation	(3 108)	(4 798)
Disposals	33	–
Accumulated amortisation and impairment losses at end of year	(40 123)	(37 048)
Net carrying amount at end of year	11 551	7 020

	Owner-occupied property R'000	Leasehold improve-ments R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2. Property and equipment							
Group							
2006							
Open market value/cost at beginning of year	65 164	17 166	67 162	8 472	20 290	422	178 676
Revaluations	8 000	–	–	–	–	–	8 000
Additions	–	963	2 049	49	2 530	–	5 591
Disposals	–	–	(643)	(85)	(356)	(83)	(1 167)
Open market value/cost at end of year	73 164	18 129	68 568	8 436	22 464	339	191 100
Accumulated depreciation and impairment losses at beginning of year	–	(11 550)	(54 981)	(6 638)	(13 872)	(330)	(87 371)
Depreciation	(1 112)	(1 275)	(5 862)	(633)	(2 098)	(40)	(11 020)
Revaluation	1 112	–	–	–	–	–	1 112
Disposals	–	–	634	80	338	83	1 135
Accumulated depreciation and impairment losses at end of year	–	(12 825)	(60 209)	(7 191)	(15 632)	(287)	(96 144)
Net carrying amount at end of year	73 164	5 304	8 359	1 245	6 832	52	94 956

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Owner-occupied property R'000	Leasehold improve-ments R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2. Property and equipment (continued)							
Group							
2005							
Open market value/cost at beginning of year	60 990	15 568	61 640	8 269	18 778	722	165 967
Revaluations	4 174	–	–	–	–	–	4 174
Additions	–	3 940	7 975	205	1 515	–	13 635
Disposals	–	(2 342)	(2 453)	(2)	(3)	(300)	(5 100)
Open market value/cost at end of year	**65 164**	**17 166**	**67 162**	**8 472**	**20 290**	**422**	**178 676**
Accumulated depreciation and impairment losses at beginning of year	–	(12 324)	(49 563)	(5 963)	(12 503)	(586)	(80 939)
Depreciation	(1 029)	(1 432)	(7 480)	(676)	(1 372)	(44)	(12 033)
Revaluation	1 029	–	–	–	–	–	1 029
Disposals	–	2 206	2 062	1	3	300	4 572
Accumulated depreciation and impairment losses at end of year	–	**(11 550)**	**(54 981)**	**(6 638)**	**(13 872)**	**(330)**	**(87 371)**
Net carrying amount at end of year	**65 164**	**5 616**	**12 181**	**1 834**	**6 418**	**92**	**91 305**

Notes

1. G J Van Zyl, a valuator with Van Zyl Valuers and a Member of The Institute of Valuers of South Africa, independently valued the properties at 31 December 2006.
2. A register containing details of owner-occupied properties and the revaluation thereof is available for inspection at the registered office of the Company.

	Group 2006 R'000	Group 2005 R'000
3. Investment properties		
Open-market value at beginning of year	**350**	770
Disposals	**(350)**	(470)
Revaluations	–	50
Open-market value at end of year	–	350

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group 2006 R'000	Group 2005 R'000	Company 2006 R'000	Company 2005 R'000
4. Taxation				
South African Revenue Services				
Taxation overpaid by the Group/Company	**29**	3 698	**29**	29
Taxation owing by the Group	**35**	–	**–**	–
5. Other accounts receivable				
Items in transit	**7 743**	4 345	**–**	–
Prepayments and deposits	**4 159**	3 721	**4**	3
Other receivables	**133 389**	6 821	**–**	–
	145 291	14 887	**4**	3

Other receivables includes amounts due from Alliance Partners which have been settled after year-end.

	Company 2006 R'000	Company 2005 R'000
6. Interest in subsidiaries		
Unlisted		
Shares at fair value	**683 256**	567 202
Loan amount owing to subsidiary	**(12 901)**	(13 754)
	670 355	553 448

A list of principal subsidiary companies is contained in note 7 of the Directors' report. The loan is interest free and has no fixed terms of maturity.

	Group 2006 R'000	Group 2005 R'000
7. Interest in associated company		
Unlisted		
Statman Investments (Pty) Limited *		
Shares at cost	**675**	675
Accumulated share of post-acquisition profits	**4 346**	3 077
Dividends received	**(1 395)**	(429)
	3 626	3 323
Directors' valuation of the unlisted associated company	**3 626**	3 323

* Financial year-end February

Summarised financial information of the associated company is disclosed in note 28.4.

	Group 2006 R'000	Group 2005 R'000	Company 2006 R'000	Company 2005 R'000
8. Other investments				
Available-for-sale				
Unlisted	**7 209**	2 365	**20**	20
Directors' valuation of unlisted investments	**7 209**	2 365	**20**	20

A register containing details of investments is available for inspection at the registered office of the Company.

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

	Group 2006 R'000	Group 2005 R'000
9. Loans and advances		
Category analysis		
Amortised cost	2 053 778	1 758 930
Current accounts	460 389	318 177
Credit card	29 002	137 638
Mortgage loans	699 122	529 247
Instalment sales and leases	299 284	209 642
Other advances	565 981	564 226
Fair value		
Other advances	114 205	129 292
	2 167 983*	1 888 222
Less: Impairment for credit losses	(64 394)*	(268 665)
Less: Interest in suspense	(37 157)*	(160 880)
	2 066 432	1 458 677
All loans and advances are denominated in South African Rand.		
Maturity analysis		
Repayable on demand	696 353	696 215
Maturing within six months	105 259	61 884
Maturing after six months but within 12 months	119 327	65 798
Maturing after 12 months	1 247 044	1 064 325
	2 167 983	1 888 222
The maturity analysis is based on the remaining period to contractual maturity at year-end.		
Impairment for credit losses		
Balance at beginning of year	268 665	294 264
Movements for year:		
Credit losses written-off	(4 995)	(39 826)
Impairments utilised in writing off sold legacy loans and advances	(214 578)*	–
Net impairments raised	15 302	14 227
Creation of credit-risk impairments on adoption of IFRS	–	22 952
Other net impairments raised/(released)	15 302	(8 725)
Balance at end of year	64 394	268 665
Comprising:		
Portfolio impairment	31 682	4 238
Specific impairment	32 712	264 427
Balance at end of year	64 394	268 665
Net recovery of credit losses		
Net impairments (raised)/released	(15 302)	8 725
Recoveries in respect of sold legacy loans and advances	7 345	–
Recoveries in respect of amounts previously written off	9 477	9 705
Other credit risk related provisions released	–	2 857
	1 520	21 287
Exceptional items as per income statement		
Recovery of amounts previously written off in respect of the release of the CGD guarantee	8 602	23 119

* Effective 1 December 2006, legacy loans and advances of R377.4 million were sold to a third party. Specific impairments and interest in suspense of R214.6 million and R157.3 million, respectively, were utilised in writing off this debt.

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Balance after interest in suspense R'000	Specific impairment R'000	Net balance R'000
9. Loans and advances (continued)			
Non-performing loans			
Group			
2006			
Category analysis			
Current accounts	**9 159**	**5 959**	**3 200**
Credit card	**6 588**	**6 446**	**142**
Mortgage loans	**4 257**	**1 134**	**3 123**
Instalment sales and leases	**6 737**	**5 638**	**1 099**
Other advances	**19 668**	**13 535**	**6 133**
	46 409	**32 712**	**13 697**
2005			
Category analysis			
Current accounts	1 830	–	1 830
Credit cards	67 826	67 579	247
Mortgage loans	28 729	12 182	16 547
Instalment sales and leases	52 355	51 186	1 169
Other advances	145 220	133 480	11 740
	295 960	264 427	31 533

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
10. Derivative financial instruments				
Group				
2006				
Held-for-trading				
Foreign exchange contracts	**1 022 312**	**30 402**	**461 355**	**13 350**
Interest rate swaps	**30 700**	**732**	**172 699**	**15 839**
	1 053 012	**31 134**	**634 054**	**29 189**
2005				
Held-for-trading				
Foreign exchange contracts	1 118 646	36 757	401 219	8 937
Interest rate swaps	100 000	–	315 832	29 594
	1 218 646	36 757	717 051	38 531

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group 2006 R'000	Group 2005 R'000
11. Negotiable securities		
Loans and receivables		
Treasury bills	**184 539**	129 509
Landbank bills	**9 867**	–
Debentures	**26 105**	58 226
Non-liquid bills and acceptances	**–**	56
Held as fair value through profit and loss		
Corporate bonds	**184 505**	191 237
	405 016	379 028
Maturity analysis		
Repayable within one month	**56 061**	153 175
Maturing within six months	**164 450**	34 616
Maturing after six months but within 12 months	**152 607**	–
Maturing after 12 months but within five years	**31 898**	191 237
	405 016	379 028

The maturity analysis is based on the remaining period to contractual maturity at year-end.

	Group 2006 R'000	Group 2005 R'000	Company 2006 R'000	Company 2005 R'000
12. Cash and cash equivalents				
Cash and bank notes	**28 350**	19 946	**–**	–
Central Bank balances	**49 325**	35 719	**–**	–
Domestic bank balances	**88 011**	151 785	**138**	87
Foreign bank balances	**1 518 288**	1 201 522	**–**	–
	1 683 974	1 408 972	**138**	87

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
13. Share capital and share premium				
13.1 Issued – Group				
At 1 January 2005	3 930 371 929	37 888	1 170 754	1 208 642
Treasury shares on consolidation of share incentive trust	(5 246 405)	(1 610)	–	(1 610)
At 31 December 2005	3 925 125 524	36 278	1 170 754	1 207 032
Treasury shares on consolidation of share incentive trust	82 500	14	–	14
At 31 December 2006	**3 925 208 024**	**36 292**	**1 170 754**	**1 207 046**

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
13. Share capital and share premium (continued)				
13.2 Issued – Company				
At 31 December 2005 and 31 December 2006	**3 938 918 524**	**39 389**	**1 170 754**	**1 210 143**

13.3 Authorised

The total authorised number of ordinary shares is 4 465 955 440 shares (2005: 4 465 955 440 shares) with a par value of 1 cent each. The total authorised number of preference shares is 15 200 000 shares (2005: 15 200 000 shares) with a par value of 1 cent each.

13.4 Unissued

The unissued ordinary shares are under the control of the Directors until the next Annual General Meeting.

13.5 Share incentive scheme

Options may be exercised in respect of 33% of the option shares after the expiration of two years from the offer date, in respect of a further 33% after the expiration of three years from the offer date and the remaining option shares after the expiration of four years from the offer date. Such percentages are to be carried forward on a cumulative basis. Should the options not be exercised by the fifth anniversary date of the offer, the option holder is obliged to exercise the option in respect of at least 20% of the options in question by the sixth anniversary date of the offer or else the said 20% of the options will lapse. The same rule applies for the seventh, eighth, ninth and tenth anniversary of the offer date until the options in question have either lapsed or been exercised.

The number of shares, which could be utilised for the purposes of the scheme are 393 891 852 (2005: 787 783 705), which is 10% (2005: 20%) of the issued share capital of the Company at year end. The number of scheme shares that may be issued to a single participant is 59 083 778, or 1.5% of the total number of issued shares. The table below sets out the movements in the options.

Refer to the shareholder spread on page 64 for information relating to the shares held by the Mercantile Share Incentive Trust.

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

13. Share capital and share premium (continued)

13.5 Share incentive scheme (continued)

	Exercise price (cents)	Options at beginning of year	Granted during year	Forfeited during year	Exercised during year	Options at end of year	Exercisable options at end of year	Relating to directors[1]
Grant date								
2006								
20 November 2001	32	5 343 000	–	(1 400 000)	–	3 943 000	3 943 000	–
11 February 2002	32	200 000	–	–	–	200 000	200 000	–
5 October 2004	18	5 000 000	–	–	–	5 000 000	1 650 000	5 000 000
7 October 2004	17	2 600 000	–	(100 000)	(500 000)	2 000 000	660 000	–
3 January 2005	15	700 000	–	–	–	700 000	–	–
11 February 2005	20	500 000	–	–	–	500 000	–	–
1 April 2005	39	1 000 000	–	–	–	1 000 000	–	–
27 July 2005	32	750 000	–	–	–	750 000	–	–
2 January 2006	31	–	350 000	–	–	350 000	–	–
9 February 2006	41	–	750 000	–	–	750 000	–	–
3 March 2006	38	–	500 000	–	–	500 000	–	–
22 March 2006	40	–	16 200 000	(1 400 000)	–	14 800 000	–	7 000 000
		16 093 000	**17 800 000**	**(2 900 000)**	**(500 000)**	**30 493 000**	**6 453 000**	**12 000 000**
2005								
20 November 2001	32	6 293 000	–	(950 000)	–	5 343 000	5 343 000	–
11 February 2002	32	350 000	–	(150 000)	–	200 000	133 333	–
5 October 2004	18	5 000 000	–	–	–	5 000 000	–	5 000 000
7 October 2004	17	3 100 000	–	(500 000)	–	2 600 000	–	–
3 January 2005	15	–	700 000	–	–	700 000	–	–
11 February 2005	20	–	500 000	–	–	500 000	–	–
1 April 2005	39	–	1 000 000	–	–	1 000 000	–	–
27 July 2005	32	–	750 000	–	–	750 000	–	–
		14 743 000	2 950 000	(1 600 000)	–	16 093 000	5 476 333	5 000 000

[1] Refer to note 28.3

Inputs into the Black-Scholes model in determining the charge for share-based payments are as follows:

	2006	2005
Weighted average fair value share price	**38 cents**	31 cents
Weighted average exercise price	**40 cents**	28 cents
Expected volatility	**92.3% – 98.7%**	103.0% – 127.2%
Option life	**6 – 10 years**	6 – 10 years
Risk free rate	**7.3%**	6.7% – 7.3%
Expected dividends	**Nil**	Nil

Expected volatility was determined by calculating the historical volatility of the Mercantile Bank Holdings Limited share price from September 2004 to the grant date of each option. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The Group recognised total expenses of R2.178 million (2005: R0.724 million) related to equity-settled share-based payment transactions.

