Mercantile Bank
Member of CGD Group

Mercantile Bank Limited.Reg. No. 1965/006706/06
An Authorised Financial Services and Credit Provider NCRCP19

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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 ended 31 December 2007 of Mercantile Bank Limited ("the Company", "the Bank" or "Mercantile").

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 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 Company'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 Company'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's annual financial statements.

The Company's annual financial statements are prepared in accordance with International Financial Reporting Standards and incorporate responsible disclosures in line with the accounting policies of the Company.
The Company's 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 Company 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 pages 4 to 49, have been approved by the Board and are signed on their behalf by:

J A S de Andrade Campos
Chairman

10 April 2008

D J Brown
Chief Executive Officer

10 April 2008

Certificate from the Company Secretary

In terms of section 268G(d) of the Companies Act, No. 61 of 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 2007 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

10 April 2008

Independent auditor's report

To the member of Mercantile Bank Limited

Report on the financial statements

We have audited the annual financial statements of Mercantile Bank Limited, which comprise the Directors' report, balance sheet at 31 December 2007, the income statement, the statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages 4 to 49.

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 controls 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 controls 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 we have 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 at 31 December 2007, and of its financial performance and its 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 **Riaan Eksteen**
Partner

10 April 2008

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, L Bam Strategy, C R Beukman Finance, T J Brown Clients & Markets, 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.

Empowerdex rating: AA (Level 3 B-BBEE Contributor)

Directors' report for the year ended 31 December 2007

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company for the year ended 31 December 2007.

1. Nature of business

The Company is a registered bank, incorporated in the Republic of South Africa ("South Africa"), and provides its clients with a full range of domestic and international banking services. In addition, it provides a full range of specialised financing, savings and investment facilities to the retail, commercial, corporate and alliance banking niche markets.

2. Holding company

Mercantile Bank Holdings Limited ("MBH"), a company incorporated in South Africa, wholly owns the Company. The ultimate holding company is Caixa Geral de Depósitos S.A. ("CGD"), a company registered in Portugal.

3. Financial results

Details of the financial results are set out on pages 13 to 37 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 during the year (2006: nil). The authorised and issued share capital of the Company is detailed in note 11 to the annual financial statements.

5. Dividends

No dividend was declared during the year under review (2006: nil).

6. Directors, Company Secretary and registered addresses

The Directors of the Company during the year and at the date of this report 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 ^+ (resigned effective 21 November 2007)
S Rapeti ∞

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

Postal:	Physical:
PO Box 782699 Sandton 2146	1st Floor Mercantile Bank 142 West Street Sandown 2196

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

7. Consolidated annual financial statements

Consolidated annual financial statements have not been presented as the Company is wholly owned by MBH, which is a company incorporated in South Africa.

8. Going concern

The Company's annual financial statements have been prepared on the going concern basis.

9. Special resolutions

A special resolution was approved by shareholders at a General Meeting held on 19 September 2007 and registered on 10 October 2007 which related to changes to the articles of association of the Company.

These changes related to:

- alignment of certain provisions to the Banks Act, JSE Limited Listings Requirements and other Corporate Governance practices;
- allowing Directors who reach the age of 70 not to vacate his/her office subject to the Board approving such; and
- alllowing for meetings to be held by teleconference or electronic means.

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 2007

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

1. Basis of presentation

The Company's 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.

In the current year, the Company has adopted IFRS 7 Financial Instruments: Disclosures, which is effective for annual reporting periods beginning on or after 1 January 2007 and has also adopted the consequential amendments to IAS 1 Presentation of Financial Statements.

The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Company's financial instruments and management of capital.

2. Recognition of assets and liabilities

2.1 Assets

The Company 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 Company.

2.2 Liabilities

The Company 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.

2.3 Contingent liabilities

The Company 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 Company, 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.

3. Financial instruments

Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company 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 Company derecognises a financial asset when:

- the contractual rights to the cash flows arising from the financial assets have expired or been forfeited by the Company; 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.

3.1 Derivative financial instruments

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

The Company 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 ("derivatives') 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.

Accounting policies
for the year ended 31 December 2007 (continued)

3. Financial instruments (continued)

3.1 Derivative financial instruments (continued)

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 Company'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.

3.2 Financial assets

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

Financial assets at fair value through profit and loss

Where the Company acquires loans and receivables with fixed interest rates, corporate bonds and derivatives that are not effective hedging instruments, these financial assets are classified at fair value through profit and loss. Financial assets are designated at fair value through profit and loss, primarily to eliminate or significantly reduce the accounting mismatch. The Company seeks to demonstrate that by applying the fair value option, it significantly reduces measurement inconsistency that would otherwise arise from measuring derivatives at fair value with gains and losses in profit and loss, and the loans and receivables and corporate bonds at amortised cost.

Available-for-sale

Available-for-sale financial assets are those non-derivatives that are designated as available-for-sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held by the Company 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.

Other investments

Investments consist of unlisted equity investments. 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.

Negotiable securities

Negotiable securities consist of government stock, Treasury bills, Landbank bills, corporate bonds and debentures.

Government stock has 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.

Corporate bonds are designated at fair value through profit and loss.

All other negotiable securities are classified as loans and receivables and are carried at amortised cost subject to impairment.

Accounting policies
for the year ended 31 December 2007 (continued)

3. Financial instruments (continued)

3.2 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 at 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, pre-payments and deposits and other receivables. These assets have been designated as loans and receivables and are measured at amortised cost.

3.3 Financial liabilities

The Company'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.

3.4 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 Company, 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 Company 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.

3.5 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.

3.6 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. A direct reduction of an impaired financial asset occurs when the Company writes off an impaired account. The Company's write-off policy sets out the criteria for write-offs, which involves an assessment of the likelihood of commercially viable recovery of the carrying amount of impaired financial asset. Both the specific and portfolio impairments raised during the year less the recoveries of advances previously written off, are charged to income.

Interest for non-performing loans and advances is not recognised to income but is suspended. In certain instances, interest is also suspended where portfolio impairments are raised.

Accounting policies
for the year ended 31 December 2007 (continued)

3. Financial instruments (continued)

3.6 Impairments (continued)

The Company 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 Company 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.

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.

4. 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.

5. 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 determined as the net asset value. All gains and losses on the sale of subsidiaries are recognised in income.

6. Associated companies

Associated companies are those companies in which the Company exercises significant influence, but not control or joint control, over their financial and operating policies and holds between 20% and 50% interest therein. These investments are designated as available-for-sale assets and are recognised at fair value. 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.

7. Property and equipment

7.1 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.

Accounting policies
for the year ended 31 December 2007 (continued)

7. Property and equipment (continued)

7.2 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 Company 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:

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

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

8. 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. However, costs that are directly associated with an identifiable and unique system controlled by the Company, 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.

9. Provisions

Provisions are recognised when the Company 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.

10. 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 unutilised tax losses are available for use against taxable profits in the foreseeable future.

Accounting policies
for the year ended 31 December 2007 (continued)

11. Sale and repurchase agreements and lending of securities

Securities sold subject to linked repurchase agreements ("repos") are reflected in the annual financial statements as investments with the proceeds recognised in cash and cash equivalents and the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits, or deposits due to customers, as appropriate. 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 purchased under agreements to resell ("reverse repos") are recorded as cash and cash equivalents. 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.

12. Instalment sales and leases

12.1 The Company as the lessee

The leases entered into by the Company 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.

12.2 The Company 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.

13. 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 Company 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.

14. 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.

15. Retirement funds

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

16. Post-retirement medical benefits

The Company provides for post-retirement medical benefits to certain retired employees. These benefits are only applicable to employees who were members of the Company'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 Company 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 annually.

Accounting policies
for the year ended 31 December 2007 (continued)

16. Post-retirement medical benefits (continued)

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 Company's contributions to the post-retirement healthcare policy are charged to income in the year to which they relate.

17. Equity compensation plans

Share options in MBH are granted to employees of the Company at the discretion of the Remuneration Committee and approved by the Board of MBH. The Company 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 Company'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.

18. 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.

19. Critical accounting estimates and judgements

The Company 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.

19.1 Impairment losses on loans and advances

The Company reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in income, the Company 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 the Company, or national or local economic conditions that correlate with defaults on assets in the Company. 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.

19.2 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.

19.3 Impairment of available-for-sale equity investments

The Company 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 Company 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, operational and financing cash flows.

Accounting policies
for the year ended 31 December 2007 (continued)

19. Critical accounting estimates and judgements (continued)

19.4 Income taxes

There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Company recognises liabilities for anticipated tax audit 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.

20. Recent accounting developments

There are standards and interpretations in issue that are not yet effective. These include the following standards and interpretations that could be applicable to the business of the Company 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 8 (Operating segments) was issued during November 2006 but is only effective for annual periods beginning on or after 1 January 2009. The Company will apply IFRS 8 from the year ending 31 December 2009.

IFRIC 11 (IFRS 2: Group and treasury share transactions) was issued during November 2006 but is only effective for annual periods beginning on or after 1 March 2007. The Company will apply IFRIC 11 from the year ending 31 December 2008.

IFRIC 12 (Service concession arrangements) was issued during November 2006 but is only effective for annual periods beginning on or after 1 January 2008. The Company will apply IFRIC 12 from the year ending 31 December 2008.

IFRIC 13 (Customer loyalty programmes) was issued during June 2007 but is only effective for annual periods beginning on or after 1 July 2008. The Company will apply IFRIC 13 from the year ending 31 December 2009.

