IJG

Securities (Pty) Ltd.
Member of the NSX

BANK WINDHOEK HOLDINGS
FY15 Results Review
OCTOBER 2015

Bank Windhoek Holdings

FY15 Results Review

Target Price (c)	1770
Current Price (c)	1600

Year End 30 June	2014A	2015A	F2016	F2017	F2018
Net interest income (N$m)	1,057	1,267	1,473	1,636	1,815
Non-interest income (N$m)	680	812	893	1,009	1,142
Profit (N$m)	625	753	890	1,015	1,159
HEPS (c)	121	150	178	203	232
P/E (x)#	13.2	10.6	9.0	7.9	6.9
DPS (c)	44	53	64	73	83
DY (%)*	2.8	3.3	4.0	4.6	5.2
P/B (x)*	2.6	2.2	1.9	1.6	1.4

Recommendation	BUY
NSX Code	BWH
Market Cap (N$m)	7933
Shares in Issue (m)	505.3
Free float (%)	20
52 week high (c)	1605
52 week low (c)	1215
Expected Total Return	14.6%

Source: BWH, IJG
#Based on HEPS and current share price
**Based on current share price*

BWH released its results for the year ended 30 June 2015. The firm recorded exceptional growth over the period, with profit before tax increasing by 21.5% year on year, to surpass the N$1 billion mark for the first time in the Bank's history. Profit after tax increased by 20.5% to N$753 million, surpassing our forecast by 7.9%. Earnings per share expanded by 20.6% to 150.4cps, while headline earnings per share expanded 24.4% to 150.5cps. Headline earnings growth exceeded our expectations by 8.3%. A dividend of 53cps was declared by the company, an increase of 20.5% over the previous year, and surpassing our expectation by 3cps, or by 6%.

Net interest income added 19.9% to N$1.267 billion on the back of a 16.7% increase in loans and advances, as well as an improvement in the net-interest margin as interest rate increases in Namibia resulted in a widening margin between South African interest rates (off which a portion of funding is priced) and Namibian rates (off which loans are priced). This income was notably better than forecast, with the company beating our net-interest income expectations by some N$60 million.

On the side of non-interest income, the company experienced growth of 19.4% to N$812 million. According to the Bank, this increase was driven by "strong growth in transaction volumes, and income from trading activities, cards and electronic channels" and comes about despite "the implementation of zero cash handling fees on certain accounts during the year under review."

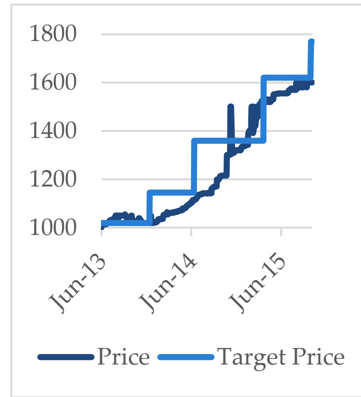
From an operating expense position, the company continued to perform well, as the cost-to-income ratio improved from 53.6% to 51.6%. This was driven by cost containment despite a notable increase in operating income. All told, operating expenses increased by 13.9% to N$1.042 billion. According to the company, this increase was mainly due to higher staffing numbers, as well as an increase in transaction volumes, as well as investment in technological upgrades.

Over the year, the bank grew its assets by 17.6% to N$28.609 billion, largely off the back of the aforementioned loan book, which grew by 16.7% to N$23.622 billion. Deposits grew by 17.1% to N$21.994 billion, while debt securities in issue increased by 33.7%, to N$2.461 billion. While this increase will no doubt have negatively affected the marginal cost of funding, given the relatively minor relative contribution of debt securities to total funding, the average cost will not have been much affected. Following these developments, the bank's funding position has improved, with the loan-to-funding ratio improving from 98.2% to 96.6%

The overall health of the bank's balance sheet remains extremely good despite a doubling in total impairments on loans and advances in FY15 when compared to FY14. Total impairments remain minute, representing just 0.2% of total advances. The group remains well capitalised with a total risk based capital adequacy ratio of 15.8%, well above the minimum regulatory requirement of 10%