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

14. Deposits

	Group 2006 R'000	Group 2005 R'000
Call deposits and current accounts	**1 480 150**	943 854
Savings accounts	**158 521**	155 853
Term and notice deposits	**1 817 336**	1 411 088
Negotiable certificates of deposit	**25 151**	35 472
Foreign bank deposits and loans	**57 989**	90 280
	3 539 147	2 636 547
Maturity analysis		
Repayable on demand and within one month	**2 103 915**	1 513 901
Maturing after one month but within six months	**1 205 089**	966 723
Maturing after six months but within 12 months	**216 378**	155 623
Maturing after 12 months	**13 765**	300
	3 539 147	2 636 547

The maturity analysis is based on the remaining period to contractual maturity at year-end.

15. Provisions

	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Onerous lease contracts R'000	Other risks R'000	Total R'000
Group							
At 31 December 2004	4 000	2 400	15 949	8 060	3 881	4 878	39 168
Additional provision raised	9 000	3 244	2 234	2 830	–	3 295	20 603
Charged to provision	(4 000)	(2 400)	(7 769)	(2 950)	(3 453)	(577)	(21 149)
Unutilised provision reversed	–	–	–	–	–	(6 975)	(6 975)
At 31 December 2005	9 000	3 244	10 414	7 940	428	621	31 647
Additional provision raised	9 553	2 100	2 439	2 553	–	5 000	21 645
Charged to provision	(8 171)	(3 244)	–	(2 164)	–	–	(13 579)
Unutilised provision reversed	–	–	–	–	(428)	(291)	(719)
At 31 December 2006	**10 382**	**2 100**	**12 853**	**8 329**	**–**	**5 330**	**38 994**

Post-retirement medical benefits

Refer to note 16 for detailed disclosure of this provision.

Leave pay

In terms of Group policy, employees are entitled to accumulate leave not taken during the year, within certain limits.

Other risks

Consists of provisions that arose from the sale of the asset finance book, legal claims and other risks. At any time there are legal or potential claims made against the Group, the outcome of which cannot at present be foreseen. These claims are not regarded as material either on an individual basis or in aggregate. Provisions are raised for all liabilities that are expected to materialise.

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

16. Post-retirement medical benefits

The Bank operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Group's assets in a separate trustee-administered fund. Independent actuaries value this scheme at least every three years. The last actuarial valuations were carried out at 31 December 2006.

A buy-out offer of members' post-retirement medical liability took place in 2005, during which some members accepted the offer. Members that did not accept the offer remain eligible for post-retirement medical benefits.

	Group	
	2006 R'000	2005 R'000
The amounts recognised in the balance sheet are as follows (refer to note 15):		
Present value of total service liabilities	18 989	16 651
Fair value of plan assets	(6 136)	(6 237)
– Provident fund	(1 457)	(1 624)
– Endowment bond	(3 729)	(4 104)
– Annuities	(950)	(509)
Liability in the balance sheet	12 853	10 414
The amounts recognised in the income statement are as follows (refer to note 23):		
Current service cost	115	414
Interest costs	1 365	1 659
Expected return on plan assets	(396)	(575)
Actuarial loss	1 957	1 736
Employer benefit payments	(1 168)	(1 085)
Payments from plan assets	846	540
Effect on curtailment	(280)	(455)
Total included in staff costs	2 439	2 234
Reconciliation of the movement in the present value of total service liabilities:		
At the beginning of year	16 651	22 277
Current service cost	115	414
Interest costs	1 365	1 659
Actuarial loss	2 306	1 610
Employer benefit payments	(1 168)	(1 085)
Net effect of settlements	–	(7 769)
Effect of curtailment	(280)	(455)
At the end of year	18 989	16 651
Reconciliation of the movement in the fair value of plan assets:		
At the beginning of year	6 237	6 328
Expected return on plan assets	396	575
Actuarial gain/(loss)	349	(126)
Payments from plan assets	(846)	(540)
At the end of year	6 136	6 237

The principal actuarial assumptions used were as follows:

Discount rate	8.25% (2005: 8.5%) compounded annually
Investment return	9.25% (2005: 6.5%) compounded annually
Rate of medical inflation	7.25% (2005: 7.0%) compounded annually
Salary inflation	6.75% (2005: 6.5%) compounded annually

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group 2006 R'000	Group 2005 R'000	Company 2006 R'000	Company 2005 R'000
17. Other accounts payable				
Accruals	**6 882**	6 218	**9**	10
Repurchase agreements	**126 343**	109 461	**–**	–
Product-related credits	**26 095**	12 291	**15**	280
Sundry creditors	**15 115**	21 508	**7**	7
	174 435	149 478	**31**	297

18. Contingent liabilities and commitments

18.1 Conditional buy-back obligation

In terms of a sale agreement, wherein the Bank disposed of its asset finance book, the Bank has an obligation to buy-back the credit agreement rights and obligations of customers that fail to meet their repayments. In 2006, by agreement, this obligation to repurchase was terminated.

	Group 2006 R'000	Group 2005 R'000
Capital balance outstanding	**–**	7 707

18.2 Guarantees and letters of credit

	Group 2006 R'000	Group 2005 R'000
Guarantees	**269 402**	261 763
Lending related	**16 201**	34 860
Mortgage	**66 618**	70 173
Performance	**186 583**	156 730
Letters of credit	**11 662**	26 058
	281 064	287 821

18.3 Commitments under operating leases

The total minimum future lease payments under operating leases are as follows:

	Group 2006 R'000	Group 2005 R'000
Property rentals:		
Due within one year	**4 042**	3 852
Due between one and five years	**6 191**	9 721
	10 233	13 573
Motor vehicle rentals:		
Due within one year	**55**	103
Due between one and five years	**–**	66
	55	169

A register containing details of the existence and terms of renewal and escalation clauses is available for inspection at the registered office of the Company.

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

19. Deferred taxation

A deferred tax asset has not been recognised for the deductible temporary differences and unutilised calculated tax losses of R969.3 million (2005: R1 013.7 million) due to the uncertain timing of the reversal of these losses and availability of future taxable income.

	Group 2006 R'000	Group 2005 R'000
20. Interest income		
Interest on:		
Cash and cash equivalents	**126 688**	82 325
Negotiable securities	**31 139**	27 957
Loans and advances	**199 336**	138 008
Amortised cost	**183 440**	128 316
Fair value	**15 896**	9 692
	357 163	248 290
21. Interest expenditure		
Interest on:		
Deposits	**180 111**	112 231
Repurchase agreements	**8 933**	913
	189 044	113 144

	Group 2006 R'000	Group 2005 R'000 (restated)	Company 2006 R'000	Company 2005 R'000
22. Non-interest income				
Transactional income	**108 481**	81 981	**266**	–
Fees and commission	**98 026**	80 259	**266**	–
Knowledge-based fees	**10 455**	1 722	**–**	–
Trading income	**38 736**	29 186	**–**	–
Foreign currency	**29 141**	24 758	**–**	–
Foreign currency commissions	**6 658**	5 698	**–**	–
Treasury operational gains/(loss)	**2 937**	(1 270)	**–**	–
Investment income	**303**	545	**–**	–
Dividends	**7**	80	**–**	–
Rental income	**296**	465	**–**	–
	147 520	111 712	**266**	–

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group 2006 R'000	Group 2005 R'000 (restated)	Company 2006 R'000	Company 2005 R'000
23. Operating expenditure				
Auditors' remuneration				
Audit fees – current	**5 250**	5 163	–	–
– prior	**121**	200	–	–
Fees for other services – taxation	**597**	1 047	–	–
– IFRS consulting	**100**	230	–	–
– controls and processes review	**–**	181	–	–
	6 068	6 821	–	–
Professional fees				
Collections	**1 155**	3 329	–	–
Consulting	**15 196**	11 091	**46**	53
Legal	**1 182**	1 657	**271**	69
Technical and other	**18 242**	19 184	–	–
	35 775	35 261	**317**	122
Depreciation and amortisation (refer to notes 1 and 2)	**14 128**	16 831	–	–
Directors' emoluments (refer to note 28.3)				
Executive directors	**8 499**	5 899	–	–
Non-executive directors fees	**3 044**	2 520	–	–
Share-based payments	**849**	311	–	–
	12 392	8 730	–	–
Lease charges				
Motor vehicles	**36**	37	–	–
Equipment	**38**	78	–	–
	74	115	–	–
Staff costs				
Salaries, wages and allowances	**90 159**	90 078	–	–
Post-retirement medical benefits (refer to note 16)	**2 439**	2 234	–	–
Contributions to retirement funds	**5 794**	5 763	–	–
Share-based payments excluding directors	**1 329**	413	–	–
Other	**4 882**	4 194	–	–
	104 603	102 682	–	–
Impairment and loss on sale of property and equipment	**2**	144		
Operating leases – premises	**6 491**	7 987	–	–
Marketing and communication	**6 303**	7 740	**640**	494
Indirect taxation				
Non-claimable Value-Added Tax	**7 538**	7 962	–	–
Skills development levy	**348**	417	–	–
Regional Services Council levies	**562**	980	–	3
	8 448	9 359	–	3
Other operating costs	**31 756**	28 616	**316**	469
Total operating expenditure	**226 040**	224 286	**1 273**	1 088
Number of persons employed by the Group at year-end	**413**	415		

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group		Company	
	2006	2005	**2006**	2005
	R'000	R'000	**R'000**	R'000
24. Taxation				
Direct taxation				
South African normal taxation	**–**	–	**–**	–
South African tax rate reconciliation				
South African standard tax rate (%)	**29.0**	29.0	**29.0**	29.0
Exempt income (%)	**(0.5)**	(0.8)	**–**	–
Deferred taxation not raised (%)	**(286.4)**	(221.0)	**–**	–
Tax losses raised/(utilised)(%)	**257.9**	192.8	**(29.0)**	(29.0)
Effective tax rate (%)	**0.0**	0.0	**0.0**	0.0
Estimated tax losses available for set-off against future taxable income	**969 281**	1 013 647	**4 670**	3 730

25. Earnings, diluted earnings, headline earnings and diluted earnings per ordinary share

	Group	
	2006	2005
	R'000	R'000
25.1 Earnings per ordinary share		
Attributable profit after taxation	**100 643**	66 996
Weighted number of ordinary shares in issue ('000)	**3 925 145**	3 927 892
Earnings per ordinary share (cents)	**2.56**	1.71
25.2 Diluted earnings per ordinary share		
Attributable profit after taxation	**100 643**	66 996
Weighted diluted number of ordinary shares in issue ('000)	**3 925 145**	3 932 811
Earnings per ordinary share (cents)	**2.56**	1.70
25.3 Headline and diluted headline earnings per ordinary share		
Attributable profit after taxation	**100 643**	66 996
Realisation of available-for-sale reserve on disposal of investments	**(2)**	885
Loss on disposal of property and equipment	**2**	144
Headline earnings	**100 643**	68 025
Headline earnings per ordinary share (cents)	**2.56**	1.73
Diluted headline earnings per ordinary share (cents)	**2.56**	1.73

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

	Group		Company	
	2006	2005	**2006**	2005
	R'000	R'000	**R'000**	R'000
		(restated)		
26. Cash flow notes				
26.1 Cash receipts from customers				
Interest income	**357 163**	248 290	**–**	–
Non-interest income and profit on sale and revaluation of investments	**147 173**	111 214	**266**	527
Adjusted for:				
Dividends received	**(7)**	(80)	**–**	–
Net loss on disposal and revaluation of investments	**347**	498	**–**	(527)
Revaluation of held-for-trading financial instruments	**(11 822)**	953	**–**	–
Recoveries of credit losses	**25 424**	32 824	**–**	–
Total cash receipts from customers	**518 278**	393 699	**266**	–
26.2 Cash paid to suppliers and employees				
Interest expenditure	**(189 044)**	(113 144)	**–**	–
Operating expenditure	**(226 040)**	(224 286)	**(1 273)**	(1 088)
Adjusted for:				
Depreciation and amortisation	**14 128**	16 831	**–**	–
Loss on sale of property and equipment	**2**	144	**–**	–
Share-based payments	**2 178**	724	**–**	–
Increase/(decrease) in provisions	**7 347**	(7 521)	**–**	–
Total cash paid to suppliers and employees	**(391 429)**	(327 252)	**(1 273)**	(1 088)
26.3 Taxation received/(paid)				
Amounts overpaid at beginning of year	**3 698**	3 572	**29**	29
Income statement charge	**–**	–	**–**	–
Less: Amounts unpaid/(overpaid) at end of year	**6**	(3 698)	**(29)**	(29)
Total taxation received/(paid)	**3 704**	(126)	**–**	–
26.4 Net increase in income earning assets				
Increase in negotiable securities	**(25 988)**	(8 749)	**–**	–
Increase in loans and advances	**(614 954)**	(498 139)	**–**	–
Net increase in income earning assets	**(640 942)**	(506 888)	**–**	–
26.5 Net increase in deposits and other accounts				
Increase in deposits	**902 600**	523 978	**–**	–
(Decrease)/increase in other accounts	**(105 083)**	192 883	**1 058**	195
Net increase in deposits and other accounts	**797 517**	716 861	**1 058**	195

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

27. Financial risk management

27.1 Foreign currency risk management

The Group, in terms of approved policy limits, manages short-term foreign currency exposures relating to trade imports, exports and interest flows on foreign liabilities. The transaction exposures and material forward exchange contracts at year-end are summarised as follows:

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2006					
Total foreign exchange assets	**1 459 295**	**37 348**	**28 834**	**4 285**	**1 529 762**
Total foreign exchange liabilities	**(24 402)**	**(10 890)**	**(22 193)**	**(329)**	**(57 814)**
Commitments to purchase foreign currency	**153 361**	**61 023**	**4 753**	**12 827**	**231 964**
Commitments to sell foreign currency	**(1 588 540)**	**(87 718)**	**(11 911)**	**(16 601)**	**(1 704 770)**
Year-end effective net open foreign currency positions	**(286)**	**(237)**	**(517)**	**182**	**(858)**
2005					
Total foreign exchange assets	1 133 799	61 959	26 848	2 708	1 225 314
Total foreign exchange liabilities	(17 685)	(49 082)	(22 324)	(1 057)	(90 148)
Commitments to purchase foreign currency	83 036	52 113	–	40 072	175 221
Commitments to sell foreign currency	(1 199 681)	(65 521)	(5 435)	(41 635)	(1 312 272)
Year-end effective net open foreign currency positions	(531)	(531)	(911)	88	(1 885)

The forward exchange contracts above have maturity dates within 12 months of the year-end. The highest and lowest rates inherent in the above contracts have been set out per foreign currency below:

	Highest rate		Lowest rate	
Foreign currency	**2006**	2005	**2006**	2005
US Dollar	**8.08**	7.00	**6.09**	6.25
Euro	**10.31**	8.60	**9.03**	7.49
Pound Sterling	**14.62**	11.70	**13.13**	11.12
Swiss Franc	**6.45**	5.26	**5.81**	5.00
Australian Dollar	**0.17**	0.22	**0.18**	0.22

27.2 Credit risk management

Potential concentrations of credit risk consist mainly of short-term cash, cash equivalent investments, advances and other receivables.