IFRIC 14 (IAS 19: The limit on a defined benefit asset, minimum funding requirements and their interaction) was issued during July 2007 but is only effective for annual periods beginning on or after 1 January 2008. The Group will apply IFRIC 14 from the year ending 31 December 2008.

Balance sheet
at 31 December 2007

	Note	2007 R'000	2006 R'000
ASSETS			
Intangible assets	2	**23 568**	11 549
Property and equipment	3	**16 655**	21 531
Other accounts receivable	4	**33 593**	161 901
Interest in subsidiaries	5	**80 116**	73 181
Other investments	6	**8 917**	10 813
Loans and advances	7	**2 814 743**	2 066 432
Derivative financial instruments	8	**43 814**	31 134
Negotiable securities	9	**275 577**	405 016
Cash and cash equivalents	10	**1 422 994**	1 683 974
Total assets		**4 719 977**	4 465 531
EQUITY AND LIABILITIES			
Shareholders' equity		**853 379**	682 772
Share capital and share premium	11	**1 483 300**	1 483 300
General reserve		**12 231**	12 231
Property revaluation reserve		**69**	69
Available-for-sale reserve		**35 531**	29 869
General credit-risk reserve		**19 403**	13 954
Accumulated loss		**(697 155)**	(856 651)
Liabilities		**3 866 598**	3 782 759
Deposits	12	**3 770 800**	3 542 031
Derivative financial instruments	8	**15 356**	29 189
Provisions	13	**42 407**	38 964
Other accounts payable	15	**38 035**	172 575
Total equity and liabilities		**4 719 977**	4 465 531

Income statement
for the year ended 31 December 2007

	Note	2007 R'000	2006 R'000
Interest income	18	**473 870**	361 270
Interest expenditure	19	**(250 092)**	(189 143)
Net interest income		**223 778**	172 127
Net (charge for)/recovery of credit losses	7	**(5 358)**	1 425
Net interest income after credit losses/recoveries		**218 420**	173 552
Net gains/(loss) on disposal and revaluation of available-for-sale investments		**5 594**	(1 513)
Non-interest income	20	**190 904**	146 084
Recurring		**175 829**	146 084
Non-recurring		**15 075**	–
Net interest and non-interest income		**414 918**	318 123
Operating expenditure	21	**(249 973)**	(228 624)
Profit before taxation and exceptional item		**164 945**	89 499
Recovery of amounts previously written off in respect of the release of the CGD guarantee	7	**–**	8 602
Profit before taxation		**164 945**	98 101
Taxation	22	**–**	–
Profit after taxation		**164 945**	98 101

Statement of changes in equity for the year ended 31 December 2007

	Share capital R'000	Share premium R'000	General reserve R'000	Property revaluation reserve R'000	Available for-sale reserve R'000	General credit-risk reserve R'000	Accumulated loss R'000	Total R'000
Shareholder's equity at 31 December 2005	124 969	1 358 331	12 231	69	11 786	10 835	(951 633)	566 588
Net movement for the year	–	–	–	–	18 083	3 119	94 982	116 184
Gains and losses on remeasurement to fair value	–	–	–	–	15 055	–	–	15 055
Release to income on disposal of available-for-sale financial assets	–	–	–	–	3 028	–	–	3 028
Increase in general credit-risk reserve	–	–	–	–	–	3 119	(3 119)	–
Profit after taxation	–	–	–	–	–	–	98 101	98 101
Shareholder's equity at 31 December 2006	**124 969**	**1 358 331**	**12 231**	**69**	**29 869**	**13 954**	**(856 651)**	**682 772**
Net movement for the year	–	–	–	–	**5 662**	**5 449**	**159 496**	**170 607**
Gains and losses on remeasurement to fair value	–	–	–	–	**11 262**	–	–	**11 262**
Release to income on disposal of available-for-sale financial assets	–	–	–	–	**(5 600)**	–	–	**(5 600)**
Increase in general credit-risk reserve	–	–	–	–	–	**5 449**	**(5 449)**	–
Profit after taxation	–	–	–	–	–	–	**164 945**	**164 945**
Shareholder's equity at 31 December 2007	**124 969**	**1 358 331**	**12 231**	**69**	**35 531**	**19 403**	**(697 155)**	**853 379**

Cash flow statement
for the year ended 31 December 2007

	Note	2007 R'000	2006 R'000
Operating activities			
Cash receipts from customers	23.1	631 290	519 983
Cash paid to suppliers and employees	23.2	(479 973)	(395 367)
Dividends received		2 167	973
Taxation paid	23.3	–	–
Net (increase) in income earning assets	23.4	(619 426)	(641 037)
Net increase in deposits and other accounts	23.5	218 496	799 776
Net cash (outflow)/inflow from operating activities		(247 446)	284 328
Investing activities			
Purchase of property, equipment and intangible assets		(19 859)	(13 213)
Proceeds on sale of property, equipment and intangible assets		108	39
Proceeds on disposal of other investments		5 594	–
Decrease in interest in subsidiaries and other investments		623	3 848
Net cash (outflow) from investing activities		(13 534)	(9 326)
Net cash (outflow)/inflow for year		(260 980)	275 002
Cash and cash equivalents at beginning of year		1 683 974	1 408 972
Cash and cash equivalents at end of year	10	1 422 994	1 683 974

Notes to the annual financial statements for the year ended 31 December 2007

1. Categories and fair values of financial instruments

	2007		2006	
	Fair value R'000	Carrying amount R'000	Fair value R'000	Carrying amount R'000
Assets				
Available-for-sale	95 607	95 607	83 994	83 994
Other investments	8 917	8 917	10 813	10 813
Interest in subsidiaries	80 116	80 116	73 181	73 181
Negotiable securities – Government stock	6 574	6 574	–	–
Loans and receivables	4 357 858	4 358 185	3 983 670	3 983 998
Current accounts	730 740	730 740	408 134	408 134
Credit card	15 184	15 184	16 286	16 286
Mortgage loans	1 196 363	1 196 363	694 983	694 983
Instalment sales and leases	276 746	276 746	268 159	268 159
Other advances	444 362	444 362	530 050	530 050
Negotiable securities – Treasury and Landbank bills	203 880	204 010	194 183	194 406
Negotiable securities – Debentures	33 996	34 193	26 000	26 105
Cash and cash equivalents	1 422 994	1 422 994	1 683 974	1 683 974
Other accounts receivable	33 593	33 593	161 901	161 901
Loans and receivables designated at fair value through profit and loss	182 148	182 148	333 325	333 325
Mortgage loans	40 902	40 902	12 074	12 074
Instalment sales and leases	26 971	26 971	25 116	25 116
Other advances	83 475	83 475	111 630	111 630
Corporate bonds	30 800	30 800	184 505	184 505
Held-for-trading	43 814	43 814	31 134	31 134
Derivative financial instruments	43 814	43 814	31 134	31 134
	4 679 427	4 679 754	4 432 123	4 432 451
Liabilities				
Held-for-trading	15 356	15 356	29 189	29 189
Derivative financial instruments	15 356	15 356	29 189	29 189
Other financial liabilities	3 808 835	3 808 835	3 714 606	3 714 606
Deposits	3 770 800	3 770 800	3 542 031	3 542 031
Other accounts payable	38 035	38 035	172 575	172 575
	3 824 191	3 824 191	3 743 795	3 743 795

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

1. Categories and fair values of financial instruments (continued)

Cash and cash equivalents have short times to maturity. For this reason, the carrying amounts at the reporting date approximate the fair values.

Treasury and Landbank bills and debentures have short times to maturity and are carried at amortised cost. Fair value is based on quoted market values at balance sheet date.

Loans and advances that are carried at amortised cost, the values reported approximate the fair value as they bear variable rates of interest. In addition, fair value is approximated through the credit impairment models.

Deposits generally have short times to maturity, thus the values reported approximate the fair value.

The fair value of public traded derivatives, securities and investments is based on quoted market values at balance sheet date.

The fair value of other financial assets and financial liabilities, excluding derivatives, is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and adjusted by relevant market pricing.

The fair value of other investments and interest in subsidiaries which are unlisted, is determined by reference to the net asset value of the entity.

The fair value of loans and advances fair valued through profit and loss is calculated using the credit spread observed at origination. The fair values are adjusted for deterioration of credit quality through the application of the credit impairment models.

	2007 R'000	2006 R'000
Loans and receivables designated at fair value through profit and loss		
Cumulative changes in fair value attributable to credit risk	–	–
Changes in fair value attributable to changes in credit risk recognised during year	–	–

At reporting date there are no significant concentrations of credit risk. The carrying amount reflected above represents the Company's maximum exposure to credit risk for such loans and receivables.

To confirm the amount of the fair value attributable to change in credit risk, a review of those loans or receivables designated at fair value through profit and loss was conducted. The Company has no credit derivatives over loans and receivables designated at fair value through profit and loss.

2. Intangible assets

	2007 R'000	2006 R'000
Computer software		
Cost at beginning of year	51 671	44 066
Additions	15 850	7 647
Transfer from property and equipment	424	–
Write-off of obsolete stock	(6 654)	(42)
Cost at end of year	61 291	51 671
Accumulated amortisation and impairment losses at beginning of year	(40 122)	(37 048)
Amortisation	(3 715)	(3 107)
Transfer from property and equipment	(424)	–
Write-off of obsolete stock	6 538	33
Accumulated amortisation and impairment losses at end of year	(37 723)	(40 122)
Net carrying amount at end of year	23 568	11 549

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

3. Property and equipment

	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
2007							
Open market value/cost at beginning of year	164	18 129	68 468	8 368	21 124	339	116 592
Additions	–	213	2 918	14	752	112	4 009
Transfer *	–	(17)	(893)	117	369	–	(424)
Disposals	–	–	–	–	(60)	(36)	(96)
Open market value/cost at end of year	164	18 325	70 493	8 499	22 185	415	120 081
Accumulated depreciation and impairment losses at beginning of year	–	(12 825)	(60 125)	(7 129)	(14 695)	(287)	(95 061)
Depreciation	–	(1 092)	(5 617)	(479)	(1 627)	(65)	(8 880)
Transfer *	–	9	934	(115)	(404)	–	424
Disposals	–	–	–	–	55	36	91
Accumulated depreciation and impairment losses at end of year	–	(13 908)	(64 808)	(7 723)	(16 671)	(316)	(103 426)
Net carrying amount at end of year	164	4 417	5 685	776	5 514	99	16 655

* Transfer between various categories of property and equipment and intangible assets.