For the purpose of valuing the company, we establish a required rate of return, or **cost of equity, of 14.12%.** Based on this cost of equity, a highly conservative **long-term growth rate for the company of 10.5%,** and a **dividend pay-out ratio of 36%,** broadly in line with historic pay-out ratios, we believe a **PE of 9.9x can be justified** on this share. Given **expected earnings growth of 18.3% in FY16,** taking **total earnings to c178/share,** we derive **a target price of c1770/share.** Coupled with an **expected dividend of 64cps,** we expect a **total return of 14.6% in FY16.** This price and dividend means a **dividend yield of 4.0%.** We thus **change our HOLD recommendation to a BUY recommendation for Bank Windhoek Holdings.**

BWH Share Price



Dividends

A final dividend of 29 cents per ordinary share was declared on 11 August 2015 for the year ended 30 June 2015. Taking into account the 24 cents per share interim dividend, this represents a total dividend of 53 cents per ordinary share for the year ended 30 June 2015 (2014: 44 cents per share).

Analyst

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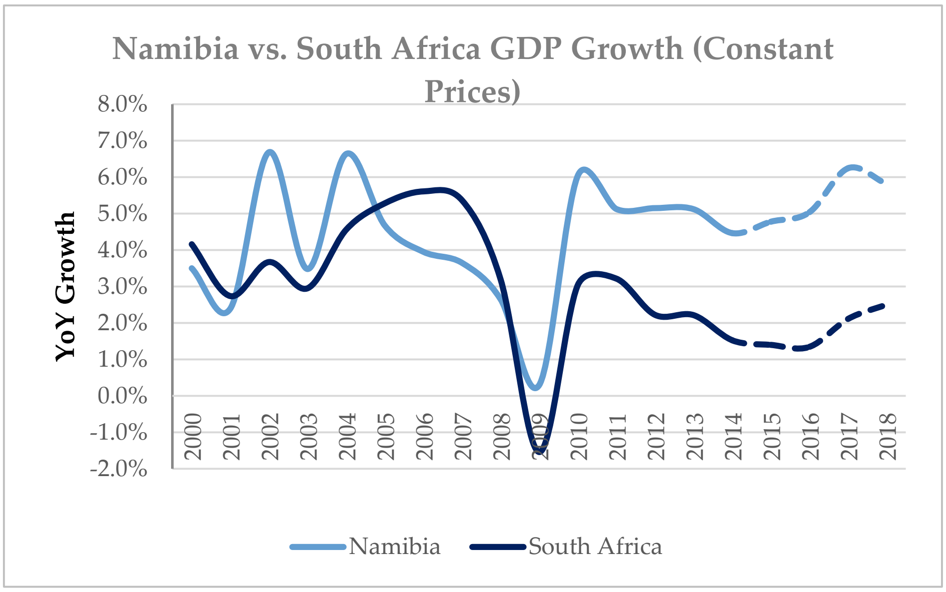
Macro backdrop

The Global and Namibian Economies

Prior to 2010, the economies of Namibia and neighboring South Africa followed fairly coherent paths, with growth showing extremely similar trends and performance. However, following the recession in 2009, the economy of Namibia fast rebounded to pre-crisis rates, while the economy of South Africa has yet to fully regain its feet. In Namibia, this growth stemmed from three key sources, namely historically low interest rates, vast Government spending and abnormally high levels of FDI, broadly to fund the construction of three new mines. Low interest rates drove major expansion in outstanding private sector credit, with total outstanding claims almost doubling in the four years from 2011 to 2015. On the Government side, major spending increases were seen, directed at both capital projects and, particularly, wage payments. In addition, Government cut income tax rates, both for corporates and individuals, in 2013, effectively putting more funds back into the pockets of the public. At the same time, three new mines were built in whole or in part between 2013 and 2015, with large multipliers and employment generation. These three factors drove major increases in GDP, particularly the consumption and investment components thereof. These two key components of GDP have resulted in a period of strong growth for the domestic economy, with average real growth over the past five years of 5.2%, when compared to average growth since Independence of 4.2%. This above-trend growth rate has, as is to be expected, resulted in some imbalances appearing in the local economy when viewed more holistically.