The Group limits its counterparty exposures to its money market investment operations by only dealing with well-established financial institutions of high credit standing. The credit exposure to any one counterparty is managed by setting transaction/exposure limits, which are reviewed by the Group Risk Management Committee.

Advances and other receivables comprise a large number of customers, dispersed across different industries and geographical areas. Ongoing credit evaluations are performed on the financial condition of these customers. Advances and other receivables are presented net of impairment for credit losses and interest in suspense.

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

27. Financial risk management (continued)

27.2 Credit risk management (continued)

Counterparties to derivatives expose the Group to credit-related losses in the event of non-performance. The counterparties to these contracts are financial institutions. The Group continually monitors its positions and the credit ratings of its counterparties and limits the amount of contracts it enters into with any one party.

At year-end, the Group did not consider there to be any significant concentration of risk, which had not been insured or adequately provided for. There were no material credit exposures in advances made to foreign entities at year-end, except for the deposits with CGD as disclosed in note 28.2.

27.3 Liquidity risk management

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs and guarantees. The Group maintains cash resources to cover these exposures. The table below summarises assets and liabilities at balance sheet date of the Group into relevant maturity groupings, based on the remaining period to the contractual maturity date:

	Assets R'000	Liabilities R'000	Total mismatch R'000
2006			
Maturing up to one month	**1 820 121**	**2 346 569**	**(526 448)**
Maturing between one and three months	**484 548**	**804 066**	**(319 518)**
Maturing between three and six months	**419 297**	**401 022**	**18 275**
Maturing between six months and one year	**328 967**	**216 378**	**112 589**
Maturing after one year	**1 396 285**	**13 765**	**1 382 520**
	4 449 218	**3 781 800**	**667 418**
2005			
Maturing up to one month	1 472 282	1 711 069	(238 787)
Maturing between one and three months	500 391	688 265	(187 874)
Maturing between three and six months	310 798	280 868	29 930
Maturing between six months and one year	130 699	158 515	(27 816)
Maturing after one year	992 212	17 486	974 726
	3 406 382	2 856 203	550 179

27.4 Fair value of financial instruments

All financial instruments have been recognised in the balance sheet at fair value, other than assets classified as loans and receivables as well as liabilities that are not derivatives. Such assets and liabilities are carried at amortised cost which approximates fair value.

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

27. Financial risk management (continued)

27.5 Interest rate risk management

The Group takes on exposures that are subject to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. Mismatches of interest rate re-pricing are monitored regularly by the Asset and Liability Committee. The table below summarises the Group's exposure to interest rate risks. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates and also indicate their effective interest rates at year-end:

	Up to 1 month R'000	1 – 3 months R'000	3 – 12 months R'000	1 – 5 years R'000	Over 5 years R'000	Non-interest bearing R'000	Total R'000	Effective interest rate %
2006								
Assets								
Intangible assets	–	–	–	–	–	11 551	11 551	–
Property and equipment	–	–	–	–	–	94 956	94 956	–
Investment properties	–	–	–	–	–	–	–	–
Taxation	–	–	–	–	–	29	29	–
Other accounts receivable	–	–	–	–	–	145 291	145 291	–
Interest in associated company	–	–	–	–	–	3 626	3 626	–
Other investments	–	–	–	–	–	7 209	7 209	–
Loans and advances	1 952 227	–	–	31 074	83 131	–	2 066 432	11.74
Derivative financial instruments	31 134	–	–	–	–	–	31 134	–
Negotiable securities	56 061	164 450	152 607	31 898	–	–	405 016	8.72
Cash and cash equivalents	915 131	277 851	413 317	–	–	77 675	1 683 974	8.24
Total assets	**2 954 553**	**442 301**	**565 924**	**62 972**	**83 131**	**340 337**	**4 449 218**	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	667 418	667 418	–
Deposits	2 209 657	640 336	617 400	13 765	–	57 989	3 639 147	6.18
Derivative financial instruments	29 189	–	–	–	–	–	29 189	–
Provisions	–	–	–	–	–	38 994	38 994	–
Other accounts payable	126 343	–	–	–	–	48 092	174 435	–
Taxation	–	–	–	–	–	35	35	–
Total equity and liabilities	**2 365 189**	**640 336**	**617 400**	**13 765**	**–**	**812 528**	**4 449 218**	**–**
On balance sheet interest sensitivity gap	**589 364**	**(198 035)**	**(51 476)**	**49 207**	**83 131**	**–**	**472 191**	**–**
Derivative financial instruments	**94 279**	**89 119**	**(10 700)**	**(105 899)**	**(66 799)**	**–**	**–**	**–**
Total net interest sensitivity gap	**683 643**	**(108 916)**	**(62 176)**	**(56 692)**	**16 332**	**–**	**472 191**	**–**

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

27. Financial risk management (continued)

27.5 Interest rate risk management (continued)

	Up to 1 month R'000	1 – 3 months R'000	3 – 12 months R'000	1 – 5 years R'000	Over 5 years R'000	Non-interest bearing R'000	Total R'000	Effective interest rate %
2005								
Assets								
Intangible assets	–	–	–	–	–	7 020	7 020	–
Property and equipment	–	–	–	–	–	91 305	91 305	–
Investment properties	–	–	–	–	–	350	350	–
Taxation	–	–	–	–	–	3 698	3 698	–
Other accounts receivable	–	–	–	–	–	14 887	14 887	–
Interest in associated company	–	–	–	–	–	3 323	3 323	–
Other investments	–	–	–	–	–	2 365	2 365	–
Loans and advances	1 331 406	2 784	12 805	–	111 682	–	1 458 677	9.75
Derivative financial instruments	36 757	–	–	–	–	–	36 757	–
Negotiable securities	153 175	34 560	56	–	191 237	–	379 028	6.96
Cash and cash equivalents	580 162	440 032	335 293	–	–	53 485	1 408 972	6.51
Total assets	2 101 500	477 376	348 154	–	302 919	176 433	3 406 382	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	550 179	550 179	–
Deposits	1 693 510	507 693	435 044	300	–	–	2 636 547	4.58
Derivative financial instruments	38 531	–	–	–	–	–	38 531	–
Provisions	–	–	–	–	–	31 647	31 647	–
Other accounts payable	109 461	–	–	–	–	40 017	149 478	–
Total equity and liabilities	1 841 502	507 693	435 044	300	–	621 843	3 406 382	
On balance sheet interest sensitivity gap	**259 998**	**(30 317)**	**(86 890)**	**(300)**	**302 919**	**–**	**445 410**	**–**
Derivative financial instruments	**77 906**	**108 761**	**129 627**	**(123 380)**	**(192 914)**	**–**	**–**	**–**
Total net interest sensitivity gap	**337 904**	**78 444**	**42 737**	**(123 680)**	**110 005**	**–**	**445 410**	**–**

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

28. Related-party information

28.1 Identity of related parties with whom material transactions have occurred

The holding company and material subsidiaries of the Group are identified on pages 10 to 11 in the Directors' report and the associated company is disclosed in note 7 to the annual financial statements. All of these entities and the directors are related parties. There are no other related parties with whom material transactions have taken place, other than as listed below.

28.2 Material related-party balances and transactions

The Company, its subsidiaries and associated company, in the ordinary course of business, enter into various financial services transactions with the ultimate holding company and its subsidiaries, other entities within the Group and the associated company. These transactions are governed by terms no less favourable than those arranged with third parties.

Balances between the ultimate holding company (CGD) and Mercantile Bank Limited:

	2006 R'000	2005 R'000
Caixa Geral de Depósitos – Lisbon (Branch of CGD)	**1 455 338**	1 144 962
Nostro accounts	**3 721**	917
Vostro accounts	**(4 734)**	(8 722)
Deposit accounts	**1 456 351**	1 152 767
Caixa Geral de Depósitos – Paris (Branch of CGD)	**429**	525
Nostro accounts	**440**	536
Vostro accounts	**(11)**	(11)
Caixa Geral de Depósitos – London (Branch of CGD)		
Vostro accounts	**(19)**	(19)
Caixa Geral de Depósitos (CGD)	**1 455 748**	1 145 468
Banco Comercial e de Investimentos (BCI) – Mozambique (Subsidiary of CGD)	**(117 288)**	(62 487)
Vostro accounts	**(1 118)**	(23)
Fixed deposits	**(114 427)**	–
Call and notice deposits	**(1 743)**	(62 464)
	1 338 460	1 082 981

Interest was paid to BCI – Mozambique amounting to R7.8 million (2005: R3.0 million).

Interest received from BCI – Mozambique and CGD in respect of the above balances during the year amounted to nil (2005: R0.1 million) and R80.4 million (2005: R35.0 million), respectively.

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

28. Related-party information (continued)

28.2 Material related-party balances and transactions (continued)

		2006 R'000	2005 R'000
Balances with the company, its subsidiaries and associated company:			
Loan to:	Loan from:		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	12 901	13 754
Portion 2 of Lot 8 Sandown (Pty) Limited	Mercantile Bank Limited	45 719	47 600
LSM (Troyeville) Properties (Pty) Limited	Mercantile Bank Limited	5 827	5 502
Lisabank Corporate Finance Limited	Mercantile Bank Limited	–	3 360
Mercantile Insurance Brokers (Pty) Limited	Mercantile Bank Limited	622	596
Mercantile Registrars Limited	Mercantile Bank Limited	3 045	8 314
Weskor Beleggings (Pty) Limited	Mercantile Bank Limited	–	784
Mercantile Bank Limited	Mercantile Nominees (Pty) Limited	189	121
Loan to Share Incentive Trust	Mercantile Bank Limited	3 097	3 111
Statman Investments (Pty) Limited	Mercantile Bank Limited	533	288
Deposit with:	Deposit by:		
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Limited	1 986	2 109
Mercantile Bank Limited	Mercantile Nominees (Pty) Limited	752	531
Mercantile Bank Limited	Mercantile Bank Holdings Limited	138	87
Mercantile Bank Limited	Mercantile Registrars Limited	7	53
Mercantile Bank Limited	Weskor Beleggings (Pty) Limited	–	50
Transactions with the company, its subsidiaries and associated company:			
Interest received by:	Interest paid by:		
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Limited	5 175	5 249
Mercantile Bank Limited	LSM (Troyeville) Properties (Pty) Limited	638	586
Mercantile Bank Limited	Weskor Beleggings (Pty) Limited	21	79
Mercantile Insurance Brokers (Pty) Limited	Mercantile Bank Limited	99	95
Mercantile Bank Limited	Statman Investments (Pty) Limited	38	10
Non–interest income earned by:	Operating expenditure paid by:		
Portion 2 of Lot 8 Sandown (Pty) Limited	Mercantile Bank Limited	8 594	8 420
LSM (Troyeville) Properties (Pty) Limited	Mercantile Bank Limited	938	910
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Limited	247	595

Other

Post-retirement medical plan

Details of the post-retirement medical plan are disclosed in note 16.

Notes to the annual financial statements
for the year ended 31 December 2006 (continued)

28. Related-party information (continued)

28.3 Director and director-related activities

No loans were made to directors during the year under review. There were no material transactions with directors, other than the following:

	Directors' fees R'000	Salary R'000	Fringe benefits R'000	Retirement funds and medical aid contributions R'000	Incentive* R'000	Share-based payments R'000	Total R'000
Director							
2006							
J A S de Andrade Campos	**1 014**	**–**	**–**	**–**	**–**	**–**	**1 014**
D J Brown	**–**	**1 973**	**–**	**211**	**2 215**	**849**	**5 248**
G P de Kock	**392**	**–**	**–**	**–**	**–**	**–**	**392**
M J M Figueira	**–**	**1 533**	**265**	**–**	**300**	**–**	**2 098**
L Hyne	**403**	**–**	**–**	**–**	**–**	**–**	**403**
A T Ikalafeng	**318**	**–**	**–**	**–**	**–**	**–**	**318**
J P M Lopes	**–**	**1 363**	**302**	**37**	**300**	**–**	**2 002**
K B Motshabi (resigned 10 November 2006)	**352**	**–**	**–**	**–**	**–**	**–**	**352**
A M Osman	**228**	**–**	**–**	**–**	**–**	**–**	**228**
S Rapeti	**337**	**–**	**–**	**–**	**–**	**–**	**337**
	3 044	**4 869**	**567**	**248**	**2 815**	**849**	**12 392**
2005							
J A S de Andrade Campos	888	–	–	–	–	–	888
D J Brown	–	1 891	–	151	1 881	311	4 234
G P de Kock	335	–	–	–	–	–	335
M J M Figueira	–	1 432	41	–	300	–	1 773
L Hyne	377	–	–	–	–	–	377
A T Ikalafeng	287	–	–	–	–	–	287
J P M Lopes (appointed 9 November 2005)	–	203	–	–	–	–	203
K B Motshabi	348	–	–	–	–	–	348
A M Osman	213	–	–	–	–	–	213
S Rapeti (appointed 29 July 2005)	72	–	–	–	–	–	72
	2 520	3 526	41	151	2 181	311	8 730

* The incentive relates to the current financial year but is only paid in the following financial year.