	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
2006							
Open market value/cost at beginning of year	164	17 166	67 062	8 404	18 975	422	112 193
Additions	–	963	2 049	49	2 505	–	5 566
Disposals	–	–	(643)	(85)	(356)	(83)	(1 167)
Open market value/cost at end of year	164	18 129	68 468	8 368	21 124	339	116 592
Accumulated depreciation and impairment losses at beginning of year	–	(11 550)	(54 901)	(6 582)	(13 066)	(330)	(86 429)
Depreciation	–	(1 275)	(5 858)	(627)	(1 967)	(40)	(9 767)
Disposals	–	–	634	80	338	83	1 135
Accumulated depreciation and impairment losses at end of year	–	(12 825)	(60 125)	(7 129)	(14 695)	(287)	(95 061)
Net carrying amount at end of year	164	5 304	8 343	1 239	6 429	52	21 531

Note:

The owner-occupied property comprises stand 624 Malvern, Johannesburg, with a building thereon. The property is valued at the offer to purchase amount received.

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

		2007 R'000	2006 R'000
4.	**Other accounts receivable**		
	Items in transit	3 913	7 743
	Loans to fellow subsidiaries and holding company (refer to note 24.2)	9 987	13 532
	Loan to the Mercantile Share Incentive Trust	–	3 097
	Prepayments and deposits	4 917	4 140
	Other receivables	14 776	133 389
		33 593	161 901
5.	**Interest in subsidiaries**		
	Unlisted		
	Shares at fair value	32 220	24 458
	Loans (refer to note 24.2)	47 896	48 723
		80 116	73 181

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

The loans bear interest at the prevailing prime rate and have no fixed terms of maturity.

		2007 R'000	2006 R'000
6.	**Other investments**		
	Available-for-sale		
	Unlisted – associated company *	4 251	3 626
	– other	209	7 187
	Listed – Mercantile Bank Holdings Limited (held by the Bank as an agent of the Mercantile Share Incentive Trust)	4 457	–
		8 917	10 813
	Directors' valuation of unlisted investments	4 460	10 813

* The percentage shareholding of the Company in this company is 21.4%. The financial year-end is February.

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

		2007 R'000	2006 R'000
7.	**Loans and advances**		
	Category analysis:		
	Amortised cost	2 755 878	2 016 058
	Current accounts	780 463	448 290
	Credit card	21 555	29 002
	Mortgage loans	1 200 419	699 122
	Instalment sales and leases	277 562	273 663
	Other advances	475 879	565 981
	Fair value through profit and loss	154 528	151 925
	Mortgage loans	40 980	12 099
	Instalment sales and leases	27 026	25 621
	Other advances	86 522	114 205
		2 910 406	2 167 983 *
	Less: Impairments for credit losses	(57 187)	(64 394) *
	Interest in suspense	(38 476)	(37 157) *
		2 814 743	2 066 432

* 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 2007 (continued)

7. Loans and advances (continued)

R35.5 million of loans and advances that were reported as instalment sales and leases at 31 December 2006, are reported as other advances in 2007.

Certain loans and advances disclosed under the amortised category in the 2006 annual financial statements, have been disclosed under the fair value through profit and loss category for 2006 and 2007.

All loans and advances are denominated in South African Rand.

	2007 R'000	2006 R'000
Maturity analysis		
Repayable on demand	900 360	701 009
Maturing within six months	136 671	105 259
Maturing after six months but within 12 months	158 547	119 327
Maturing after 12 months	1 714 828	1 242 388
	2 910 406	2 167 983

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

	Gross amount R'000	Interest in suspense R'000	Total impairments R'000	Net balance R'000
Detailed category analysis of loans and advances				
2007				
Current accounts	780 463	20 128	29 595	730 740
Credit card	21 555	1 568	4 803	15 184
Mortgage loans	1 241 399	1 768	2 366	1 237 265
Instalment sales and leases	304 588	256	615	303 717
Other advances	562 401	14 756	19 808	527 837
	2 910 406	38 476	57 187	2 814 743
2006				
Current accounts	448 290	7 089	33 067	408 134
Credit card	29 002	4 075	8 641	16 286
Mortgage loans	711 221	2 717	1 447	707 057
Instalment sales and leases	299 284	105	5 904	293 275
Other advances	680 186	23 171	15 335	641 680
	2 167 983	37 157	64 394	2 066 432

	Total R'000	Current accounts R'000	Credit card R'000	Mortgage loans R'000	Instalment sales and leases R'000	Other advances R'000
Impairments for credit losses						
2007						
Balance at beginning of year	64 394	33 067	8 641	1 447	5 904	15 335
Movements for year:						
Credit losses written-off	(17 556)	(240)	(3 483)	(683)	(5 646)	(7 504)
Net impairments raised	10 349	(3 232)	(355)	1 602	357	11 977
	57 187	29 595	4 803	2 366	615	19 808

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

7. Loans and advances (continued)

	Total R'000	Current accounts R'000	Credit card R'000	Mortgage loans R'000	Instalment sales and leases R'000	Other advances R'000
Impairments for credit losses (continued)						
2006						
Balance at beginning of year	268 665	3 517	67 616	12 725	51 327	133 480
Movements for year:						
Credit losses written-off	(4 995)	–	(3 836)	–	–	(1 159)
Impairments utilised in writing off sold legacy loans and advances *	(214 578)	–	(59 302)	(9 335)	(45 066)	(100 875)
Net impairments raised	15 302	29 550	4 163	(1 943)	(357)	(16 111)
	64 394	33 067	8 641	1 447	5 904	15 335

* 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.

	2007 R'000	2006 R'000
Impairments for credit losses consist of:		
Portfolio impairments	**32 663**	31 682
Specific impairments	**24 524**	32 712
Balance at end of year	**57 187**	64 394
Net (charge for)/recovery of credit losses		
Net impairments movement	**(7 207)**	(15 397)
Recoveries in respect of sold legacy loans and advances	**–**	7 345
Recoveries in respect of amounts previously written off	**1 849**	9 477
	(5 358)	1 425
Exceptional item as per income statement		
Recovery of amounts previously written off in respect of the release of the CGD guarantee	**–**	8 602

	Gross amount R'000	Interest in suspense R'000	Portfolio impairment R'000	Net balance R'000
Category analysis of performing loans and advances				
2007				
Current accounts	**779 056**	**19 918**	**29 170**	**729 968**
Credit card	**15 317**	**–**	**826**	**14 491**
Mortgage loans	**1 220 604**	**–**	**554**	**1 220 050**
Instalment sales and leases	**301 319**	**–**	**332**	**300 987**
Other advances	**521 718**	**–**	**1 781**	**519 937**
	2 838 014	**19 918**	**32 663**	**2 785 433**
2006				
Current accounts	439 131	7 089	27 108	404 934
Credit cards	18 339	–	2 195	16 144
Mortgage loans	704 247	–	313	703 934
Instalment sales and leases	292 442	–	266	292 176
Other advances	637 347	–	1 800	635 547
	2 091 506	7 089	31 682	2 052 735

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
7. Loans and advances (continued)		
Category analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	779 056	439 131
Credit card	15 317	18 339
Mortgage loans	1 220 604	704 247
Instalment sales and leases	301 319	292 442
Other advances	520 963	636 457
	2 837 259	2 090 616
Category analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	–	–
Credit card	–	–
Mortgage loans	–	–
Instalment sales and leases	–	–
Other advances	755	890
	755	890

	Past due for: 0 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other enhancements R'000
Category age analysis of loans that are past due but not impaired					
2007					
Current accounts	–	–	–	–	–
Credit card	119	201	215	535	–
Mortgage loans	2 413	6 689	–	9 102	7 203
Instalment sales and leases	191	283	–	474	474
Other advances	1 284	245	–	1 529	1 279
	4 007	7 418	215	11 640	8 956
2006					
Current accounts	–	–	–	–	–
Credit cards	903	291	280	1 474	–
Mortgage loans	9 850	3 230	–	13 080	12 762
Instalment sales and leases	195	–	–	195	195
Other advances	1 860	–	–	1 860	1 810
	12 808	3 521	280	16 609	14 767

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

7. Loans and advances (continued)

	Gross amount R'000	Interest in suspense R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other enhancements R'000
Category analysis of loans and advances that are individually impaired					
2007					
Current accounts	**1 407**	**210**	**425**	**772**	**219**
Credit card	**6 238**	**1 568**	**3 977**	**693**	**–**
Mortgage loans	**20 795**	**1 768**	**1 812**	**17 215**	**18 338**
Instalment sales and leases	**3 269**	**256**	**283**	**2 730**	**2 705**
Other advances	**40 683**	**14 756**	**18 027**	**7 900**	**9 016**
	72 392	**18 558**	**24 524**	**29 310**	**30 278**
2006					
Current accounts	9 159	–	5 959	3 200	265
Credit cards	10 663	4 075	6 446	142	–
Mortgage loans	6 974	2 717	1 134	3 123	4 124
Instalment sales and leases	6 842	105	5 638	1 099	755
Other advances	42 839	23 171	13 535	6 133	9 891
	76 477	30 068	32 712	13 697	15 035

Collateral held as security and other credit enhancements

All customers of the Bank are accorded a client risk grading. The risk grading of a client reflects, in broad terms, the client's creditworthiness and standing with the Bank. Specific criteria are applicable to the different risk grades. The risk grading of clients calls for judgement and continuing critical appraisal of the client's financial standing and forms an integral part of the Bank's assessment of the client concerned. Changes in the risk grades are automated based on arrears on an instalment debt account.