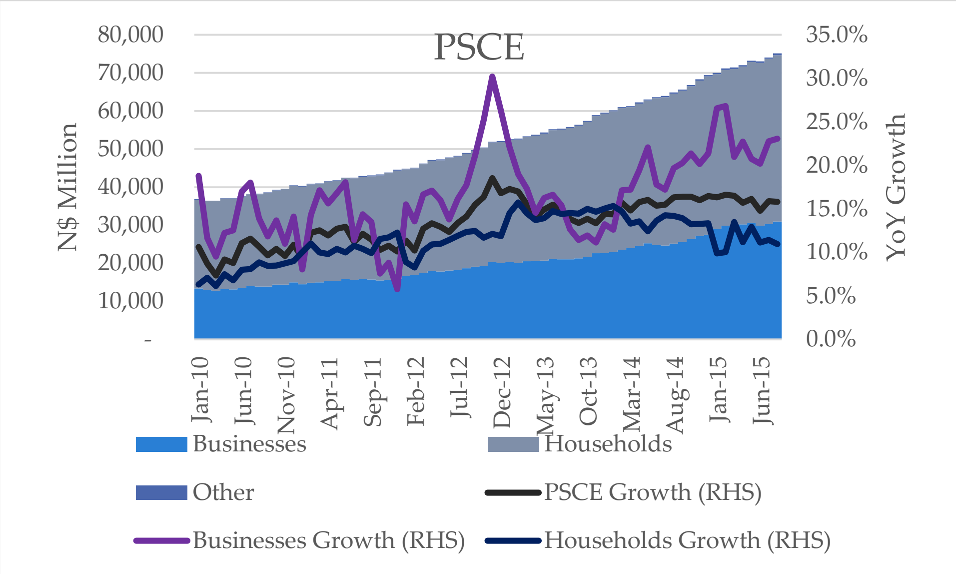
The most notable of these imbalances is a sizable deterioration of the country's external position, and a drying-up of banking sector liquidity. Historically low interest rates through a period of strong growth have resulted in strong growth in credit issuance, and an uptick in household debt levels. However, this has been supported by strong growth in household incomes, meaning that debt-to-income ratios remain broadly manageable. As is the aim of low interest rates, saving has been disincentivised while borrowing and spending incentivised. As such, the banking sector has seen a major increase in their loan-to-deposit ratios and loan-to-funding ratios. This is due to both the numerator increasing, and the denominator increasing notably more slowly. In addition, due to the small open nature of the Namibian economy, much of the credit issued is used to purchase imported goods, particularly cars, consumer electronics and furniture. This has taken a sizable toll on the external position of the country, as these purchases do not net-off in the balance of payments, thus representing a net outflow. As funds have left the local economy, a tightening of liquidity conditions have been seen, largely on account of the multiplier effects between currency in circulation and the broad money supply. In addition, major net outflows of Namibia Dollars into Angola following the launch of a direct-exchange agreement with the Angolan central bank, has also put liquidity pressure on the local economy.

Funding costs

The cost of funding has increased across the board over the past 12 months, as demand for government securities has weakened following major increases in the supply of debt, and limited demand for such through the interest rate hiking cycle. As such, spreads have widened across the curve. As most of the financial entities looking to raise debt securities are considered higher risk than Government, these entities have had to pay up for debt funding. On the deposits side, slow increases in interest rates in Namibia and South Africa have seen deposit rates increasing, albeit fairly marginal.