	2006 R'000	2005 R'000
Amounts paid by CGD to:		
M J M Figueira	**845**	851
J P M Lopes (appointed 9 November 2005)	**381**	58
	1 226	909

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

28. Related-party information (continued)

28.3 Director and director-related activities (continued)

Service agreements

D J Brown, *Chief Executive Officer*
Mr Brown's employment as Chief Executive Officer commenced on 31 March 2004 and is for a maximum period of five years. Mercantile may re-appoint Mr Brown at the expiry of the five-year period provided that agreement is reached on the terms and conditions for his re-appointment.

In consideration for the rendering of his services under the Service Agreement, Mr Brown is also entitled to payment of an annual incentive bonus calculated in accordance with a performance plan as agreed with the Board of Directors of Mercantile from time to time.

M J M Figueira, *Executive Director*
Mr Figueira has been seconded to Mercantile by CGD.

Mr Figueira's employment in Mercantile commenced on 26 May 2004 for a period of three years. In terms of the service agreement Mr Figueira agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director. Mr Figueira resigned with effect from 28 February 2007 to return to Portugal.

J P M Lopes, *Executive Director*
Mr Lopes has been seconded to Mercantile by CGD.

Mr Lopes's employment in Mercantile commenced on 9 November 2005 and it will last for a period of three years. In terms of the service agreement Mr Lopes agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director.

Share options
On 5 October 2004, 5 000 000 share options in the Company were granted to Mr Brown at an exercise price of 18 cents each. A further 7 000 000 share options were granted to him on 22 March 2006 at an exercise price of 40 cents each (refer to note 13.5).

Directors' interests
No directors held beneficial and/or non-beneficial interests, directly or indirectly, in shares issued by Mercantile Bank Holdings Limited.

28.4 Summarised financial information of the associated company

Statman Investments (Pty) Limited

	2006 R'000	2005 R'000
Income statement		
Profit after taxation	4 666	3 094
Balance sheet		
Non-current assets	13 128	13 996
Current assets	14 257	10 804
Current liabilities	(8 454)	(7 076)
Non-current liabilities	(1 989)	(2 204)
Equity	16 942	15 520
Percentage held	21.4	21.4
Nature of business	Investment holding	
Place of incorporation	South Africa	

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

28. Related-party information (continued)

28.4 Summarised financial information of associated company (continued)

The Group in applying the equity method of accounting uses the most recent audited annual financial statements of the associated company. These are not always drawn up to the same date as the annual financial statements of the Group. In instances where significant events occurred between the last financial statement date of an associated company and the financial statement date of the Group, the effect of such events are adjusted for.

29. Segment information

The primary business segments of the Group are as follows:

Business segment	Scope of products and services
Retail banking *	Banking, investment and other financial services offered to banking customers.
Treasury*	Managing internal liquidity, foreign exchange services as well as serving retail and alliance banking customers.
Alliance banking, MBL credit card and structured loans*	Card processing services, electronic banking and structured loans offered to banking customers.
Support and other services	Support services for the above segments, insurance brokers, associate income, exceptional income and inter-group eliminations.

* Excludes the allocation of attributable support costs.

The primary segments are as follows:

	Retail banking		Treasury		Alliance banking, MBL credit card and structured loans		Support and other services		Total	
	2006 R'000	2005 R'000	**2006 R'000**	2005 R'000	**2006 R'000**	2005 R'000	**2006 R'000**	2005 R'000	**2006 R'000**	2005 R'000
(2005 restated)										
Segment results										
Segment revenue[1]	**180 975**	138 586	**43 093**	31 363	**44 098**	32 527	**47 126**	43 884	**315 292**	246 360
Segment expenditure	**(51 482)**	(54 722)	**(28 693)**	(22 637)	**(10 485)**	(17 755)	**(135 380)**	(129 172)	**(226 040)**	(224 286)
Contribution/(loss) before allocated costs	**103 687**	80 544	**14 400**	8 451	**31 693**	14 739	**(49 137)**	(36 738)	**100 643**	66 996
Other information										
Net capital expenditure	**1 234**	1 449	**(144)**	(65)	**(9)**	10 736	**10 949**	1 432	**12 030**	13 552
Depreciation and amortisation	**(2 547)**	(2 676)	**(412)**	(1 186)	**(1 688)**	(5 809)	**(9 481)**	(7 160)	**(14 128)**	(16 831)
Other non-cash operating expenditure	**–**	–	**–**	–	**–**	–	**9 527**	868	**9 527**	868
Share of income from associated companies	**–**	–	**–**	–	**–**	–	**1 269**	516	**1 269**	516
Segment position										
Segment assets	**1 948 333**	1 286 538	**2 090 757**	1 821 658	**276 669**	161 631	**133 459**	136 555	**4 449 218**	3 406 382
Segment liabilities	**2 673 095**	2 268 292	**795 335**	397 384	**203 822**	121 379	**109 548**	69 148	**3 781 800**	2 856 203
Carrying amounts of segment assets include:										
Investments in associated company	**–**	–	**–**	–	**–**	–	**3 626**	3 323	**3 626**	3 323

Notes to the annual financial statements

for the year ended 31 December 2006 (continued)

29. Segment information (continued)

The secondary segments are as follows:

	Gauteng		Other provinces		Total	
	2006	2005	**2006**	2005	**2006**	2005
	R'000	R'000	**R'000**	R'000	**R'000**	R'000
(2005 restated)						
Segment revenue[1]	**289 722**	222 640	**25 570**	23 720	**315 292**	246 360
Net capital expenditure	**11 887**	13 096	**143**	456	**12 030**	13 552
Segment assets	**4 123 303**	3 122 311	**325 915**	284 071	**4 449 218**	3 406 382

[1] Segment revenue consists of net interest income, net loss on disposal and revaluation of assets and non–interest income

Segment revenue has been restated for the year ended 31 December 2005 and now excludes net credit recoveries and exceptional items.

30. Prior year restatement

Non-interest income and operating expenditure in the income statement has been restated for 2005 in order to be consistent with the disclosure in the current year.

Certain costs incurred by Alliance partners are settled by Mercantile on their behalf and subsequently reimbursed by these Alliance partners to Mercantile. The reimbursements were previously treated as non-interest income and the costs as operating expenditure. The accounting treatment for 2006 has been changed whereby the reimbursements received are offset against the costs incurred.

	2005
	R'000
Group	
Income statement	
Non-interest income	
Amount previously reported	117 903
Reimbursable expenses	(6 191)
Restated non-interest income	111 712
Operating expenditure	
Amount previously reported	230 477
Reimbursable expenses	(6 191)
Restated operating expenditure	224 286

Risk management and control

Group risk management philosophy

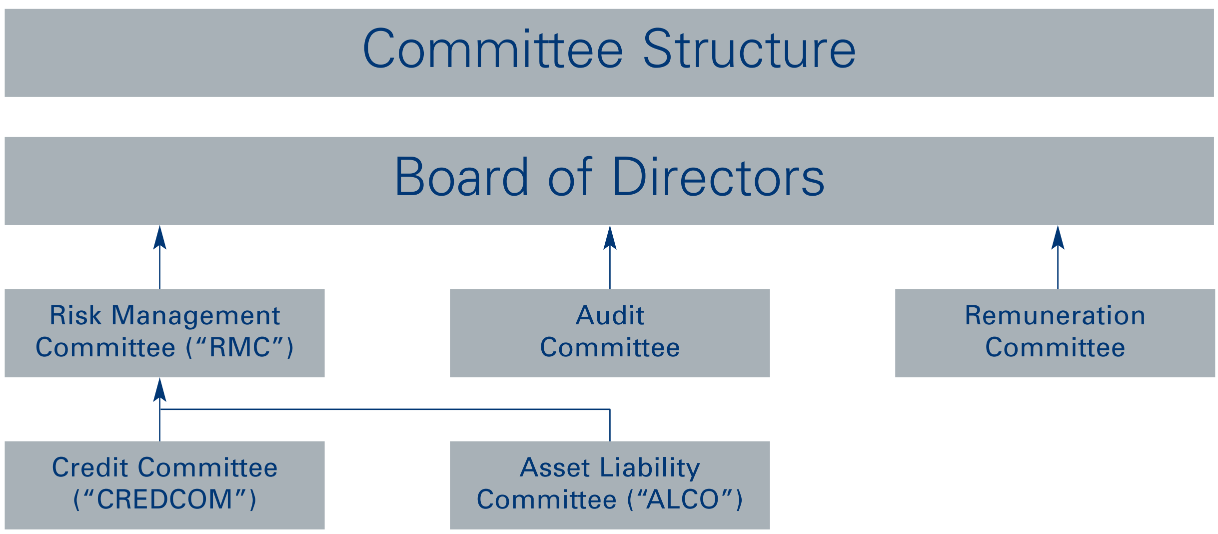
The Group recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks. The Group operates in a dynamic environment where the past is not necessarily an acceptable guide to the future. Risk management is a key focus of the Group and addresses a wide spectrum of risks. In any economy there are sectors that are more vulnerable to cyclical downturn than others. Economic variances are monitored to assist us in managing our exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a portfolio balance. In every risk sector it is the weaker counterparties that are at greatest risk of failure in an economic downturn. Our business development efforts are focused on the stronger companies and individuals, establishing policy criteria, which eliminate weaker credits or investments from the portfolio. A passive role in the face of potential or actual adverse conditions is not accepted.

A philosophy of enterprise-wide risk management within a Risk Management Monitoring and Control Framework has been established to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters and that the management of risk is an independent process from that of taking on/creating risk within the Group. Risk management policies are essentially conservative, with proper regard to the mix of risk and reward. The Group will take all necessary steps to safeguard its depositors' funds, its own asset base and shareholders' funds.

Enterprise-wide risk management

An Enterprise-wide Risk Management Framework is adopted to ensure appropriate and focused management of all risks. Risk assessment is a dynamic process and is reviewed regularly. Risk dimensions will vary in importance based on the business activities of an organisation. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework, where all risks are identified, quantified and managed in order to achieve an optimal risk reward profile. The presence of accurate measures of risk, makes risk adjusted performance possible, creates the potential to generate increased shareholder returns and allows the risk taking behaviour to be more closely aligned with our strategic objectives.

Risk management is performed on a Group wide basis involving the Board, credit management, senior management, independent risk management, business line management, finance and control, legal/compliance, treasury and operations, with significant support from internal audit and information technology.



Risk management and control (continued)

Enterprise-wide risk management (continued)

The Group continues to develop credit risk modelling analytical tools and is expanding on its information assessment to better understand and manage its credit risk portfolios. The Early Warning system that was developed and implemented during 2006 continues to be expanded and will be rolled out to the branch network during 2007.

Principal risk categories have been identified, defined and categorised into direct and indirect risks. This set of risk definitions forms the basis of management and control relative to each division or subsidiary within the Group and will also form a consistent, common language for outside examiners and/or regulators to follow.

Board committees monitor various aspects of the different identified risks. These include:

Direct Risks	Indirect Risks
Credit Risk	Strategic Risk
Counterparty Risk	Reputation Risk
Currency Risk	Legal Risk
Liquidity Risk	Fraud Risk
Interest Rate Risk	International Risk
Market (Position) Risk	Political Risk
Solvency Risk	Competitive Risk
Operational Risk	Pricing Risk
Technology Risk	Sensitivity Risk
Compliance Risk	

Direct risks are found in most banking transactions. They are quantifiable and can be clearly defined. These risks are evaluated through examination of our databases, statistics and other records.

Indirect risks are considered to ensure that a complete risk assessment is carried out. They are present in almost every decision made by management and the Board and thus impact on the Group's image and success. These decisions are usually intended to enhance the Group's long-term viability or success and therefore are difficult to quantify at a given point in time.

The responsibility for understanding the risks incurred by the Group and ensuring that they are appropriately managed, rest with the Board. The Board approves risk management strategies, and delegates the power to take decisions on risks and to implement strategies on risk management and control to the RMC. Discretionary limits and authorities are in turn delegated to line heads and line managers within laid down parameters to enable them to execute the Group's strategic objectives within predefined risk management policies. Major risks are managed, controlled and reviewed by those who influence the risk to minimise the impact of adversity.

The Board fully recognises that they are accountable for the process of risk management and the system of internal control. Management reports regularly to the Board on the effectiveness of internal control systems and significant control weaknesses identified.

Focus has been increased on the overall improvement in the management of credit and counterparty risk through the implementation and ongoing development of the comprehensive on-line Early Warning Risk Identification Process together with a Risk Assessment Decision Support Tool and a comprehensive Portfolio Review Report.

Increased focus was also placed on Business Continuity Management ("BCM") during the year under review. BCM ensures the availability of all key staff and processes required to support essential activities in the event of an interruption to, or disruption of, business. BCM is an important aspect of risk management and its value has been proven in creating a more resilient operational platform, through activities such as business impact assessments, business continuity planning and implementation, testing of business continuity and implementing corrective actions. A comprehensive simulation was conducted during November 2006, with identified gaps addressed and/or plans put in place to resolve the identified issues.

Further enhancements have been made in the management of the Group's assets and liabilities with increased monitoring of liquidity and interest rate risk through sensitivity evaluation and forecasting techniques. An internally developed MIS system was enhanced during the year under review to improve the quality of internal reporting.