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 60% of debtors repayable under 90 days and depending on debtor credit quality
Pledge of shares	percentage dependent on liquidity and credit quality of the shares pledged
Limited pledge and cession	variable depending on asset type and value
Cession of life and endowment policies	100% of surrender value
Pledge of call and savings accounts, fixed and notice deposits	90% – 100%
Vacant land	50% of professional valuation
Residential properties	80% of the professional valuation
Commercial and industrial properties	70% of professional valuation
Catering, industrial and office equipment	variable depending on asset type and depreciated value
Trucks	variable depending on asset type and depreciated value
Earthmoving equipment	variable depending on asset type and depreciated value
Motor vehicles	variable depending on asset type and depreciated value

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

7. Loans and advances (continued)

Collateral held as security and other credit enhancements (continued)

All collateral held by the Bank in respect of an advance, will be realised in accordance with the terms of the agreement or facility conditions applicable thereto. Cash collateral and pledged assets that can be allocated in accordance with the terms of the pledge and cession or suretyship are applied in reduction of related exposures. Pledged assets, other than cash or cash equivalent collateral, and tangible security articles are appropriated and disposed of, where necessary, after legal action, in compliance with the applicable Court rules and directives.

A customer in default will be advised of the default and afforded an opportunity to regularise the arrears. Failing normalisation of the account legal action and repossession procedures will be followed and all attached assets disposed of in accordance with the applicable legislation. In the case of insolvent and deceased estates, the duly appointed Liquidator/Trustee disposes of all assets.

8. Derivative financial instruments

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
2007				
Held-for-trading				
Foreign exchange contracts	**924 445**	**39 566**	**486 032**	**7 481**
Interest rate swaps	**103 251**	**4 248**	**80 907**	**7 875**
	1 027 696	**43 814**	**566 939**	**15 356**
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

9. Negotiable securities

	2007 R'000	2006 R'000
Loans and receivables		
Treasury bills	**204 010**	184 539
Landbank bills	**–**	9 867
Debentures	**34 193**	26 105
Available-for-sale		
Government stock	**6 574**	–
Held at fair value through profit and loss		
Corporate bonds	**30 800**	184 505
	275 577	405 016
Maturity analysis		
Repayable within one month	**102 752**	56 061
Maturing within six months	**145 769**	164 450
Maturing after six months but within 12 months	**20 482**	152 607
Maturing after 12 months but within five years	**–**	31 898
Maturing after five years	**6 574**	–
	275 577	405 016

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

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
10. Cash and cash equivalents		
Cash and bank notes	**35 910**	28 350
Central Bank balances	**60 889**	49 325
Domestic bank balances	**315 080**	88 011
Foreign bank balances	**1 011 115**	1 518 288
	1 422 994	1 683 974

11. Share capital and share premium

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
Opening and closing balance	**62 484 352**	**124 969**	**1 358 331**	**1 483 300**

Notes:

1. The total authorised number of ordinary shares is 62 630 000 shares (2006: 62 630 000 shares) with a par value of R2.00 per share.
2. No shares were issued during the financial years ended 31 December 2006 and 31 December 2007.
3. The unissued shares are under the control of the shareholders until the next Annual General Meeting.

	2007 R'000	2006 R'000
12. Deposits		
Call deposits and current accounts	**1 389 568**	1 483 034
Savings accounts	**174 714**	158 521
Term and notice deposits	**2 066 671**	1 817 336
Negotiable certificates of deposit	**39 695**	25 151
Foreign bank deposits and loans	**100 152**	57 989
	3 770 800	3 542 031
Maturity analysis		
Repayable on demand and within one month	**2 072 342**	2 106 799
Maturing after one month but within six months	**1 267 181**	1 205 089
Maturing after six months but within 12 months	**284 187**	216 378
Maturing after 12 months	**147 090**	13 765
	3 770 800	3 542 031

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

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

13. 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
At 31 December 2005	9 000	3 244	10 414	7 911	428	621	31 618
Additional provision raised	9 553	2 100	2 439	2 522	–	5 000	21 614
Charged to provision	(8 171)	(3 244)	–	(2 134)	–	–	(13 549)
Unutilised provision reversed	–	–	–	–	(428)	(291)	(719)
At 31 December 2006	**10 382**	**2 100**	**12 853**	**8 299**	**–**	**5 330**	**38 964**
Additional provision raised	**14 976**	**4 880**	**1 490**	**3 075**	**–**	**2 100**	**26 521**
Charged to provision	**(12 356)**	**(3 790)**	**–**	**(2 738)**	**–**	**(4 194)**	**(23 078)**
At 31 December 2007	**13 002**	**3 190**	**14 343**	**8 636**	**–**	**3 236**	**42 407**

Post-retirement medical benefits

Refer to note 14 for detailed disclosure of this provision.

Leave pay

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

Other risks

Consists of provisions for legal claims and other risks. At any time there are legal or potential claims made against the Company of which the outcome is unknown. 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.

14. Post-retirement medical benefits

The Company operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Company'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 2007. The actuary's opinion is that the plan is in a sound financial position.

	2007 R'000	2006 R'000	2005 R'000
The amounts recognised in the balance sheet are as follows (refer to note 13):			
Present value of total service liabilities	**20 223**	18 989	16 651
Fair value of plan assets	**(5 880)**	(6 136)	(6 237)
Provident fund	**(838)**	(1 457)	(1 624)
Endowment bond	**(3 446)**	(3 729)	(4 104)
Annuities	**(1 596)**	(950)	(509)
Liability in the balance sheet	**14 343**	12 853	10 414
The amounts recognised in the income statement are as follows (refer to note 21):			
Current service cost	**116**	115	414
Interest costs	**1 539**	1 365	1 659
Expected return on plan assets	**(549)**	(396)	(575)
Actuarial loss	**936**	1 957	1 736
Employer benefit payments	**(1 202)**	(1 168)	(1 085)
Payments from plan assets	**650**	846	540
Effect on curtailment	**–**	(280)	(455)
Total included in staff costs	**1 490**	2 439	2 234

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000	2005 R'000
14. Post-retirement medical benefits (continued)			
Reconciliation of the movement in the present value of total service liabilities:			
At beginning of year	**18 989**	16 651	22 277
Current service cost	**116**	115	414
Interest costs	**1 539**	1 365	1 659
Actuarial loss	**781**	2 306	1 610
Employer benefit payments	**(1 202)**	(1 168)	(1 085)
Net effect of settlements	**–**	–	(7 769)
Effect of curtailment	**–**	(280)	(455)
At end of year	**20 223**	18 989	16 651
Reconciliation of the movement in the fair value of plan assets:			
At beginning of year	**6 136**	6 237	6 328
Expected return on plan assets	**549**	396	575
Actuarial (loss)/gain	**(155)**	349	(126)
Payments from plan assets	**(650)**	(846)	(540)
At end of year	**5 880**	6 136	6 237

The principal actuarial assumptions used were as follows:

Discount rate	8.00% (2006: 8.25%) compounded annually
Investment return	9.00% (2006: 9.25%) compounded annually
Rate of medical inflation	7.25% (2006: 7.25%) compounded annually
Salary inflation	6.75% (2006: 6.75%) compounded annually

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in an amount of R2.0 million and a decrease of R1.7 million, respectively.

	2007 R'000	2006 R'000
15. Other accounts payable		
Accruals	**12 244**	6 949
Loans from fellow subsidiary (refer to note 24.2)	**31**	189
Repurchase agreements	**–**	126 343
Product-related credits	**12 340**	26 081
Sundry creditors	**13 420**	13 013
	38 035	172 575
16. Contingent liabilities and commitments		
16.1 Guarantees and letters of credit and committed undrawn facilities		
Guarantees	**391 335**	269 402
Lending related	**16 760**	16 201
Mortgage	**105 724**	66 618
Performance	**268 851**	186 583
Letters of credit	**19 937**	11 662
Committed undrawn facilities	**223 589**	269 478
	634 861	550 542

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
16. Contingent liabilities and commitments (continued)		
16.2 Commitments under operating leases		
The total minimum future lease payments under operating leases are as follows:		
Property rentals:		
Due within one year	3 304	4 042
Due between one and five years	4 289	6 191
	7 593	10 233
Motor vehicle rentals:		
Due within one year	–	55
Due between one and five years	–	–
	–	55

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.

17. Deferred taxation

A deferred tax asset has not been recognised for the deductible temporary differences and unutilised estimated tax losses of R730.7 million (2006: R939.6 million) due to the uncertain timing of the reversal of these losses and probability of future taxable profits.