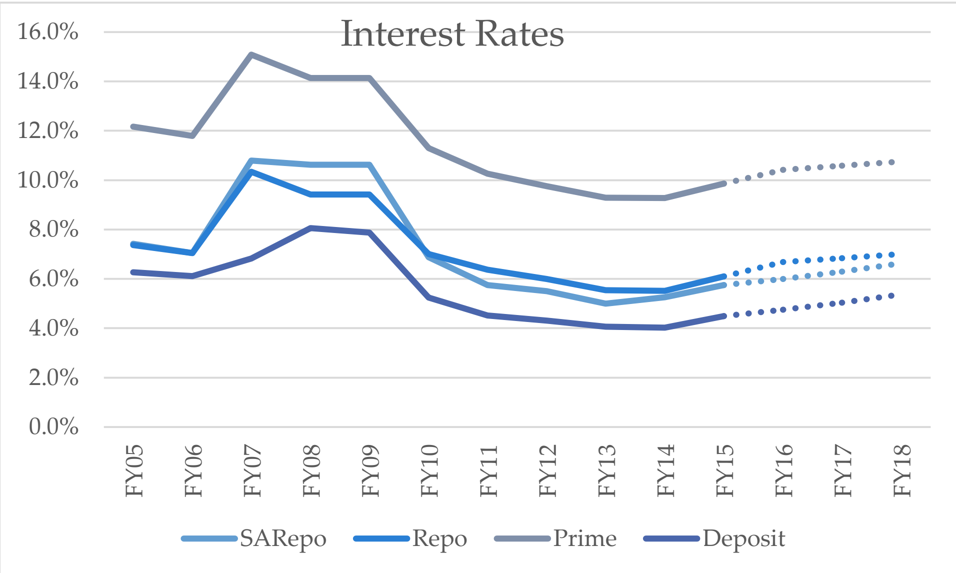
Credit demand and supply

Demand for credit remains strong in the Namibian market, despite the increasing interest rate environment. However, the supply of credit, particularly to households, has started to slow. This is largely driven by liquidity constraints within many of the commercial banks, and preference being given to commercial borrowers over retail borrowers. However, at just over 15% year on year growth, credit extension growth remains strong. Should the liquidity situation worsen, however, we can expect to see a rapid slowdown in credit growth.



Interest Rates

The developing interest rate environment in Namibia and South Africa remains difficult to call. On the South African side, slow and slowing growth and structural challenges suggest that lower interest rates are warranted. However, longer-term inflation pressures remain to the upside and given the structural nature of growth constraints, lower interest rates are unlikely to provide much relief. Nevertheless, recent statements from the South African Reserve Bank have been extremely dovish, despite the latest rate hike taking place just three months ago.



In Namibia, interest rates appear to remain on an upward trajectory for the immediate future, particularly on account of the extremely weak external position in the country. The preserve of the external position, as measured by the hard-currency reserves of the country, remains the primary mandate of the Bank of Namibia, due to the link between hard currency reserves and the exchange rate peg with the South African rand (as part of the CMA agreement, Namibia has to maintain sufficient hard currency reserves to cover currency in circulation). Following historically low interest rates thorough much of the past three years, major growth in credit extension, coupled with expansive fiscal policy, drove deterioration in hard-currency reserves.[1] As reserves are now well below the prudential benchmark of three months of import cover, higher interest rates are warranted and required to stem the net outflow of funds from the economy, be it through the current or capital accounts. Moreover, higher interest rates may present an opportunity to attract investment inflows into Namibia to help to support the Government deficit and the external position.

On the other hand, however, after extremely strong growth for the past half-decade, the Namibian economy is on the brink of a slowdown, which will likely require lower interest rates to support the economy. This situation

[1] Claims that the decline in reserves was driven by mining sector imports on account of the construction of new mines in the country are incorrect, as these mines and thus related imports were FDI funded, meaning the imports (on the current account side of the balance of payments) are netted off in the capital and financial account. This means that there is no negative impact on the balance of payments as a whole, and thus on the reserve position.

illustrates the importance of getting interest rate policy correct, as not only do low interest rates cause fast growth in credit and erode the external position, but the maintenance of policy space to counteract endogenous or exogenous risks, remains critical to a smooth functioning economy.

The current knife-edge situation in South Africa and Namibia means that we broadly maintain our base case scenario for interest rate increases in both countries. However, increases in the repo rate are expected to be moderate and dispersed over a period of months. In total, we expect to see rates lift by just 25 basis points in FY16, which increase already took place in July.

In Namibia, we expect interest rates to continue to increase by a further 25 basis points in FY16, taking the Namibian repo spread over South Africa to 75 basis points. In FY17, on the back of inflation concerns as base effects from falling oil prices are rolled out, we expect a further 50 basis point increase in South Africa. However, expected growth slowdowns in Namibia mean that the Bank of Namibia can be expected to allow the spread to close up once again.

Fiscal Policy

Following five years of expansive budgets, in late 2015 the Minister of Finance announced that Government was going to look to reduce spending over coming months. This was driven by a number of factors, but most notably that the large deficit was proving difficult and increasingly costly to fund. In addition to this, it appears that after a number of years of strong growth, a high revenue base was generated and forecasted growth in revenue for Governments FY16 year may have been somewhat ambitious. Going forward, SACU receipts from the SACU customs pool are expected to decline, as the South African and global economies have been fairly lackluster for a number of years, thus slowing trade flows. Moreover, should commodity prices weaken further, mining tax income and royalties may decline, while personal income tax, corporate income tax and VAT may all see slower growth going forward should the economy start to slow.