Risk management life cycle/process

A process is currently underway to review all of the Group's policies and procedures. These standards are an integral part of the Group's governance infrastructure and risk management profile, reflecting the expectations and requirements of the Board in respect of key areas of control. The standards ensure alignment and consistency in the way that prevalent risk types are managed and form part of the four phases of the risk management life cycle, defined as:

Risk management and control (continued)

Risk management life cycle/process (continued)

Risk identification (and comprehension)

Risk identification focuses on recognising and understanding existing risks or risks that may arise from positions taken and future business activity as a continuing practice.

Risk measurement (and evaluation using a range of analytical tools)

Once risks have been identified, they need to be measured. Certain risks will obviously lend themselves more easily to measurability than others, but it is necessary to ascertain the magnitude of each risk.

Risk management (as an independent function)

The Group's principal business focuses on the management of liabilities and assets in the balance sheet. Major risks are managed and reviewed by those who influence the risk. ALCO and RMC meet on a regular basis to collaborate on risk control, establish how much risk is acceptable and decide on how the Group will stay within targets and laid down thresholds.

Risk monitoring (and compliance with documented policies)

Open, two-way communication between the Group and the South African Reserve Bank ("SARB") is fundamental to the entire risk monitoring and supervisory process. To achieve this, responsible line heads are required to document conclusions and communicate findings to ALCO and RMC in the first instance and to the SARB via the Finance Division through DI returns and periodic meetings.

Basel II – influencing risk management developments at Mercantile Bank Limited ("the Bank")

The Basel Committee released the revised international Basel II Capital Accord in June 2004. The Accord is designed to differentiate minimum regulatory capital requirements in a risk sensitive manner and encourage and recognise sound risk management, internal control and governance practices.

The new Accord provides a range of approaches that vary in levels of sophistication for the measurement of credit and operational risk to determine capital levels. It provides a flexible structure in which banks, subject to supervisory review, will adopt approaches that best fit their level of sophistication and their risk profile.

In today's complex environment, combining effective bank-level management with market discipline and regulatory supervision best attains systemic safety and soundness. Building on these principles, the new accord has far-reaching implications for banks in terms of minimum capital standards linked to risks, risk measurement systems and methods, risk management practices and public disclosure of risk profile information. It focuses mainly on improving the management of credit and operational risks, enhancements to the supervisory review process and more extensive risk disclosure. The SARB has announced that Basel II will be implemented with effect 1 January 2008. A pre-implementation parallel run will commence in October 2007 to provide local banks and the Regulator the opportunity to evaluate the impact of the new framework on capital requirements and risk management processes.

Mercantile continues to form part of various Basel II committees in association with the SARB, The Banking Association and other financial institutions. During the current year, the Group participated in the fifth comprehensive quantitative impact study ("QIS5") conducted in South Africa, performed informal field testing and participated in the formal field testing of the Draft Regulations of the Banks Act.

The comprehensive, detailed and compliance criteria set by Basel II requires substantial investments in data collection, information technology systems and business process changes. Projects remain in place to identify and define gaps and to address the implementation of enhancements required in respect of methodologies, systems and business processes across the areas of market, credit and operational risk management to satisfy the stringent criteria to be met for Basel II compliance and ensure timeous implementation. The Group recognises the significance of Basel II in aligning regulatory capital to risk and further entrenching risk reward principles and practices in bank management and decision making.

Corporate governance

1. Board of Directors

The Boards of directors of Mercantile Bank Holdings Limited and Mercantile Bank Limited (collectively referred to as "the Board") hold joint Board meetings. The Board subscribes to and is committed to ensuring that the Group complies with the principles and standards set out in the code of corporate practices and conduct expressed in the King Report on Corporate Governance for South Africa 2002 ("King II") and is satisfied that the Group complied in all material respects with these principles throughout the year under review.

The following is a summary of the corporate governance processes of the Group for the year ended 31 December 2006:

The Board exercises effective control over the Group and gives strategic direction to the Bank's management. Key responsibilities of the Board assisted by its Board Committees are to:

- approve the Group's strategy, mission and objectives and monitor/review the implementation thereof;
- approve and annually review the Group's limits of authorities;
- annually review corporate governance processes and assess the achievement of these against objectives set;
- annually review its charter and approve changes to the charters of the Board Committees;
- annually approve the non-executive directors' remuneration and submit such for approval and ratification by shareholders at the Annual General Meeting;
- annually approve executive directors' remuneration and/or increases thereto;
- annually approve the Group's budget (includes capital expenditure);
- be accountable for financial, operational and internal systems of control and overall risk management;
- approve changes to the Group's financial and accounting policies;
- approve the audited financial statements and interim results;
- be responsible for ensuring that the Group complies with all relevant laws, regulations and codes of business practice and codes of ethics;
- appoint appropriate Board Committees and determine the composition thereof; and
- annually approve the Board and Board Committees' self-evaluations conducted on their effectiveness.

The Board comprises of non-executive and executive directors with different skills, professional knowledge and experience, with independent non-executive directors comprising the majority on the Board. For detail on the composition of the Board and changes to such during the financial year ended 31 December 2006, the frequency of meetings and attendance thereof, refer to Annexure A to this document. The roles of the Chairman of the Board and Chief Executive Officer ("CEO"), who are appointed by the Board, are separated, thereby ensuring a clear division of responsibilities at the head of the Group. The Chairman of the Board is an independent non-executive director.

Non-executive directors offer independent judgement and, apart from their fees, there are no extraneous factors that could materially affect their judgement. If there is an actual or potential conflict of interest, the director (executive or non-executive) concerned, after declaring his/her interest in terms of the Companies Act No 61 of 1973, as amended ("Companies Act"), is excluded from the related decision-making process.

The process of identification of suitable candidates to fill vacancies on the Board and to re-appoint directors on termination of their term of office, is conducted by the Nominations Committee. This Committee's nominations are submitted to the Board for approval, subject to the Registrar of Banks having no objections to the nominations. Any person appointed to fill a casual vacancy or as an addition to the Board, will retain office only until the next Annual General Meeting unless the appointment is confirmed at that meeting.

Currently a director is required to retire from the Board at age 70. Shareholders will be asked to approve proposed changes to the articles of association at the forthcoming Annual General Meeting (refer to the notice of Annual General Meeting, special resolution number 1 on page 66) and subject to the approval of such the Board will be given the power to allow for a director to continue his service beyond the retirement age. Until age 70 all directors, except the CEO who has a five year service contract, retire on a three-year rotational basis. If eligible for re-election, they can be re-elected at the Annual General Meeting.

Corporate governance (continued)

1. Board of Directors (continued)

The Board operates in terms of a charter, which defines its duties, responsibilities and powers. The charter is reviewed annually. The evaluation of the performance of the Board as a whole is conducted annually by means of a self-evaluation process. An independent evaluation of the Chairman is conducted by the other directors. The evaluation of individual non-executive directors' performance is conducted on a bilateral basis between the Chairman and each director.

At 31 December 2006, the Board, which has a unitary board structure, comprised of nine directors, of which three were executives. One of the executive directors representing the major shareholder and whose contract of employment with Mercantile terminates in 2007, resigned as an executive director and employee with effect from 28 February 2007.

Of the six non-executive directors, five are classified as independent, one of whom is a woman. Three of the directors are classified as black in terms of the relevant legislation. The Board is satisfied that its composition reflects an appropriate balance in this respect.

The Board has unrestricted access to all company information, records, documents and property.

2. Group Secretary

The appointment and removal of the Group Secretary is a matter for consideration by the Board as a whole. The Group Secretary ensures that statutory and regulatory procedures are complied with. The Group Secretary provides a central source of advice and guidance on business ethics and compliance with good corporate governance, assisting the Board as a whole and its members individually with guidance as to how their duties, responsibilities and powers should be adequately discharged and exercised in the best interests of the Group. If necessary, directors are entitled to obtain independent professional advice at the Group's expense.

The Group Secretary also maintains and regularly updates, a corporate governance manual, copies of which are distributed to all directors, and organises and conducts a Board approved induction programme to familiarise new non-executive directors with the Group's operations, their fiduciary duties, and the Group's corporate governance processes. The Group Secretary assists the Board in developing a training framework annually to assist the non-executive directors with continuous development as directors and in particular in a banking environment.

3. Board Committees

To assist the Board in carrying out its duties and responsibilities, a number of Board Committees exist. This does not relieve the Board of any of its responsibilities. These Committees all operate in terms of approved charters, which define their roles. All Board Committees' charters are reviewed annually. Changes to the charters are subject to Board approval. The performance of Board Committees, based on the duties and responsibilities as set out in the respective charters, are evaluated annually by means of a self-evaluation process, which results are discussed at the Board Committee concerned and then reviewed and approved by the Board. For detail on the composition of the Board Committees, frequency of meetings and attendance thereof, refer to Annexure A.

All directors who are not members of the Board Committees may attend Committee meetings. All directors who are not Committee members receive copies of the documentation sent to the Board Committees from time to time.

Further details on the Board committees are provided below:

3.1 Group Audit Committee ("GAC")

The GAC comprises two independent non-executive directors, one of whom acts as Chairman, and the CEO. The Chairman of the Board is not a member but is invited to the GAC meetings.

GAC meetings are held at least three times per annum. The meetings of the Committee are attended by the head of Internal Audit, the External Auditors, the head of Risk, the Compliance Officer, the head of Finance and the head of Corporate Services and Treasury. The head of Internal Audit, the Compliance Officer, the head of Finance, any member of the Executive Committee and the External Auditors have unrestricted access to the Chairman of the Committee. As defined in its charter, the primary objective of the Committee is to assist the Board to fulfil its responsibilities relative to:

Corporate governance (continued)

3. Board Committees (continued)

3.1 Group Audit Committee ("GAC") (continued)

- financial control and reporting;
- compliance with statutory and regulatory legislation which includes but is not limited to the Banks Act, Companies Act, the Listings Requirements of the JSE Limited ("JSE"), Common law, International Financial Reporting Standards ("IFRS") and tax legislation;
- Corporate Governance;
- Risk Management; and
- shareholder reporting.

Inter alia, the Committee reviews accounting policies, the audited annual financial statements, interim results, internal and external auditors' reports, the adequacy and efficiency of internal control systems, the effectiveness of management information systems, the internal audit process and the Bank's continuing viability as a going concern. The Compliance Officer also gives feedback to the Committee on compliance issues and updates on changes to legislation, which could have an impact on the Group.

The External Auditors' appointment and remuneration are recommended by the Committee and approved at the Annual General Meeting. The principles for recommending the use of the External Auditors for non-audit services are set by the Committee.

The GAC has fulfilled its responsibilities in terms of its charter during the year under review.

The GAC considers the annual financial statements of the Group and its subsidiaries to be a fair presentation of its financial position, and the results of operations and cash flows for the year ended 31 December 2006, in terms of IFRS, the Companies Act, the Banks Act and JSE Listings Requirements.

3.2 Risk Management Committee ("RMC")

This Committee comprises of five members, three of whom are independent non-executive directors, the CEO and an Executive Director. The Chairman of the Board chairs this Committee.

RMC meetings are held at least four times per annum. The RMC meetings are attended by the head of Risk, the head of Special Projects and Asset and Liability Management, the head of Finance, the head of Credit, the Compliance Officer and the head of Corporate Services and Treasury.

As defined in its charter, the RMC's objectives are to:

- assist the Board to fulfil its risk management and control responsibilities, in the discharge of its duties relating to risk and control management, assurance, monitoring and reporting;
- provide monitoring and oversight of the risk management process;
- facilitate communication between the Board, GAC, internal auditors, compliance and other parties engaged in the risk management activities;
- ensure the quality, integrity and reliability of the Group's risk management; and
- provide an independent and objective oversight and review of the information presented by management on risk management generally and specifically taking into account reports by management and the GAC to the Board on financial, operational and strategic risks.

The RMC has fulfilled its responsibilities in terms of its charter during the year under review.

For more detailed information relating to the Risk Management of the Group refer to pages 51 to 53.

3.3 Directors' Affairs Committee

This Committee comprises all the non-executive directors on the Board. The Chairman of the Board chairs this Committee. Meetings are held at least four times per annum.

As defined in its charter, the primary objectives of this Committee are to:

- assist the Board in its determination, evaluation and monitoring of the appropriateness and effectiveness of the corporate governance structures, processes, practices and instruments of the Group; and
- assist the Board in ensuring that the Group is compliant in all material aspects with King II and other corporate governance practices.

Corporate governance (continued)

3. Board Committees (continued)

3.4 Nominations Committee

This Committee comprised of all the non-executive directors on the Board and was chaired by the Chairman of the Board.

The Committee was to meet at least once per annum with its primary objectives, as defined in its charter, to:

- establish and maintain a continuity plan for the Board;
- be responsible for the process of Board nominations and appointments for recommendation to the Board and in doing so, review the skills, experience and other qualities required for the effectiveness of the Board;
- ensure that a management succession plan was in place; and
- assist the Board in determining whether the employment/appointment of any directors should be terminated (excludes resignations).

At the last Board meeting of the financial year, the Board disbanded the Nominations Committee by incorporating the role, power and duties of the Nominations Committee, set out in its charter, into the charter of the Directors' Affairs Committee. Therefore the Directors' Affairs Committee in addition to its current role (refer to item 3.3 above), will fulfil the role the Nominations Committee has performed to date. The rationale for the Board's decision is that the Nominations Committee had fulfilled some of the functions of the Directors' Affairs Committee stipulated in the Banks Act to date.

3.5 Remuneration Committee

This Committee comprises all the independent non-executive directors of the Board excluding the Chairman of the Board. An independent non-executive director chairs this Committee. The CEO attends this Committee's meetings by invitation. The Committee must meet at least twice per annum.
As defined in its charter, the Committee's primary objectives are to:

- assist the Board in determining the broad policy for executive and senior management remuneration and the Bank's remuneration philosophy (refer to item 4 below for further detail);
- assist the Board in reviewing the remuneration of the executive directors; and
- assist the Board in reviewing the non-executive directors' fees.