	2007 R'000	2006 R'000
18. Interest income		
Interest on:		
Loans to subsidiaries	6 627	5 834
Loans and receivables	435 237	318 811
Cash and cash equivalents	142 501	126 688
Negotiable securities	18 776	14 827
Loans and advances	273 960	177 296
Loans and receivables at fair value through profit and loss	30 549	34 487
Mortgage loans	4 187	208
Instalment sales and leases	3 246	1 799
Other advances	13 410	16 168
Corporate bonds	9 706	16 312
Held-for-trading		
Interest rate swaps	1 457	2 138
	473 870	361 270
19. Interest expenditure		
Interest on:		
Deposits	244 093	169 902
Repurchase agreements	2 095	8 933
Held-for-trading		
Interest rate swaps	3 904	10 308
	250 092	189 143

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
20. Non-interest income		
Fee and commission income	136 860	106 079
Loans and receivables at fair value through profit and loss	161	115
Loans and receivables	136 699	105 964
Trading income	51 861	38 736
Held-for-trading	57 609	44 902
Foreign currency	42 516	29 141
Foreign currency commissions	8 540	6 658
Derivative assets	(583)	(732)
Derivative liabilities	7 136	9 835
Loans and receivables at fair value through profit and loss	(6 653)	(6 479)
Loans and advances	(7 482)	(10 398)
Corporate bonds	829	3 919
Loans and receivables		
Profit on settlement	905	313
Investment income	2 183	1 269
Dividends	2 167	973
Rental income	16	296
	190 904	146 084

	2007 R'000	2006 R'000
21. Operating expenditure		
Auditors' remuneration		
Audit fees – current year	5 825	5 250
– prior year	273	121
Fees for other services – taxation	427	597
– IFRS consulting	80	100
	6 605	6 068
Professional fees		
Collections	297	1 155
Consulting	18 692	14 372
Legal	853	911
Computer consulting and services	21 407	18 241
	41 249	34 679
Depreciation and amortisation (refer to notes 2 and 3)	12 595	12 874
Directors' emoluments (refer to note 24.3)		
Executive directors	7 737	8 499
Non-executive directors' fees	3 071	3 044
Share-based payments	1 458	849
	12 266	12 392

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
21. Operating expenditure (continued)		
Lease charges		
Motor vehicles	9	36
Equipment	104	38
	113	74
Staff costs		
Salaries, wages and allowances	88 629	89 947
Post-retirement medical benefits (refer to note 14)	1 490	2 439
Contributions to retirement funds	6 453	5 776
Share-based payments excluding directors	2 583	1 329
Other	5 748	4 879
	104 903	104 370
Impairment and loss on sale of property and equipment	13	2
Operating leases – premises	14 785	14 068
Marketing and communication	7 412	5 616
Indirect taxation		
Non-claimable Value-Added Tax	5 052	7 291
Skills development levy	929	277
Regional Services Council levies	–	554
	5 981	8 122
Other operating costs	44 051	30 359
Total operating expenditure	249 973	228 624
Number of persons employed by the Company at year-end	419	413

	2007 R'000	2006 R'000
22. Taxation		
Direct taxation		
South African normal taxation	–	–
South African tax rate reconciliation:		
South African standard tax rate (%)	29.0	29.0
Exempt income (%)	(0.4)	(0.5)
Expenses not deductible for tax purposes (%)	0.7	0.0
Deferred taxation not raised (%)	4.5	(8.3)
Tax losses (%)	(33.8)	(20.2)
Effective tax rate (%)	0.0	0.0
Estimated tax losses available for set-off against future taxable income	730 727	939 601

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

	2007 R'000	2006 R'000
23. Cash flow notes		
23.1 Cash receipts from customers		
Interest income	473 870	361 270
Non-interest income and net gain or loss on disposal and revaluation of available-for-sale investments	196 498	144 571
Adjusted for: Dividends received	(2 167)	(973)
Net (gain)/loss on disposal and revaluation of available-for-sale investments	(5 594)	1 513
Revaluation of held-for-trading financial instruments	(33 166)	(11 822)
Recoveries in respect of amounts previously written off	1 849	25 424
Total cash receipts from customers	631 290	519 983
23.2 Cash paid to suppliers and employees		
Interest expenditure	(250 092)	(189 143)
Operating expenditure	(249 973)	(228 624)
Adjusted for: Depreciation and amortisation	12 595	12 874
Loss on sale of property and equipment	13	2
Share-based payments	4 041	2 178
Increase in provisions	3 443	7 346
Total cash paid to suppliers and employees	(479 973)	(395 367)
23.3 Taxation paid		
Amounts unpaid at beginning of year	–	–
Income statement charge	–	–
Less: Amounts unpaid at end of year	–	–
Total taxation paid	–	–
23.4 Net increase in income earning assets		
Decrease/(Increase) in negotiable securities	129 439	(25 988)
(Increase) in loans and advances	(748 865)	(615 049)
Net (increase) in income earning assets	(619 426)	(641 037)
23.5 Net increase/(decrease) in deposits and other accounts		
Increase in deposits	228 769	902 654
(Decrease) in other accounts	(10 273)	(102 878)
Net increase in deposits and other accounts	218 496	799 776

24. Related-party information

24.1 Identity of related parties with whom transactions have occurred

The holding company and ultimate holding company is identified on page 4 in the Directors' report. Subsidiaries of the Company are identified below. All of these entities and the Directors are related parties. There are no other related parties with whom transactions have taken place, other than as listed below.

24.2 Related-party balances and transactions

The Company, in the ordinary course of business, enters into various financial services transactions with the ultimate holding company and its subsidiaries, the holding company, fellow subsidiaries, the share incentive trust and the Company's subsidiaries. These transactions are governed by terms no less favourable than those arranged with third parties. Loans to and from fellow subsidiaries and other transactions are detailed hereafter.

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

24.2 Related-party balances and transactions (continued)

Balances with the holding company, subsidiaries, fellow subsidiaries and associated company:

	Held %	2007 R'000	2006 R'000
Loans to subsidiaries			
Portion 2 of Lot 8 Sandown (Pty) Limited	100	43 987	45 719
LSM (Troyeville) Properties (Pty) Limited	100	5 931	5 827
Less: Provisions held against loan accounts		(2 022)	(2 823)
		47 896	48 723
Loans to holding company and fellow subsidiaries			
Mercantile Bank Holdings Limited		9 825	12 901
Mercantile Insurance Brokers (Pty) Limited		162	622
Mercantile Registrars Limited		3 042	3 045
Less: Provisions held against loan accounts		(3 042)	(3 036)
		9 987	13 532
Loan from fellow subsidiary			
Mercantile Nominees (Pty) Limited		31	189
Loan to associated company			
Statman Investments (Pty) Limited		695	533
Deposits from holding company and fellow subsidiaries			
Mercantile Bank Holdings Limited		197	138
Mercantile Insurance Brokers (Pty) Limited		1 621	1 986
Mercantile Nominees (Pty) Limited		799	752
Mercantile Registrars Limited		–	7
		2 617	2 883

Transactions with the holding company, subsidiaries, fellow subsidiaries and associated company:

	2007 R'000	2006 R'000
Interest received from:		
Portion 2 of Lot 8 Sandown (Pty) Limited	5 862	5 175
LSM (Troyeville) Properties (Pty) Limited	765	638
Weskor Beleggings (Pty) Limited	–	21
Statman Investments (Pty) Limited	40	38
Interest paid to:		
Mercantile Insurance Brokers (Pty) Limited	81	99
Non-interest income earned from:		
Mercantile Insurance Brokers (Pty) Limited	68	247
Operating expenditure with:		
Portion 2 of Lot 8 Sandown (Pty) Limited	9 251	8 594
LSM (Troyeville) Properties (Pty) Limited	1 011	938

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

24.2 Related-party balances and transactions (continued)

Balances and transactions with the ultimate holding company (CGD) and its subsidiary:

	2007 R'000	2006 R'000
Caixa Geral de Depósitos – Lisbon (Branch of CGD)	897 628	1 455 338
Nostro accounts	1 763	3 721
Vostro accounts	(2 994)	(4 734)
Deposit accounts	898 859	1 456 351
Caixa Geral de Depósitos – Paris (Branch of CGD)	152	429
Nostro accounts	174	440
Vostro accounts	(22)	(11)
Caixa Geral de Depósitos – London (Branch of CGD) Vostro accounts	(18)	(19)
Caixa Geral de Depósitos (CGD)	897 762	1 455 748
Banco Comercial e de Investimentos (BCI) – Mozambique (Subsidiary of CGD)	(37 928)	(117 288)
Vostro accounts	(142)	(1 118)
Fixed deposits	(37 327)	(114 427)
Call and notice deposits	(459)	(1 743)
	859 834	1 338 460

Interest was paid to BCI – Mozambique amounting to R7.9 million (2006: R7.8 million).

Interest received from CGD in respect of the above balances during the year amounted to R73.1 million (2006: R80.4 million).

Post-retirement medical plan

Details of the post-retirement medical plan are disclosed in note 14.

24.3 Director and director-related activities

No loans were made to Directors during the year under review. There were no 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							
2007							
J A S de Andrade Campos	1 100	–	–	–	–	–	1 100
D J Brown	–	2 146	–	236	2 681	1 458	6 521
G P de Kock	498	–	–	–	–	–	498
M J M Figueira (resigned 28 February 2007)	–	259	59	–	–	–	318
L Hyne	452	–	–	–	–	–	452
A T Ikalafeng	347	–	–	–	–	–	347
J P M Lopes	–	1 429	383	44	500	–	2 356
A M Osman (resigned 21 November 2007)	226	–	–	–	–	–	226
S Rapeti	448	–	–	–	–	–	448
	3 071	3 834	442	280	3 181	1 458	12 266

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

24.3 Director and director-related activities (continued)

	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
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

Amounts paid by CGD to:

	2007 R'000	2006 R'000
M J M Figueira (resigned 28 February 2007)	**124**	845
J P M Lopes	**560**	381
	684	1,226

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.