Given the size of Government in Namibia as well as its influence on the consumptive activity of the country, a sizable slowdown in spending would be likely to cause the economy to slow. However, at the same time, Government cannot continue to spend heavily on non-productive activities without creating long-term sustainability risks for the country, particularly on the side of debt sustainability and the external position. As such, it is believed that the Government will slow spending in the immediate future, but not dramatically so. Thereafter, we expect to see a reprioritisation of expenditure towards large infrastructure projects, given the immanent infrastructure backlog in key areas such as housing, water and electricity.

Outlook

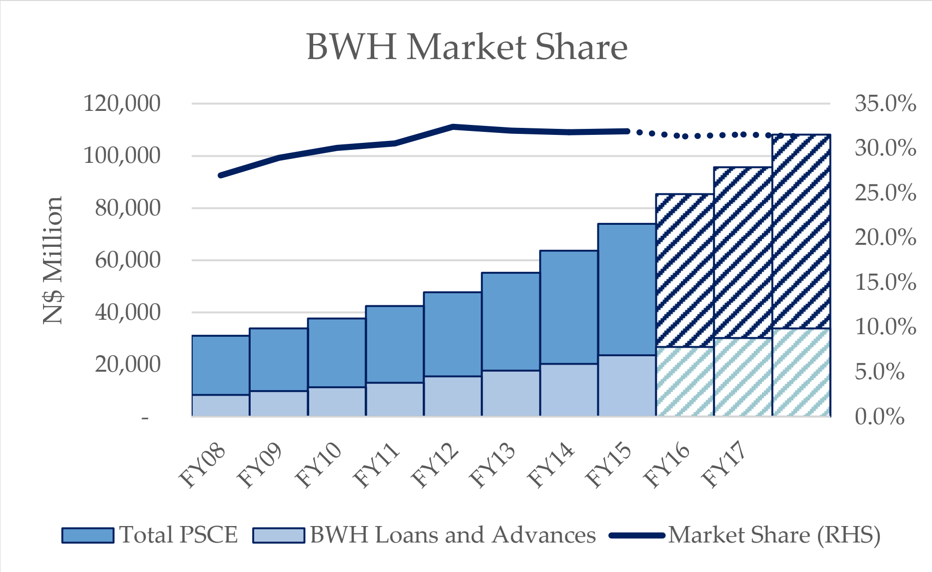
The outlook for South Africa remains challenging, with commodity prices, social challenges and energy shortages hampering the development of the economy. Moreover, the current fiscal position of Government, given the general macroeconomic situation, remains somewhat precarious as policy makers seek to balance the mandates of prudent fiscal management with providing much needed services and investment into the economy, notably social and economic infrastructure.

For Namibia, however, the outlook remains somewhat more positive, despite some general challenges. A slowing of Government activity, coupled with infrastructure challenges and lower commodity prices are likely to put pressure on the local economy from a growth and sustainability perspective. Nevertheless, the bulk of these challenges are highly manageable, and as such the outlook for Namibia remains broadly positive, should policy makers make the correct decisions for long-term sustainability.