3.6 Transformation Committee

This Committee comprises three independent non-executive directors and the CEO. The chairman of the Board chairs this Committee. This Committee must meet at least four times per annum.

As defined in its charter, this Committee's primary objectives are to:

- assist the Board in determining the targets to be achieved and the monitoring of the progress towards achieving these targets in respect of the following key black economic empowerment ("BEE") initiatives as laid down in the Broad-Based Black Economic Empowerment Act and the Financial Sector Charter:
  - employment equity targets for the various levels of management and other employees;
  - skills development programmes to promote black skills;
  - procurement from BEE accredited companies;
  - corporate social investment;
  - the total amount to be invested in BEE transaction financing and other transformation projects;
  - the composition of the Board of directors in relation to gender and black people; and
- assist the Board in determining which black individual/s should be considered for direct ownership in the Group.

3.7 Technology Committee

This Committee which is a committee of Mercantile Bank Limited, the major subsidiary of Mercantile, comprises two independent non-executive directors and two executive directors. An independent non-executive director chairs this Committee. This Committee was formed during the year to monitor and manage a special project of the Bank relating to the replacement of its core banking system. The Technology Committee fulfilled its charter for the 2006 year and the Board has decided to extend its mandate into 2007.

Corporate governance (continued)

3. Board Committees (continued)

3.8 Management Committees

A number of Management Committees have been formed to assist executive management and the Board in carrying out its duties and responsibilities. These are:

Assets and Liability Committee (ALCO)
Credit Committee
Employment Equity Committee
Executive Committee (Exco)
Human Resources Committee
IT Steering Committee

All these committees operate in terms of their charters, which define their duties and responsibilities.

Non-executive directors may attend any management committee meetings.

4. Remuneration philosophy

The main purpose of the remuneration philosophy adopted in the Group is to promote performance-based and equitable remuneration practices.

In order to attract, motivate and retain staff the Group ensures that remuneration practices are fair, equitable and competitive. The three main elements of remuneration are the following:

- the total guaranteed package concept gives all employees a certain degree of flexibility as they can structure their packages to include a 13th cheque, select the appropriate level of travel allowance (in accordance with SARS' regulations) and choose the appropriate medical aid plan. External equity is ensured by comparing packages to market levels through salary surveys. This is done at least once a year prior to annual salary review processes. Increases and movements in individual pay scales are based on performance, levels of competence and current position/pay level against market. The market median pay level for the position is used as a guideline.
- short-term incentives are important to support the pay for performance philosophy and form an important component of variable pay. The incentive bonus scheme introduced in 2004 has been reviewed annually after benchmarking it against market practices.
- the third element of the remuneration mix is long-term incentives. The purpose of this element is to reward key staff members whose contribution within the next three to five years is viewed as critical and whose retention is regarded as a priority. Criteria for the allocation of share options to senior and middle management staff have been formulated. The current share option scheme will be reviewed in 2007.

The policy on the remuneration of executive directors is consistent with that of senior management. Non-executive directors receive fees for their services as directors of the Group and for services rendered as members of the various Board Committees.

5. Internal audit function

The Internal Audit function forms part of the risk management process. The head of Internal Audit, who reports to the Group Audit Committee, performs a function independent from any other function in the Group. He has direct and unrestricted access to the Chairman of the Group Audit Committee, the CEO, the Chairman of the Risk Management Committee and the Chairman of the Board.

The Group Audit Committee must concur with any decision to appoint or dismiss the head of Internal Audit.

The Board reviewed the Internal Audit Charter, which governs internal audit activity in the Group, during the year. The charter defines the role, objectives, authority and responsibility of the Internal Audit function.

All significant operations, business activities and support functions are subject to Internal Audit review. The audit plan is risk based and is drawn up annually and approved by the Group Audit Committee.

Internal Audit audits the adequacy and effectiveness of control and governance processes throughout the Group. Any significant or material control weaknesses are reported to management, the Group Audit Committee and/or the Risk Management Committee for consideration and the necessary remedial action.

To complement the Group internal audit function:

- the Bank has entered into a co-sourcing arrangement with KPMG, to provide specialist internal audit skills in the IT and Treasury environments; and
- CGD's Internal Audit Department carries out assignments in accordance with CGD's requirements.

Corporate governance (continued)

6. External Auditor's services: Outsourcing policy

The Group will not contract its External Auditors on an outsourcing basis where such an engagement compromises their independence and, in particular, the following areas are specifically excluded from the services that are procured from the External Auditors:

- bookkeeping or other services related to accounting records or annual financial statements;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions or contribution-in-kind reports for financial reporting purposes;
- actuarial services;
- internal audit outsourcing and or co-sourcing;
- performance of management functions;
- as staff-recruitment agent;
- broker-dealer, investment advisor or investment banking services; and
- legal services.

The CEO may approve non-auditing services projects up to R250 000 subject to subsequent ratification by the GAC. For amounts in excess of R250 000 prior approval by the GAC is required.

7. Compliance function

The role of the independent compliance function is to identify, assess and monitor the statutory and regulatory risks faced by the Group and advise and report to senior management and the Board on these risks. The compliance function is mandated to make the Board aware of any procedural concerns that may lead to non-compliance and alert members to incidents of non-compliance whilst taking remedial action to avert such incidents.

To ensure the independence of the compliance function from the business activities of the Group, the Board authorised the compliance function to:

- carry out its responsibilities on its own initiative in all areas of the Group in which regulatory risk may or may not exist;
- ensure it is provided with sufficient resources to enable it to carry out its responsibilities effectively;
- not have direct business line responsibilities; and
- report directly to the Board or a committee of the Board, whenever necessary.

The Board approved a charter for the compliance function. At least once a year, the Board will review the charter and its ongoing implementation to assess the extent to which the Group is managing its regulatory risks effectively. The compliance function keeps senior management and the Board informed about significant regulatory issues and any trends exhibited, and identifies where urgent intervention is needed.

Reporting to the Board is in the form of a Level of Compliance Report to both the Risk Management Committee and the Group Audit Committee (the same report is also submitted to the South African Reserve Bank, once discussed by the Group Audit Committee).

The Financial Intelligence Centre Act ("FICA") and The Financial Advisory and Intermediary Services Act ("FAIS") were two key areas that the Compliance Department focused on during the year under review. As required by FICA, the Money Laundering Control Officer managed compliance with anti-money laundering legislation. FICA requirements have been built into business processes and ongoing monitoring is undertaken. FICA has also been amended to counter terrorist financing, following the promulgation of the Protection of Constitutional Democracy against Terrorist and Related Activities Act.

With the aim of elevating compliance with anti-money laundering and terrorist financing controls to the standards outlined in international best practice documents, the regulatory focus during the year was the re-identification and verification of our existing client base in terms of local money laundering control legislation (i.e. the Financial Intelligence Centre Act). In keeping with these requirements, non-compliant accounts were frozen.

The ongoing implementation of FAIS was the other major imperative for the business and the Compliance function during the year, with the majority of our Retail Banking Staff undergoing further training in the rendering of financial advice and related services, to meet the Fit and Proper requirements of the legislation. Reports on compliance with the requirements of FAIS, were also completed and submitted to the Financial Services Board during the year.

The Compliance function during the year under review also initiated preparations and projects for the implementation of the new National Credit Act.

No material incidents of non-compliance were reported during the year under review.

Corporate governance (continued)

8. Dealing in securities of the Group

The Group's dealings in securities policy ("the policy"), which was amended during the year, regarding dealings in the Group's securities by directors and the Group Secretary, complies with the Listings Requirements of the JSE. Should any director and the Group Secretary or their associates wish to trade in the Group's securities, held either directly or indirectly, beneficially or non-beneficially, written clearance must be obtained in advance from the Chairman of the Board or the designated director for this purpose. The policy also restricts trading by certain individuals employed by the Bank which includes but is not limited to the senior managers and the Mercantile Bank Holdings Limited share incentive scheme participants. All individuals bound by the policy may not trade during the following periods:

– when the company is trading under cautionary announcement;
– the period between the end of either the financial year or half-year and release of results pertaining to that period; and
– any period when there exists any matter which constitutes unpublished price sensitive information.

The policy also emphasises that each individual (whether a director or employee) is obliged to comply with the provisions of the Securities Services Act No 36 of 2004 which deals with insider trading rules.

The policy is implemented by the Group Secretary who is required to keep a written record of all written clearances given and, as soon as the trade has been executed, to ensure that disclosure is made on SENS in terms of the JSE Listings Requirements.

9. Code of Banking Practice

The Group subscribes to the Code of Banking Practice ("the Code") that provides valuable safeguards for its clients. The Group attempts to conduct its business with uncompromising integrity and fairness, so as to promote complete trust and confidence. In meeting this fundamental objective, the Group conducts its relationships with the regulatory authorities, clients, competitors, employees, shareholders, suppliers and the community at large, by striving for high service levels with integrity, and encourages its employees to acquaint themselves with the Code and honour its precepts.

10. Integrated sustainability reporting

Ethical Standards

The Group is committed to high moral, ethical and legal standards and expects all representatives of the Group to act in accordance with the highest standards of personal and professional integrity in all aspects of their activities and to comply with all applicable laws, regulations and the Group's policies.

The Group's commitment is clearly stated in the Group's Code of Ethics which contains a set of standards which the Group believes could contribute to its commercial success, as adherence thereto is a strategic business imperative.

The Board believes that the Group has adhered to the ethical standards during the year under review.

Safety, Health and Environmental Principles

The Group is, on an ongoing basis, striving to improve security to protect the safety and well being of its employees during the execution of their duties and of persons who may enter any of its premises. Regular inspections of the workplace are carried out to identify potential hazards and the Group does not hesitate to take and enforce such measures that may be reasonably practicable, to eliminate or mitigate any hazard or potential hazard to the safety of its employees or other persons.

The Group acknowledges that the sound management of natural resources is a cornerstone of sustainable development, including justifiable social and economic development. In order to apply those environmental standards the Group is adhering to the Environmental Risk Management Policy as previously approved by the Risk Management Committee.

11. Transformation

The Group is fully committed to social and economic transformation and regards it as a key business imperative. Initiatives are driven and directed by the Board and integrated into the Group's strategic business plans. The Transformation Committee monitors the progress of transformation in the Group. The Committee's charter stipulates how transformation will be implemented, monitored and integrated across the Group.

The key elements of the charter, which are based on the Financial Sector Charter Scorecard requirements and aligned to the strategy of the Group, are as follows:

Corporate governance (continued)

11. Transformation (continued)

Employment Equity

Transformation in the workplace is an important aspect of employment equity, and the Group strives to provide an environment that values and fosters diversity and equality. This includes developing a culture that supports mutual trust, respect and dignity.

Adherence to the Employment Equity Act and associated Skills Development legislation is regarded as essential. The desired results of the implementation of the employment equity plan are to improve the representation of black people, women and people with disabilities towards reflecting the demographic profile of the country and prioritising the development and career advancement of the designated groups.

As employment equity is regarded as a key business imperative, it is included in each of the divisions' key result areas. Targets have been set through to 2008 and progress is monitored on a quarterly basis. Good progress has been made in the employment of black people in the skilled/junior management and semi-skilled categories. The challenge remains the attraction, employment and retention of suitably experienced and skilled employment equity candidates for middle management and senior management level positions.

Skills Development

The various components of the new performance management system were implemented during the year under review. This includes personal development plans for all staff detailing individual training and development priorities.

Various training programmes were presented over the last year. The emphasis was on credit skills, related financial and business skills for most of the staff in the Retail and Commercial Banking division and its support departments.

Another area that received attention was the assessment and development of senior managers. This initiative forms part of succession planning. Other steps include the identification of a talent pool comprising of staff at middle management level who show potential for advancement to more senior positions.

A third group of learners, from the BANKSETA Letsema learnership programme, targeting unemployed people from previously disadvantaged groups were employed on a one-year contract. A trainee programme was also implemented and some of the learners of the 2005 intake were offered trainee positions. The employment and retention of learners as trainees and permanent staff has been very successful.

Corporate Social Investment

The Group is committed to the upliftment and transformation of communities and has developed a comprehensive framework for its Corporate Social Investment policy and plan. The implementation of this plan will commence during 2007.

Procurement

A targeted procurement strategy to enhance Black Economic Empowerment has been adopted. The objective is to actively promote the effective and efficient development and support of suppliers and contractors from historically disadvantaged South African enterprises. The principles are detailed in the Group's Procurement Policy.

Enterprise development

Targets are in place and initiatives are underway aimed at identifying opportunities to provide financing within appropriate risk measures to enterprises owned or controlled by designated groups.

Ownership and control

The Board has commenced exploratory discussions with potential candidates within a framework and approach to be used to consider empowerment partners for the Group, as approved by CGD.

12. Annual financial statements

Accounting policies and the basis of accounting on which annual financial statements are prepared, are set out on pages 12 to 20 of this report.

13. Regulation

The South African Reserve Bank, the Financial Services Board and the JSE regulate the various activities of the Group.

14. Communication with stakeholders

The Board communicates with its shareholders in accordance with the Companies Act and Listings Requirements of the JSE. Appropriate communication is also sent to the employees of the Bank from time to time. The Board has delegated authority to the CEO to speak to investment analysts from time to time. Communication with the SARB, the Registrar of Companies and the JSE is done in compliance with the respective laws/guidelines.