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

The following share options in Mercantile Bank Holdings have been granted to Mr Brown (refer to note 25):
– On 5 October 2004, 5 000 000 at an exercise price of 18 cents each;
– On 22 March 2006, 7 000 000 at an exercise price of 40 cents each; and
– On 26 February 2007, 8 000 000 at an exercise price of 34 cents each.

Directors' interests

No directors held beneficial and/or non-beneficial interests, directly or indirectly, in shares issued by Mercantile Bank Holdings Limited (2006: nil).

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

25. Share incentive scheme

The options granted are in respect of the holding company, Mercantile Bank Holdings Limited, to the employees of the Bank.

Effective 18 July 2007, options could be exercised in respect of 33% of the option shares after the expiration of three years from the offer date, in respect of a further 33% after the expiration of four years from the offer date and the remaining option shares after the expiration of five years from the offer date. Options granted prior to this date, 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.

Subsequent to year-end, the Board approved the removal of the expiry condition from the sixth anniversary date. All unexpired options will now lapse after ten years from the date of issue.

The number of shares, which could be utilised for the purposes of the scheme, are 393 891 852 (2006: 393 891 852), which is 10% (2006: 10%) of the issued share capital of Mercantile Bank Holdings Limited 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:

Grant date	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]
2007								
20 November 2001	32	3 943 000	–	(1 988 600)	(1 000 000)	954 400	954 400	–
11 February 2002	32	200 000	–	–	–	200 000	200 000	–
5 October 2004	18	5 000 000	–	–	–	5 000 000	3 300 000	5 000 000
7 October 2004	17	2 000 000	–	–	(1 000 000)	1 000 000	660 000	–
3 January 2005	15	700 000	–	–	–	700 000	231 000	–
11 February 2005	20	500 000	–	–	–	500 000	165 000	–
1 April 2005	39	1 000 000	–	(1 000 000)	–	–	–	–
27 July 2005	32	750 000	–	–	–	750 000	247 500	–
2 December 2005	31	350 000	–	–	–	350 000	115 500	–
9 February 2006	41	750 000	–	–	–	750 000	–	–
3 March 2006	38	500 000	–	–	–	500 000	–	–
22 March 2006	40	14 800 000	–	(2 300 000)	–	12 500 000	–	7 000 000
26 February 2007	34	–	24 000 000	(2 750 000)	–	21 250 000	–	8 000 000
1 June 2007	36	–	500 000	–	–	500 000	–	–
1 December 2007	36	–	1 000 000	–	–	1 000 000	–	–
		30 493 000	**25 500 000**	**(8 038 600)**	**(2 000 000)**	**45 954 400**	**5 873 400**	**20 000 000**
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 December 2005	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

(1) Refer to note 24.3.

Notes to the annual financial statements for the year ended 31 December 2007 (continued)

25. Share incentive scheme (continued)

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

	2007 R'000	2006 R'000
Weighted average fair value share price at grant date	**34 cents**	38 cents
Weighted average exercise price	**34 cents**	40 cents
Expected volatility	**82.10%**	92.3% – 98.7%
Option life	**6 – 10 years**	6 – 10 years
Risk free rate	**7.58%**	7.30%
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 Company recognised total expenses of R4.0 million (2006: R2.2 million) related to equity-settled share-based payment transactions.

Risk management and control

Risk management philosophy

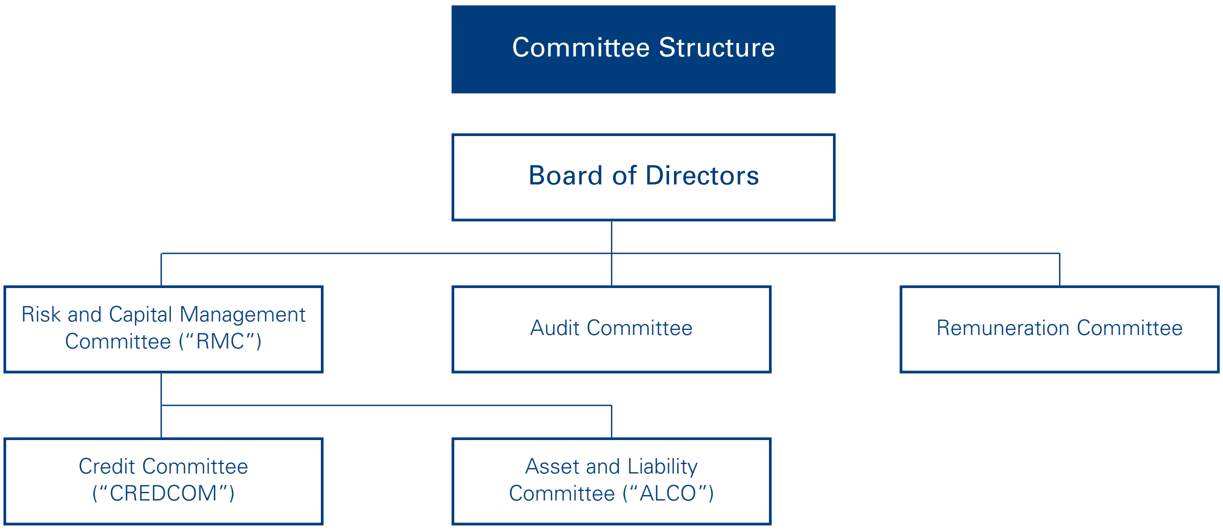
The Company recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks. The Company operates in a dynamic environment where the past is not necessarily an acceptable guide to the future. Risk management is a key focus of the Company and addresses a wide spectrum of risks that are continually evaluated and policies and procedures reviewed to adapt to changing circumstances. In any economy there are sectors that are more vulnerable to cyclical downturn than others. Economic variances are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. Our business development efforts are focused on the stronger companies and individuals, establishing policy criteria, which eliminate weaker credit 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. The management of risk is an independent process from that of taking on/creating risk within the Company. Risk management policies are essentially conservative, with proper regard to the mix of risk and reward. The Company 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 Company 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)

Risk management life cycle/process

All of the Company's policies and procedures manuals have been reviewed and signed off by the relevant divisional heads. These standards are an integral part of the Company'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 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 Company's principal business focuses on the management of liabilities and assets in the balance sheet. Major risks are managed and reviewed by an independent risk function. The ALCO and RMC meet on a regular basis to collaborate on risk control, establish how much risk is acceptable and decide on how the Company will stay within targets and laid down thresholds.

Risk monitoring (and compliance with documented policies)

Open, two-way communication between the Company 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 the ALCO and RMC in the first instance and to the SARB via the Finance Division through DI returns and periodic meetings.

Management of risk

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 within the Company and also forms a consistent common language for outside examiners and/or regulators to follow.

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 Company's image and success. These decisions are usually intended to enhance the Company's long-term viability or success and therefore are difficult to quantify at a given point in time.

Board Committees monitor various aspects of the different identified risks, which 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	

Risk management and control (continued)

Management of risk (continued)

The responsibility for understanding the risks incurred by the Company and ensuring that they are appropriately managed lies 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 Company's strategic objectives within predefined risk management policies. Major risks are managed, controlled and reviewed by an independent risk function.

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.

A process is in place whereby the Top 10 risks faced by the Company are identified. These risks are assessed and evaluated in terms of a risk score attached to inherent risk and residual risk. Action plans are put in place to reduce the identified inherent risks to within acceptable residual risk parameters. The Top 10 risks are re-evaluated quarterly.

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

Increased focus has also been placed on Business Continuity Management ("BCM") during the year under review. BCM ensures the availability of 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. Comprehensive simulations are conducted on an ongoing basis, 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 Company's assets and liabilities with increased monitoring of liquidity and interest rate risk through sensitivity evaluation and forecasting techniques. An internally developed Management Information System was enhanced during the year under review to improve the quality of internal reporting.

During the year under review, the Company established a Capital Management Committee under the auspices of the RMC to proactively evaluate and manage the Capital requirements of the Company as determined by Basel II requirements.

Under the enterprise-wide risk management framework we have categorised the direct risks of the Company and report on those deemed to be of the most significance.

Credit risk

Credit parameters and tolerance levels are clearly defined and reflected in governing procedures and policies. The Company offers a spread of banking products common within the banking industry with a specific focus on small and medium-sized businesses across a wide variety of industries. Whilst personal market products are also offered, no specific targeting of the broader personal retail based market is undertaken. The primary risks encountered are associated with the lending of money and the issuing of contingent financial or performance guarantees to third parties on behalf of customers.

Dependent upon the risk profile of the customer, the risk inherent in the product offering and the track record/payment history of the client, varying types and levels of security are taken to mitigate credit related risks. Clean or unsecured lending will only be considered for financially strong borrowers.

Counterparties to derivatives expose the Company to credit-related losses in the event of non-performance. The counterparties to these contracts are financial institutions. The Company 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 Company did not consider there to be any significant concentration of risk, which had not been insured or adequately provided for. There were no material exposures in advances made to foreign entities at year-end, except for the deposits placed with CGD as disclosed in note 24.2.

A portfolio analysis report is prepared and presented to the RMC analysing the performance and makeup of the book including customer and segment concentration analyses.