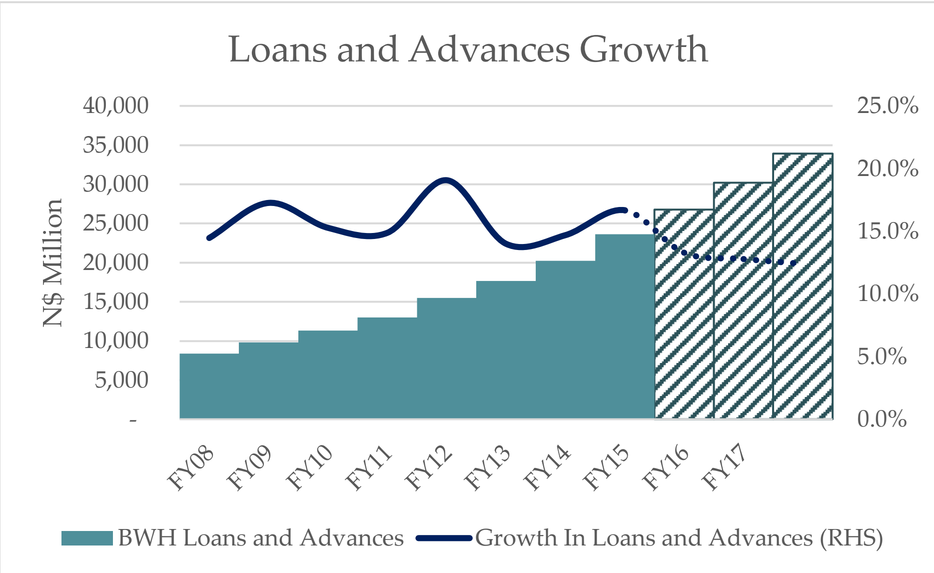
Interest income and the asset base

Asset growth

Between FY05 and FY12, BWH successfully grew its market share[2] within the Namibian banking sector, from 24.7% to 32.4%. Thereafter, however, the bank's market share has stabilised and declined, albeit very marginally. As of the end of FY15, the bank had a market share of 31.9%. Going forward, we expect to see market share stabilise between 31.0 and 31.6%. This is due to two primary factors. Firstly, Bank Windhoek has grown its loan book aggressively over the past few years through the bottom of the interest rate cycle. Now that interest rates are increasing, the banking sector as a whole is likely to see some consolidation. Given liquidity challenges in the sector, we believe that the banks with "big brothers" outside of Namibia are likely to have a natural upper-hand over local banks, due to the availability of liquidity and funding via the parent company. This fact illustrates the unlevelled nature of the playing field in the country, between local and foreign owned banks. Secondly, we have seen a number of new entrants into the local banking space over the past two years. While still small in nature, these entities are likely to be competing for market share, both from a funding and advances perspective. We do not foresee any of the new entrants claiming major market share in the next three years, however they are likely to stem the growth in market share seen by the two largest commercial banks over recent years. Nevertheless, given the number of players in the market and the bank's current market share, the current and expected market shares remain highly attractive, and well above the bank's natural market share.



Bank Windhoek's loan book is expected to continue to grow over the next three years, however at a slowing rate, primarily due to the forecasted general slowdown in private sector credit extension growth, as interest rate hikes and banking sector liquidity constraints dampen demand and supply of credit to the highly saturated Namibian credit market.



2 Market share in this regard is measured as loans and advances to customers as a percent of total private sector credit extension.

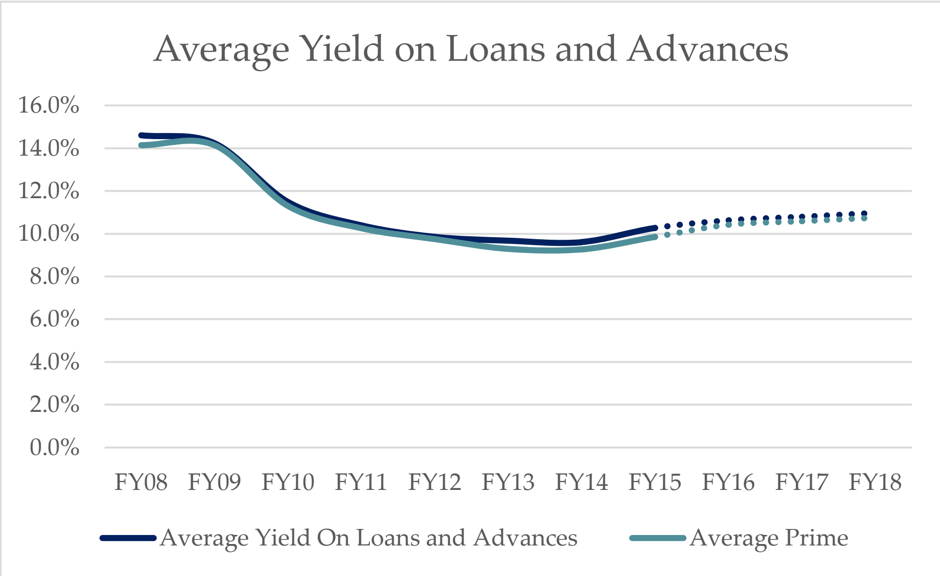
In Namibia the transmission mechanism for monetary policy is fairly slow, with a 9-24 month lag between changes in interest rates and a notable slowdown in net new credit issuance. Thus, despite the fact than Namibia is in the midst of an interest rate hiking cycle, credit demand remains high. However, commercial banks are becoming increasingly reluctant to lend to households, given current high levels of household debt, increasing interest rates and low liquidity in the sector.