Corporate governance (continued)

Annexure A

Attendance of meetings by directors

			Committees						
	Date appointed to Board	Board (joint meetings)	Group audit	Risk manage-ment	Directors' affairs	Nomi-nations	Remune-ration	Trans-formation	v Techno-logy (con-stituted Feb 2006)
Number of meetings held during the year under review		ù 6	4	5	5	2	3	5	6
Directors J A S de Andrade Campos	26.07.2002	c 6/6	–	c 5/5	c 5/5	c 2/2	–	c 5/5	–
D J Brown	29.03.2004	6/6	4/4	5/5	–	–	–	5/5	6/6
G P de Kock	23.11.2000	6/6	+ 0/1	5/5	5/5	2/2	c 3/3	–	6/6
M J M Figueira “	26.05.2004	6/6	–	5/5	–	–	–	–	5/6
L Hyne	01.06.2003	6/6	c 4/4	5/5	5/5	2/2	3/3	–	–
A T Ikalafeng	16.11.2004	6/6	–	–	5/5	2/2	3/3	5/5	–
J P M Lopes	09.11.2005	6/6	–	* 4/4	–	–	–	–	–
K B Motshabi ””	16.11.2004	4/6	1/3	2/5	2/5	1/2	1/3	3/5	–
A M Osman	02.02.2004	5/6	–	–	5/5	2/2	–	–	–
S Rapeti	29.07.2005	6/6	–	–	4/5	1/2	1/3	+	c 6/6

– non-member of Committee
* appointed 24.05.2006
”” resigned effective 10.11.2006 (Board and all committees)
“ resigned effective 28.02.2007
c chairman of meeting
+ appointed 10.11.2006
ù one of which was a two day Strategy Board meeting
v Board Committee of Mercantile Bank Limited and all others were for the year ended 31 December 2006 joint Board Committees

Capital adequacy statement

at 31 December 2006

	Risk-weighting	Average assets 31 December 2006 R'000	Risk-weighted assets 31 December 2006 R'000	Risk-weighted assets 31 December 2005 R'000
Mercantile Bank Limited				
Banking book				
Cash, off-balance sheet activities and central government transactions	0%	2 101 793	–	
Landbank bonds	10%	151 927	15 193	14 726
Letters of credit and other bank advances	20%	131 777	26 355	31 059
Residential mortgage loans and performance-related guarantees	50%	723 483	361 742	294 388
Other assets including counterparty risk exposure	100%	1 859 955	1 859 955	1 292 550
		4 968 935	2 263 245	1 632 723
Primary capital			1 495 530	1 495 530
Secondary capital			43 259	21 001
Impairments			(856 650)	(952 984)
Net qualifying capital and reserves			682 139	563 547
Capital adequacy ratio (%)			30.1	34.5
Primary capital (%)			28.2	33.2
Secondary capital (%)			1.9	1.3

Analysis of shareholders

at 31 December 2006

Shareholders' spread

	2006	2005
Number of public shareholders	**6 969**	6 857

Percentage of shares held by:

	2006		2005	
	Number	**%**	Number	%
Public	**311 124 327**	**7.90**	311 107 329	7.90
Non-public	**3 627 794 197**	**92.10**	3 627 811 195	92.10
– Directors	**–**	**–**	–	–
– Employees	**65 502**	**–**	–	–
– Trustees of share incentive scheme	**13 710 500**	**0.35**	13 793 000	0.35
– Holders of 10% or more of shares	**3 614 018 195**	**91.75**	3 614 018 195	91.75

Major shareholders holding in excess of 5% of the company's share capital

	Number of shares	%
2006		
Caixa Geral de Depósitos SA	**3 614 018 195**	**91.75**
2005		
Caixa Geral de Depósitos SA	3 614 018 195	91.75

Performance on the JSE year ended 31 December

	2006	2005
Number of shares issued	**3 938 918 524**	3 938 918 524
Share price (cents)		
Year-end	**26**	36
Highest	**45**	60
Lowest	**24**	16
Number of shares traded	**89 716 935**	115 504 164
Value of shares traded (R'000)	**30 377**	40 100
Average price (cents)	**34**	35
Market capitalisation (R'000)	**1 020 554**	1 418 010

Group addresses

Mercantile Bank Group

Head Office
Mercantile Bank
142 West Street, Sandown, 2196
PO Box 782699, Sandton, 2146
Tel: 011 302 0300
Fax: 011 883 7765

Mercantile Bank

Boksburg
North Atlas Centre,
Cnr Atlas and Rand Roads,
Boksburg, 1419
PO Box 31558,
Braamfontein, 2017
Tel: 011 918 5276
Fax: 011 918 4159

Bruma
11 Ernest Oppenheimer Boulevard,
Bruma, 2198
PO Box 31558,
Braamfontein, 2017
Tel: 011 622 0916
Fax: 011 622 8833

Cape Town City
Ground Floor, M&B House,
Pier Place, Foreshore,
Cape Town, 8001
PO Box 51, Cape Town, 8000
Tel: 021 419 9402
Fax: 021 419 5929

Cape Town Tygerberg
Ground Floor,
Tygerpoort Building,
7 Mispel Street, Belville, 7530
PO Box 5436, Tygerberg, 7536
Tel: 021 910 0161
Fax: 021 910 0163

Comaro Crossing
Shop FF9, Comaro Crossing
Shopping Centre,
Orpen and Comaro Roads,
Oakdene, 2190
PO Box 31558,
Braamfontein, 2017
Tel: 011 435 0640
Fax: 011 435 1586

Durban
123 Cowey Road, Cowey Centre,
Morningside, Durban, 4001
PO Box 4651, Durban,4000
Tel: 031 209 9048
Fax: 031 209 9446

Germiston
The Lake Shopping Centre,
William Hill and Lake Streets,
Germiston, 1401
PO Box 31558,
Braamfontein, 2017
Tel: 011 824 5813
Fax: 011 824 5823

Horizon
153 Ontdekkers Road, Horizon,
Roodepoort, 1724
PO Box 31558,
Braamfontein, 2017
Tel: 011 763 6000
Fax: 011 763 8742

Pretoria Hatfield
Pro-Equity Court,
Pretorius and Gordon Roads,
Hatfield, Pretoria, 0083
PO Box 31558,
Braamfontein, 2017
Tel: 012 342 1151
Fax: 012 342 1191

Pretoria West
477 Mitchell Street,
Pretoria West, 0183
PO Box 31558,
Braamfontein, 2017
Tel: 012 327 4671
Fax: 012 327 4645

Sandton
Ground Floor, 142 West Street,
Sandown, 2196
PO Box 31558, Braamfontein, 2017
Tel: 011 302 0763
Fax: 011 884 1821

Strijdom Park
Shop 2, Homeworld Centre,
Cnr Hans Strijdom Drive and
CR Swart Roads, Strijdom Park,
Randburg, 2194
PO Box 31558,
Braamfontein, 2017
Tel: 011 791 0854
Fax: 011 791 2387

Troyeville
77 Bezuidenhout Street Bertrams,
2094
PO Box 31558,
Braamfontein, 2017
Tel: 011 624 1450
Fax: 011 614 9611

Vanderbijlpark
Shop 1, Russell's Building,
54 President Kruger Street,
Vanderbijlpark, 1911
PO Box 31558,
Braamfontein, 2017
Tel: 016 981 4132
Fax: 016 981 0767

Welkom
Tulbagh House, 11 Tulbagh Street,
Welkom, 9459
PO Box 2207, Welkom, 9460
Tel: 057 357 3142
Fax: 057 352 7879

Mercantile Insurance Brokers

Head Office
Mercantile Bank,
142 West Street,
Sandown, 2196
PO Box 782699, Sandton, 2146
Tel: 011 302 0556/7/8
Fax: 011 302 0752

Notice of Annual General Meeting

Mercantile Bank Holdings Limited

Member of CGD Group
Reg No: 1989/000164/06
(Incorporated in the Republic of South Africa)
Share code: MTL ISIN: ZAE000064721
("Mercantile " or "the Company")

Notice is hereby given that an Annual General Meeting ("the meeting") of the shareholders of the Company will be held at 08:30 on Thursday, 24 May 2007 in the Boardroom, First Floor, Mercantile Bank, 142 West Street, Sandown, Sandton for the following purposes:

SPECIAL RESOLUTION

1 AMENDMENTS TO THE ARTICLES OF ASSOCIATION OF THE COMPANY:

RESOLVED as a special resolution that the articles of association of the Company be and are hereby amended, with or without modification –

1. the insertion in article 1 thereof in alphabetical order with the existing definitions and a consequent renumbering of the sub-articles in that article –

   ""the JSE" means JSE Limited as it is now named or as it may from time to time hereafter be named;";

   "the Securities Services Act" means the Securities Services Act 2004 including any re-enactment or amendment thereof;

   "uncertificated shares" means shares which are uncertificated securities defined in the Securities Services Act being shares that are not evidenced by a certificate or other document of title and are transferable by entry without a written instrument.

2. the deletion of articles 4.1 and 4.2 and the insertion in its stead of the following new clause 4.2 ;

   "4.2 Nothing in this article 4 contained shall oblige the Company to enquire (although the sub-article shall not prevent it from enquiring) whether a member is an associate of other shareholders if the total value of shares registered or to be registered in his / her or its name is less than 1% (one percent) of the nominal share capital of the Company."

3. the deletion of "Sections 36 and 38" in article 4.6 thereof and the insertion in its stead of "Section 38";

4. the deletion of the existing clause 13 and the insertion in its stead of the following new clause 13 –

   "13 If sanctioned by the Company in a general meeting and subject to the statutes and any amendment thereof the Company may pay commission, not exceeding 10% (ten percent), to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the Company or of his procuring or agreeing to procure subscriptions, whether absolute or conditional, for any shares of the Company.";

Notice of Annual General Meeting (continued)

5. the deletion of "Section 28(2)(b)" in article 15 thereof and the insertion in its stead of "Section 38(2)(b)";

6. the insertion of a new article 17.4:

"17.4 Transfer of ownership in an uncertificated share shall be effected upon the debiting and crediting, respectively of both the account in the sub-register from which the transfer is effected and the account in the sub-register to which the transfer is to be made, in accordance with the rules of the Central Securities Depository and a transferee shall, upon the entry of his/her or its name in a sub-register but subject to the provisions of the Statutes, become a member of and be recognised as a member by the Company in respect of the uncertificated shares registered in his/her or its name."

7. to the deletion of the sentence "If the Company is wound up, any such amounts which have not been claimed shall be paid to the Guardians Fund." in article 23.2.3 thereof;

8. the deletion of article 47 thereof and the insertion of the following new article 47 –

"47 A director shall vacate his office automatically if and as soon as he reaches the age of 70 (seventy) unless the directors determine otherwise.";

9. the deletion of article 51 thereof and the insertion in its stead of the following new article 51 –

"51 The remuneration of directors shall from time to time be ratified and / or approved by the Company in a general meeting subject to Articles 57 and 66.";

10. the deletion of articles 54.4 and 54.6 thereof and the insertion in their stead of the following new articles 54.4 and 54.6 –

"54.4 if he is absent from meetings of the directors for two consecutive meetings and is not represented at any such meetings by an alternate director and the directors resolve that the office be vacated, provided that the directors shall have power to grant any director leave of absence for any or an indefinite period; or

"54.6 on the date stipulated in the notice he has given in writing of his intention to resign or such other date as agreed to by the directors; or"

11. The deletion of the existing clause 68 and the insertion in its stead of the following new clause 68:

"68 The directors may meet for the despatch of business, adjourn and otherwise regulate their meetings as they think fit. The quorum for directors meetings shall be a majority in number of the directors appointed at the time. A director may at any time and the secretary upon the written request of a director shall convene a meeting of the directors. There shall be not less than four meetings of directors per annum. A meeting shall for the purposes of these articles include a meeting by teleconference or any other acceptable electronic means."

12. the deletion of the existing clause 73.2 and the insertion in its stead of the following new clause 73.2:

"73.2 Any director who serves on an executive or other committee, or who devotes special attention to the business of a company, or who otherwise performs services which, in the opinion of the directors are outside the scope of the ordinary duties of a director, may be paid such extra remuneration (in addition to the remuneration he/she may be entitled to as director) by way of salary and/or by way of an amount equal to the percentage of dividends declared, provided that such amount shall be limited to a reasonable maximum which in the event of non-executive directors has to be approved and/or ratified at an Annual General Meeting and in the event of executive directors, their remuneration is to be approved by the Board by a disinterested quorum of directors"

13. the insertion after "Any director shall" in article 76.1 thereof of ", subject to the approval of the Board,";

Notice of Annual General Meeting (continued)

14. the deletion of article 77.

The reason for that part of the special resolution contained in –

- parts 2 and 3 thereof is the repeal of section 36 of the Banks Act;
- part 4 thereof is that the articles of the Company do not presently provide that commission payable in respect of a subscription for shares shall not exceed 10%;
- part 5 thereof is to correct an incorrect reference to a section of the Banks Act;
- part 6 thereof is to provide for the transfer of uncertificated shares;
- part 7 thereof is to provide that unclaimed moneys will not be paid to the Guardians Fund on a winding-up of the Company;
- part 8 thereof is to provide that a director need not vacate his office on reaching the age of 70, as is presently the case, if the directors determine that he need not;
- part 9 thereof is to clarify the position regarding the remuneration of executive directors;
- part 10 thereof is –
    - to provide for the vacation of office, unless the directors grant leave of absence, by a director who is absent from meetings of the directors for two consecutive meetings, and not as at present during six consecutive months, and is not represented at such meetings by an alternate;
    - to allow for the immediate resignation of a director;
- part 11 thereof is to provide for the holding of a meeting by teleconference or other acceptable electronic means;
- part 12 thereof is to provide for the approval of extra remuneration for executive and non-executive directors;
- part 13 thereof is to provide for the approval of the directors in relation to the appointment by any director of an alternate director; and
- part 14 thereof is that there is no intention to appoint associate directors.

The effect of the special resolution is to amend the Company's articles of association so as to provide for these matters.

ORDINARY RESOLUTIONS

2 ADOPTION OF ANNUAL FINANCIAL STATEMENTS:

To receive and adopt the annual financial statements of the Company and of the Mercantile Group for the year ended 31 December 2006.