Risk management and control (continued)

Management of risk (continued)

Credit risk (continued)

The Company has adopted a conservative approach to credit granting within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process whereby levels of credit approval are determined by the experience of the mandated individual with dual or multiple sign-off on all material values. An ongoing weekly review is also undertaken by the CREDCOM of all lending in excess of R1 million. In addition the early warning system is applied to actively manage all accounts within the risk structure. The system identifies a number of characteristics relating to the performance of the accounts and based on various predefined algorithms, flags issues of concern. Monitoring is done by the Early Warning Department and any concerns are raised with the Credit Department and Retail or Commercial banking units. The Company is in the process of further developing a Decision Support tool to assist credit decision makers through the provision of indicative performance criteria and other information necessary to assist in making increasingly informed decisions. Such indicative performance data will be measured against predefined acceptance bands and result in the allocation of an overall acceptability rating.

There have been no material changes in the credit approval structure or overall make-up of the book from the prior reporting period.

The table below summarises the Company's maximum exposure to credit risk at balance sheet date:

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2007				
Current accounts	**780 463**	–	–	**780 463**
Credit card	**21 555**	**32 679**	–	**54 234**
Mortgage loans	**1 241 399**	**190 910**	–	**1 432 309**
Instalment sales and leases	**304 588**	–	–	**304 588**
Other advances	**562 401**	–	–	**562 401**
Guarantees	–	–	**391 335**	**391 335**
Letters of credit	–	–	**19 937**	**19 937**
	2 910 406	**223 589**	**411 272**	**3 545 267**
2006				
Current accounts	448 290	–	–	448 290
Credit card	29 002	–	–	29 002
Mortgage loans	711 221	269 478	–	980 699
Instalment sales and leases	299 284	–	–	299 284
Other advances	680 186	–	–	680 186
Guarantees	–	–	269 402	269 402
Letters of credit	–	–	11 662	11 662
	2 167 983	269 478	281 064	2 718 525

Operational risk

Operational risks faced by the Company are extensive and inter alia include risks associated with reputation, robbery, fraud, theft of data, legal challenges, statutory and legislative compliance, operational processes, employment policies, documentation risk and business continuity. Strategies, procedures and action plans to monitor, manage and limit the risks associated with operational processes, systems and external events include:

Risk management and control (continued)

Management of risk (continued)

Operational risk (continued)

- documented operational policies, processes and procedures with segregation of duties;
- training and upskilling staff on operational procedures and legislative compliance;
- an operational event logger wherein all losses associated with operational issues including theft and robbery are recorded and evaluated to facilitate corrective action;
- ongoing improvements to the Disaster Recovery and Business Continuity plans including conducting a variety of simulation exercises in the branches and critical operations environments; and
- conducting a variety of internal audits and reviews by both the Compliance and Internal Audit Departments in line with annual plans approved by the Board.

There have been no material losses during the reporting period that require specific identification.

Market risk

Market risk is the risk of revaluation of any financial instrument as a consequence of changes in market prices or rates and can be quantified as the potential change in the value of the banking book as a result of changes in the financial environment between now and a future point in time.

The Board determines market risk limits. These limits are reviewed at least annually dependent on market events.

The Company does not currently have any proprietary trading positions and therefore has minimal exposure to market risk. Before the Company enters into a proprietary trading position, the Trading Committee will evaluate and approve such positions. This Committee will ensure that the Company is prudently positioned, taking into account agreed limits, policies, prevailing markets, available liquidity and the relationship between risk and reward primarily to the financial risks of changes in foreign currency exchange rates and interest rates. The Company enters into derivative financial instruments to manage its exposure to interest rate and foreign currency risk, including:

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

Detailed market risk reports are produced on a daily basis, which allows for monitoring against prescribed limits. In the unlikely event of an unauthorised limit violation, the Asset and Liability Management Forum ("ALM") records such violation, which is immediately corrected and reported to the ALCO, which is a subcommittee of the RMC.

The Company does not perform a detailed sensitivity analysis on the potential impact of a change in exchange rates due to the fact that the Company does not currently have any proprietary trading positions. A detailed sensitivity analysis is performed for liquidity and interest rate risk as described below.

There has been no significant change to the Company's exposure to market risks or the manner in which it manages and measures the risk.

Foreign currency risk

The Company, in terms of approved limits, manages short-term foreign currency exposures relating to trade imports, exports and interest flows on foreign liabilities.

The Company has conservative limits in terms of net open foreign currency positions which are well below the limits allowed by the South African Reserve Bank. For the year under review the highest net open position recorded for any single day was R5.1 million.

Risk management and control (continued)

Management of risk (continued)

Foreign currency risk (continued)

The transaction exposures and foreign exchange contracts at balance sheet date are summarised as follows:

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2007					
Total foreign exchange assets	**913 287**	**65 356**	**30 444**	**8 116**	**1 017 203**
Total foreign exchange liabilities	**(60 493)**	**(18 578)**	**(20 794)**	**(89)**	**(99 954)**
Commitments to purchase foreign currency	**245 343**	**67 736**	**20 242**	**8 320**	**341 641**
Commitments to sell foreign currency	**(1 097 925)**	**(114 958)**	**(30 513)**	**(16 640)**	**(1 260 036)**
Year-end effective net open foreign currency positions	**212**	**(444)**	**(621)**	**(293)**	**(1 146)**
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)

Interest rate risk

Interest rate risk is the impact on net interest earnings and the sensitivity to economic value as a result of increases or decreases in interest rates arising from the execution of the core business strategies and the delivery of products and services to customers. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected adverse movements arise. The ALM forum monitors interest rate repricing on a daily basis and reports back to the ALCO and RMC.

The Company is exposed to interest rate risk as it takes deposits from clients at both fixed and floating interest rates. The Company manages the risk by maintaining an appropriate mix between fixed and floating rate funds and by the use of interest rate swap contracts.

Under interest rate swap contracts, the Company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the Company to mitigate the risk of changing interest rates on the fair value of issued fixed rate debt and the cash flow exposures on the issued variable rate debt. The interest rate swaps reprice on a quarterly basis. The floating rate on the interest rate swaps is based on the three-month JIBAR. The Company will settle the difference between the fixed and floating interest rate on a net basis.

Sources of interest rate risk include volatility and changes in interest rate levels, yield curves and spreads. These affect the interest rate margin realised between lending income and borrowing costs when applied to our rate sensitive assets and liabilities. The Company is also exposed to basis risk, which is the difference in repricing characteristics of two floating-rate indices such as the South African prime rate and three-month JIBAR.

To measure such risk, the Company aggregates interest rate sensitive assets and liabilities into fixed time bands in accordance with the respective interest repricing dates. The Company uses both dynamic maturity gap and duration analysis, which measures the mismatch level between the average time over which the cash inflows are generated and cash outflows are required. Various reports are prepared taking alternative strategies and interest rate forecasts into consideration. These reports are presented to the ALCO and RMC on a regular basis.

To monitor the effect of the gaps on net interest income, a regular forecast of interest rate sensitive asset and liability scenarios is produced. It includes relevant banking activity performance and trends, different forecasts of market rates and expectations reflected in the yield curve.

Risk management and control (continued)

Management of risk (continued)

Interest rate risk (continued)

For regulatory purposes, the assessment and measurement of interest rate risk is based on the accumulated impact of interest rate sensitive instruments resulting from a parallel movement of plus or minus 200 basis points on the yield curve.

In addition, the impact on equity and profit and loss resulting from a change in interest rates is calculated monthly based on management's forecast of the most likely change in interest rates.

At reporting date, a 50 basis point change was applied as a sensitivity analysis to determine exposure to interest rates. If interest rates increased/decreased by 50 basis points and all other variables remained constant, the Company's net profit and equity at year-end would increase or decrease by R13.6 million (2006: increase or decrease by R11.5 million).

This is mainly attributable to the Company's exposure to interest rates on its lending and borrowings in the banking book.

The table below summarises the Company's exposure to interest rate risk. 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 %
2007								
Assets								
Intangible assets	–	–	–	–	–	23 568	23 568	–
Property and equipment	–	–	–	–	–	16 655	16 655	–
Other accounts receivable		–	–	–	–	33 593	33 593	–
Interest in subsidiaries	47 896	–	–	–	–	32 220	80 116	–
Other investments	–	–	–	–	–	8 917	8 917	–
Loans and advances	2 660 214	–	–	111 091	43 438	–	2 814 743	13.48
Derivative financial instruments	4 248	–	–	–	–	39 566	43 814	–
Negotiable securities	102 752	145 769	20 482	–	6 574	–	275 577	11.13
Cash and cash equivalents	784 050	371 528	170 618	–	–	96 798	1 422 994	9.01
Total assets	3 599 160	517 297	191 100	111 091	50 012	251 317	4 719 977	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	–	–	–
Deposits	2 125 366	590 292	802 812	146 742	348	105 240	3 770 800	7.06
Derivative financial instruments	7 875	–	–	–	–	7 481	15 356	–
Provisions	–	–	–	–	–	42 407	42 407	–
Other accounts payable	–	–	–	–	–	38 035	38 035	–
Total equity and liabilities	2 133 241	590 292	802 812	146 742	348	193 163	3 866 598	
On balance sheet interest sensitivity gap	1 465 919	(72 995)	(611 712)	(35 651)	49 664	–	795 225	
Derivative financial instruments	80 950	93 209	(21 500)	(110 101)	(42 558)	–	–	
Total net interest sensitivity gap	1 546 869	20 214	(633 212)	(145 752)	7 106	–	795 225	

Risk management and control (continued)

Management of risk (continued)

Interest rate risk (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 %
2006								
Assets								
Intangible assets	–	–	–	–	–	11 549	11 549	–
Property and equipment	–	–	–	–	–	21 531	21 531	–
Other accounts receivable	–	–	–	–	–	161 901	161 901	–
Interest in subsidiaries	–	–	–	–	–	73 181	73 181	–
Other investments	–	–	–	–	–	10 813	10 813	–
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	356 650	4 465 531	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	682 772	682 772	–
Deposits	2 212 541	640 336	617 400	13 765	–	57 989	3 542 031	6.18
Derivative financial instruments	29 189	–	–	–	–	–	29 189	–
Provisions	–	–	–	–	–	38 964	38 964	–
Other accounts payable	126 343	–	–	–	–	46 232	172 575	–
Total equity and liabilities	2 368 073	640 336	617 400	13 765	–	825 957	4 465 531	
On balance sheet interest sensitivity gap	586 480	(198 035)	(51 476)	49 207	83 131	–	469 307	
Derivative financial instruments	94 279	89 119	(10 700)	(105 899)	(66 799)	–	–	
Total net interest sensitivity gap	680 759	(108 916)	(62 176)	(56 692)	16 332	–	469 307	

Risk management and control (continued)

Management of risk (continued)

Liquidity risk

Liquidity risk is the risk of being unable to meet current and future cash flow and collateral requirements when they become due, without negatively affecting the normal course of business. The Company is exposed to daily cash needs from overnight deposits, current accounts, maturing deposits, loan drawdowns and guarantees.