Explanatory note:

At the Annual General Meeting the directors must present the audited annual financial statements for the year ended 31 December 2006 to shareholders together with the reports of the directors and auditors as contained in the 2006 Annual Report.

3 NON-EXECUTIVE DIRECTORS' REMUNERATION

To approve and ratify the proposed fees payable to the non-executive directors of the Mercantile Group from time to time for the financial year ending 31 December 2007, effective 1 January 2007.

3.1 Chairman of the Mercantile Board:
R1 100 000 per annum

3.2 Director of the Mercantile Board:
R162 000 per annum

3.3 Director of Mercantile Bank Limited ("the Bank"),the major subsidiary of the Company:
R35 000 per annum

3.4 Chairman of the Group Audit Committee:
R55 000 per annum

Notice of Annual General Meeting (continued)

3.5 Member of the Group Audit Committee: R50 000 per annum

3.6 Chairman of the Remuneration Committee: R43 000 per annum

3.7 Member of the Remuneration Committee: R50 000 per annum

3.8 Member of the Risk Management Committee: R50 000 per annum

3.9 Member of the Transformation Committee: R50 000 per annum

3.10 Member of the Directors' Affairs Committee: R50 000 per annum

3.11 Chairman of the Technology Committee (Committee of the Bank): R43 000 per annum

3.12 Member of the Technology Committee (Committee of the Bank): R50 000 per annum

Explanatory note:

Shareholders are requested to approve the remuneration payable to non-executive directors for serving on the Boards and Board Committees of the Company and the Bank. The Chairman of the Mercantile Board's fee includes remuneration for the Chairman's participation on other Boards and Board Committees. The Board members' total fees are dependent on their participation on Board Committees. Refer to Annexure A on page 62 for the Board and Board Composition as at 31 December 2006.

4 RE-ELECTION OF DIRECTORS RETIRING BY ROTATION

To re-elect by way of separate resolutions directors in the place of those retiring in accordance with the Company's articles of association. The directors retiring are:

J A S de Andrade Campos	(appointed: 26/07/2002)
G P de Kock	(appointed: 23/11/2000)
A T Ikalafeng	(appointed: 16/11/2004)

and being eligible offer themselves for re-election.

An abbreviated curriculum vitae of each director offering himself for re-election is contained on page 72 of the annual report.

Explanatory note:

In accordance with the articles of association of the Company one third of the directors is required to retire at each meeting and may offer themselves for re-election. In terms of the articles of association of the Company the managing director, during the period of his service contract, is not taken into account when determining which directors are to retire by rotation.

5 AUDITORS

To re-appoint Deloitte & Touche as independent auditors of the Company and to authorise the directors and or Group Audit Committee, a Board Committee of the Company, to determine the remuneration payable to the auditors for the ensuing year.

Explanatory note:

Deloitte & Touche has indicated their willingness to continue as the Company's auditors until the next Annual General Meeting. The remuneration and non-audit fees paid to the auditors are contained on page 38.

As special business and requiring shareholder approval, shareholders are requested to consider and if deemed fit, pass with or without modification the following resolutions numbers 6, 7, 8 and 9.

6 CONTROL OF AUTHORISED BUT UNISSUED SHARES

"RESOLVED as an ordinary resolution that all the unissued shares in the authorised share capital of the Company be and are hereby placed under the control of the directors of the Company, who are authorised to allot and issue the same to such persons and on such terms and conditions as they may determine in their sole and absolute discretion, subject to the provisions of the Companies Act, No.61 of 1973 (as amended), the provisions of the Banks Act, No. 94 of 1990 (as amended) and the Listings Requirements of JSE Limited."

The approval is given in the form of a general authority and accordingly:

- is only valid until the next Annual General Meeting of the Company; and
- may be varied or revoked by any general meeting of the Company prior to such Annual General Meeting.

Notice of Annual General Meeting (continued)

7 GERERAL AUTHORITY TO ISSUE SHARES FOR CASH

"RESOLVED that the directors be given the general authority to issue unissued shares of a class already in issue held under their control, for cash, when the directors consider it appropriate in the circumstances, subject to the provisions of the Companies Act, No. 61 of 1973 (as amended), the provisions of the Banks Act, No. 94 of 1990 (as amended), the Listings Requirements of JSE Limited and to the following limitations, that:

- the authority shall be valid until the next Annual General Meeting of the Company (provided it shall not extend beyond 15 months from the date of this resolution);
- a paid press announcement giving full details, including the impact on net asset value, net tangible asset value, earnings and headline earnings per share, will be published at the time of any issue representing, on a cumulative basis within one financial year, 5% or more of the number of shares in issue prior to such issue;
- issues for cash in any one financial year may not exceed 15% of the Company's issued share capital;
- the issues must be made to public shareholders as defined by the Listings Requirements of JSE Limited; and
- in determining the price at which an issue of shares may be made in terms of this authority, the maximum discount permitted will be 10% of the volume weighted average traded price as determined over the 30 business days prior to the date that the price of the issue is determined or agreed by the directors of the Company."

The approval of a 75% majority of the votes cast by shareholders present or represented by proxy at this meeting is required for this resolution to become effective.

8 AMENDMENTS TO THE TRUST DEED OF THE MERCANTILE SHARE INCENTIVE SCHEME

"RESOLVED as an ordinary resolution that the amendment of the Trust Deed constituting the Mercantile Share Incentive Scheme in the manner set out in the agreement between the trustees and the Company which was tabled at the meeting, and initialled by the Company Secretary for purposes of identification, be and is hereby approved."

Explanatory note:

The reason for and the effect of the resolution is:

1) The Company's shareholders at the Annual General Meeting held on 29 June 1999, approved, in terms of the ordinary resolution number 9, the Mercantile Share Incentive Scheme ("the Scheme"). Pursuant thereto, the directors of Mercantile Bank Holdings Limited and trustees of the Scheme have identified certain interpretation inconsistencies between certain of the clauses contained in the Trust Deed constituting the Scheme and other administrative errors.

2) As a result of these, the Company has proposed amendments to address such;

3) The significant amendments include the following:

   - allowing the trustees to pass resolutions by way of a round robin resolution;
   - allowing for a beneficiary who ceases to be an employee for any reason other than dismissal or death to only be able to exercise options which had already become exercisable;
   - giving directors power to amend the scheme except for where the JSE Limited Listings Requirements specifically requires shareholder approval; and
   - provide parameters for periods options are to be exercised in, in terms of Clause 20.1 of the Trust Deed where shareholders had given discretion to the Board of Directors in this regard.

   Copies of the proposed amendments to the Scheme may be inspected during normal business hours at the Company's registered office, 1st floor, Mercantile Bank 142 West Street, Sandown, Sandton.

Notice of Annual General Meeting (continued)

9 SIGNATURE OF DOCUMENTS

"**RESOLVED** that any one Director or the Company Secretary of the Company be and is hereby authorised to do all such things and sign all documents and take all such action as they consider necessary to implement the resolutions set out in the notice convening this Annual General Meeting at which this ordinary resolution will be considered."

Voting and proxies

A member entitled to attend, speak and vote at this meeting is entitled to appoint a proxy (who need not be a member of the Company) to attend, vote and speak in his/her stead.

Members which are companies or other body corporates, may, in terms of section 188 (1) of the Companies Act, No. 61 of 1973 (as amended), by resolution of their directors or other governing body, authorise any person to act as its representative at the meeting.

Certificated shareholders and own-name dematerialised shareholders, who are unable to attend this meeting but wish to be represented thereat, must complete and return the attached form of proxy in accordance with the instructions contained therein. A form of proxy is attached for this purpose and must be lodged at the Company's transfer secretaries or the Company's registered address by no later than 08:30 on Tuesday 22 May 2007. The detail of these addresses are on page 65.

Dematerialised shareholders, excluding own-name dematerialised shareholders, who wish to attend this meeting, must request their Central Securities Depository Participant ("CSDP") or broker to provide them with a Letter of Representation or must instruct their CSDP or broker to vote by proxy on their behalf in terms of the agreement entered into between the shareholder and their CSDP or broker.

By order of the Board

Ms R van Rensburg
Company Secretary
Sandton
8 March 2007

Registered office

First Floor
Mercantile Bank
142 West Street
Sandown, 2196
(PO Box 782699, Sandton, 2146)

Transfer Secretaries

Computershare Investor Services 2004
(Proprietary) Limited
Ground Floor
70 Marshall Street
Johannesburg 2001
(PO Box 61051, Marshalltown, 2107)

Brief *curriculum vitae*

of each director standing for re-election

J A S de Andrade Campos, age 69, holds a degree in Law from Coimbra University in Portugal. Having started his career as Public Prosecutor, he later held senior positions in various banks and other companies in Europe and Africa, including Chairman of Banque Franco Portugaise in Paris (part of CGD group).

G P de Kock, age 52, attended Executive Programmes at the Universities of Cape Town and Stanford, California. He retired in 2004 as Managing Director of Woolworths Financial Services (Pty) Limited and as an Executive Director of Woolworths Holdings Limited. Before that he was the General Manager of the Credit Card Division of Edgars Stores Limited. He is currently operating as an independent consultant in the retail and financial services industries.

A T Ikalafeng, age 40, holds a BSc degree and MBA degree from Marquette University in the USA, Certificate in Finance from Wits, and a CM(SA). He has held various marketing positions in the USA and SA, including a six-year tenure at NIKE as Marketing Director RSA and Africa. In 2002 he founded the multi-disciplinary branding consultancy called "The Brand Leadership Group" of which he is currently Managing Director. He is non-executive director at Foodcorp (Pty) Limited and a member of the Vega School of Brand Communications Advisory Board.

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Form of proxy

Mercantile Bank Holdings Limited

Member of CGD Group

Reg No: 1989/000164/06

(Incorporated in the Republic of South Africa)

Share code: MTL ISIN: ZAE000064721

("Mercantile" or "the Company")

for use by certificated and own-name dematerialised ordinary shareholders at the Annual General Meeting of the Company to be held at 08:30 on Thursday, 24 May 2007 ("the meeting") in the Boardroom, First Floor, Mercantile Bank, 142 West Street, Sandown, Sandton

I/We (please print names in full)

of (please print address)

being (a) member(s) of the Company, holding ordinary shares in the Company, hereby appoint:

1. or failing him/her,

2. or failing him/her,

3. the Chairman of the meeting,

as my/our proxy to attend, speak and vote on my/our behalf at the Annual General Meeting to be held at the registered office of the Company, in Sandton, on Thursday, 24 May 2007 at 08:30 and at any adjournment thereof, and to vote or abstain from voting on the special and ordinary resolutions to be proposed at the meeting, as follows:

	Resolutions	For	Against	Abstain
1.	Special resolution number 1: Amendments to articles association			
2.	Ordinary resolution number 1: Adoption of annual financial statements			
3.	Ordinary resolution number 2: Non-executive directors' remuneration			
4.	Re-election of directors			
	4.1 Ordinary resolution number 3: J A S de Andrade Campos			
	4.2 Ordinary resolution number 4: G P de Kock			
	4.3 Ordinary resolution number 5: A T Ikalafeng			
5.	Ordinary resolution number 6: Re-appointment of auditors			
6.	Ordinary resolution number 7: Control of authorised but unissued shares			
7.	Ordinary resolution number 8: General authority to issue shares for cash			
8.	Ordinary resolution number 9: Amendments to the Trust Deed of the Mercantile Share Incentive Scheme			
9.	Ordinary resolution number 10: Signature on documents			

Signed this day of 2007

Signature of member(s)

Assisted by me (where applicable)

Please read the notes and instructions on the reverse hereof.

Form of proxy (continued)

Notes

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend, speak and vote in his/her stead. A proxy need not be a member of the Company.

2. Every person present and entitled to vote at the meeting as a member or as a proxy or as a representative of a body corporate shall, on a show of hands, have one vote only, irrespective of the number of shares such person holds or represents, but in the event of a poll, a member shall be entitled to that proportion of the total votes in the Company which the aggregate amount of the nominal value of the shares held by him/her/it bears to the aggregate amount of the nominal value of all the shares issued by the Company.

3. Please insert the relevant number of shares/votes in the appropriate spaces on the face hereof and how you wish your votes to be cast. If you return this form of proxy duly signed without any specific directions, the proxy will vote or abstain from voting at his/her/its discretion.

Instructions on signing and lodging this form of proxy

1. A deletion of any printed matter and the completion of any blank spaces need not be signed or initialled. Any alteration or correction must be initialled by the authorised signatory/ies.

2. The Chairman shall be entitled to decline or accept the authority of a person signing this form of proxy:

   (a) under a power of attorney; or

   (b) on behalf of a company,

   unless that person's power of attorney or authority is deposited at the registered office of the Company not later than 08:30 on Tuesday, 22 May 2007.

3. You may insert the name of any person(s) whom you wish to appoint as your proxy in the blank space(s) provided for that purpose.

4. When there are joint holders of shares, all joint shareholders must sign this form of proxy.

5. The completion and lodging of this form of proxy will not preclude the member who grants this proxy from attending the meeting and speaking and voting in person thereat to the exclusion of any proxy appointed in terms hereof should such member wish to do so.

6. Documentary evidence establishing the authority of a person signing this form of proxy in a representative capacity must be attached to this form of proxy, unless previously recorded by the transfer secretaries of the Company or waived by the Chairman of the meeting. The Chairman of the meeting may reject any form of proxy not completed and/or received in accordance with these notes and/or instructions, or with the Articles of Association of the Company.

7. Completed forms of proxy should be returned to the registered office, First Floor, Mercantile Bank, 142 West Street, Sandown, 2196 (PO Box 782699, Sandton, 2146) or faxed to the Company Secretary (fax number +27 11 883 7765) or posted to PO Box 61051, Marshalltown, 2107 or faxed to the transfer secretaries (fax number +27 11 688 5238) to be received by no later than 08:30 on Tuesday, 22 May 2007.