To measure liquidity risk, the Company aggregates assets and liabilities into fixed time bands in accordance with the respective maturity dates, which measures the mismatch level between the average time over which the cash inflows are generated and cash outflows are required.

The ALM forum monitors liquidity risk on a daily basis and reports back to the ALCO and RMC. Ultimate responsibility for liquidity risk management rests with the Board. An appropriate liquidity risk management framework has been developed for the management of the Company's short, medium and long-term funding and liquidity requirements.

Through active liquidity management, the Company seeks to preserve stable, reliable and cost effective sources of funding. To accomplish this, management uses a variety of liquidity risk measures that consider market conditions, prevailing interest rates, liquidity needs and the desired maturity profile of liabilities.

To manage this risk, the Company performs, amongst others, the following:

- maintenance of stock of readily available, high quality liquid assets in excess of the statutory requirements as well as strong balance sheet liquidity ratios;
- assumptions based sensitivity analysis to assess potential cash flows at risk;
- management of concentration risk, being undue reliance on any single counterparty or counterparty group, sector, market, product, instrument, currency and tenor;
- maintenance of sources of funding for contingency funding needs;
- monitoring of daily cash flow movements/cash flow requirements, including daily settlements and collateral management processes;
- creation and monitoring of prudential liquidity risk limits; and
- maintenance of an appropriate term mix of funding.

There were no significant changes in the Company's liquidity position during the current financial year or the manner in which it manages and measures the risk. The Company is adequately funded and able to meet all its current and future obligations.

The table below summarises assets and liabilities of the Company into relevant maturity groupings, based on the remaining period to the contractual maturity at balance sheet date:

	Assets R'000	Liabilities R'000	Total mismatch R'000
2007			
Maturing up to one month	**1 839 050**	**2 163 481**	**(324 431)**
Maturing between one and three months	**592 655**	**751 773**	**(159 118)**
Maturing between three and six months	**258 494**	**519 894**	**(261 400)**
Maturing between six months and one year	**179 121**	**284 360**	**(105 239)**
Maturing after one year	**1 850 657**	**147 090**	**1 703 567**
	4 719 977	**3 866 598**	**853 379**
2006			
Maturing up to one month	1 841 358	2 347 528	(506 170)
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	1 391 361	13 765	1 377 596
	4 465 531	3 782 759	682 772

Risk management and control (continued)

Management of risk (continued)

Liquidity risk (continued)

The remaining period to contractual maturity of financial liabilities of the Company at balance sheet date which includes the interest obligation on unmatured deposits and derivatives calculated up to maturity date is summarised in the table below:

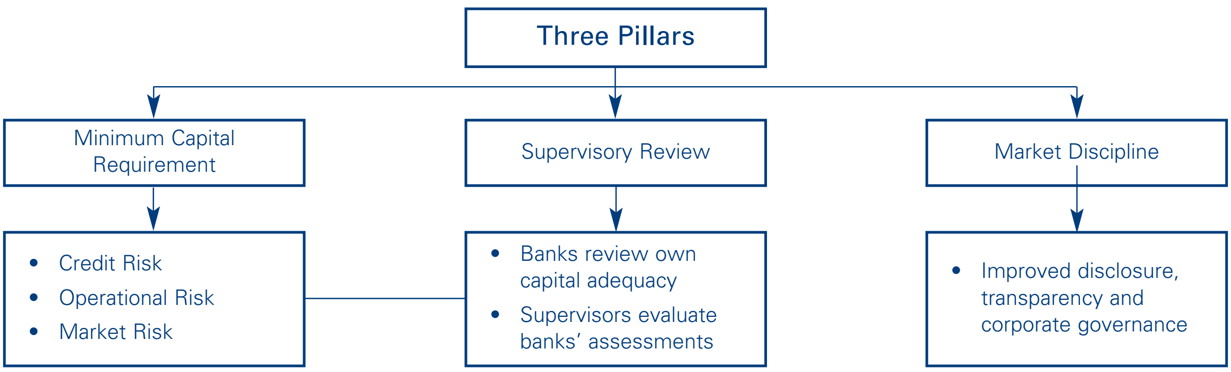
	Up to 1 month R'000	1 – 3 months R'000	3 – 6 months R'000	6 – 12 months R'000	Over 1 year R'000
2007					
Deposits	**2 058 045**	**768 400**	**537 375**	**306 368**	**175 918**
Derivative financial instruments	**3 444**	**3 344**	**1 850**	**1 322**	**7 018**
Other accounts payable	**38 035**	**–**	**–**	**–**	**–**
Guarantees, letters of credit and committed undrawn facilities	**634 861**	**–**	**–**	**–**	**–**
Operating lease commitments	**366**	**698**	**890**	**1 350**	**4 289**
	2 734 751	**772 442**	**540 115**	**309 040**	**187 225**
2006					
Deposits	2 105 301	800 776	416 510	234 381	16 995
Derivative financial instruments	6 759	6 068	3 027	2 429	14 669
Other accounts payable	174 435	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	550 542	–	–	–	–
Operating lease commitments	454	866	1 104	1 674	6 191
	2 837 491	807 710	420 641	238 484	37 855

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 acknowledge sound risk management, internal control and governance practices.

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 overall objective of the new Accord is to improve the safety and soundness of the financial system. This will ensure a more resilient, more stable and a better source for credit, risk intermediation and growth. The principles of Basel II were built around three pillars. These pillars can briefly be summarised by the following diagram:



Risk management and control (continued)

Basel II (continued)

The new Accord provides a range of approaches that vary in levels of sophistication for the measurement of credit, operational and market 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. The Bank evaluated the various options available and decided that the most appropriate approaches to follow for the calculation of the minimum capital requirement in terms of the Banks Act would be the Standardised Approach for Credit, Operational and Market risk.

The Accord has been implemented with effect 1 January 2008. A pre-implementation parallel process has been in place since October 2007.

The Bank continues to form part of various Basel II committees in association with the SARB, The Banking Association and other financial institutions.

The Company 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.

Capital management

The Bank is subject to minimum capital requirements as defined in the Banks Act and the Regulations relating to the Banks Act. The management of the Company's capital takes place under the auspices of the RMC, through the ALCO. The RMC considers the various risks faced by the Company and analyses the need to hold capital against these risks whilst taking account of the regulatory requirements. In addition, the level of capital required to support the Company's targeted business growth is taken into consideration.

Risk weighted capital is allocated to the different business units in line with their targeted growth requirements.

The objective of the Company's capital management approach is to ensure the maintenance of sound capital ratios, taking all the above requirements into account, whilst producing appropriate returns to shareholders. Capital to support the Company's needs is currently generated by retained earnings.

In terms of regulation, the Company is able to consider different tiers of capital. The capital of the Bank consists almost entirely of tier 1 capital. Following the recapitalisation of the Company in 2004, it has remained capitalised well beyond regulatory and internal requirements.

The approach to capital management has been enhanced over the past year in line with Basel II.

Risk management and control (continued)

Capital management (continued)

The level of capital for the Bank is as follows:

	Risk weighting %	Average assets 31 December 2007 R'000	Risk-weighted assets 31 December 2007 R'000	Risk-weighted assets 31 December 2006 R'000
Banking book				
Cash, off-balance sheet activities and central government transactions	0	**1 410 022**	–	–
Landbank bonds	10	–	–	15 193
Letters of credit and other bank advances	20	**384 222**	**76 844**	26 355
Residential mortgage loans, performance-related guarantees and committed undrawn facilities	50	**1 165 108**	**582 554**	361 742
Other assets including counterparty risk exposure	100	**2 462 631**	**2 462 631**	1 859 955
		5 421 983	**3 122 029**	2 263 245

	2007 R'000	2006 R'000
Primary capital	**798 377**	638 880
Share capital and share premium	**1 483 299**	1 483 299
General reserve	**12 231**	12 231
Less: Impairments	**(697 153)**	(856 650)
Secondary capital	**39 025**	43 259
General debt provisions	**39 025**	28 407
Fifty per cent of a revaluation surplus	–	14 852
Net qualifying capital and reserves	**837 402**	682 139

	2007 %	2006 %
Capital adequacy ratio*	**26.8**	30.1
Primary capital	**25.6**	28.2
Secondary capital	**1.2**	1.9

* These ratios are calculated as a percentage of risk weighted assets in line with the risk weightings ascribed to these assets under the Banks Act.

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