From the bottom of the cycle, rates are up 125 basis points, however the manner in which these rates have increased has been hugely positive for the banking sector. The slow and steady increases, with Namibian rates leading South African rates, has seen a widening in the net interest margin of banks, without any notable increase in non-performing loans.

Nevertheless, going forward we do expect to see a slowdown in credit extension growth and expect the largest impact of current and expected rate increases and liquidity challenges to take effect and markedly slow growth in FY16, 17 and 18. For these three years, we expect to see PSCE growth normalising, bearing in mind the abnormally high levels of PSCE growth seen over recent years, and the high base created by this growth. We forecast year on year growth of 15.1%, 14.4% and 13.1% for FY16, 17 and 18, respectively.

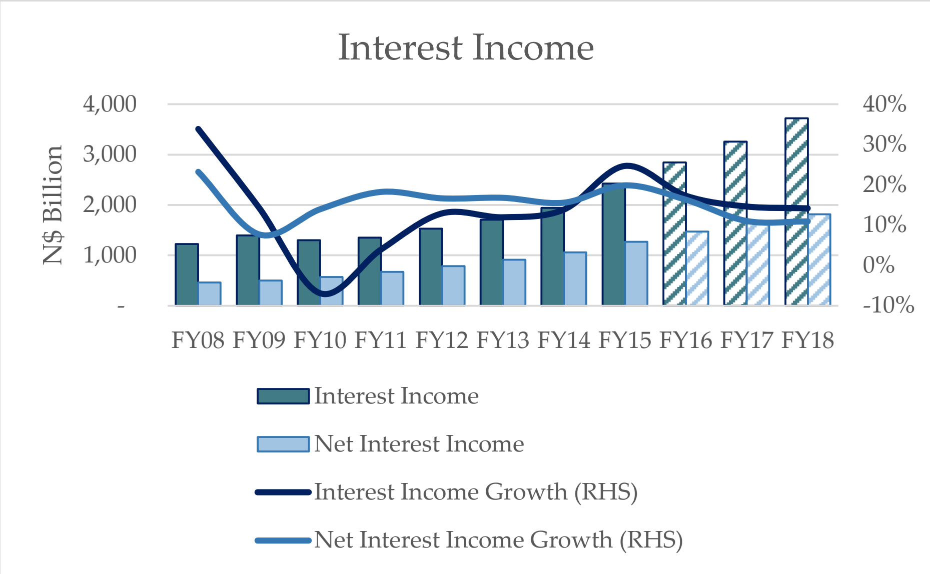
Yield on earning assets and interest income

The average yield on earning assets for Bank Windhoek surpassed our expectations, coming in at 10.3% compared to our expectation of 9.6%. This was primarily due to higher base lending rates than expected, but also due to the bank reviewing its approach to classification of sub-prime and sub-mortgage rate clients. Going forward, we expect Bank Windhoek's average yield on loans to maintain a small spread over prime due both to the weighting of mortgage loans on their book, which attract a higher interest rate than shorter duration loans, and the new focus on reclassification of sub-prime clients. For FY16 we expect a yield of 10.6%, while for FY17 and FY18 we expect 10.8%. This slight pickup will be driven by increasing interest rates.



Following extremely strong interest income growth in FY15, largely on account of interest rate increases on a book that has grown much over recent years, we expect to see some consolidation in interest income in growth going forward. Following expansion of 24.7% in FY15, we expect to see some normalisation in growth, to 17.3%, 14.6% and then 14.2% in FYs 16, 17 and 18, respectively. This is largely due to the fact that we expect to see a slowdown in PSCE issuance as interest rates increase and liquidity declines. Many of the banks are now running tight loan-to-funding ratios, meaning that without new funding loan growth is likely to slow. However, on the back of weakening credit issuance, government spending and commodity prices, coupled with structural issues in Namibian and South Africa, interest rates are not expected to climb rapidly going forward.

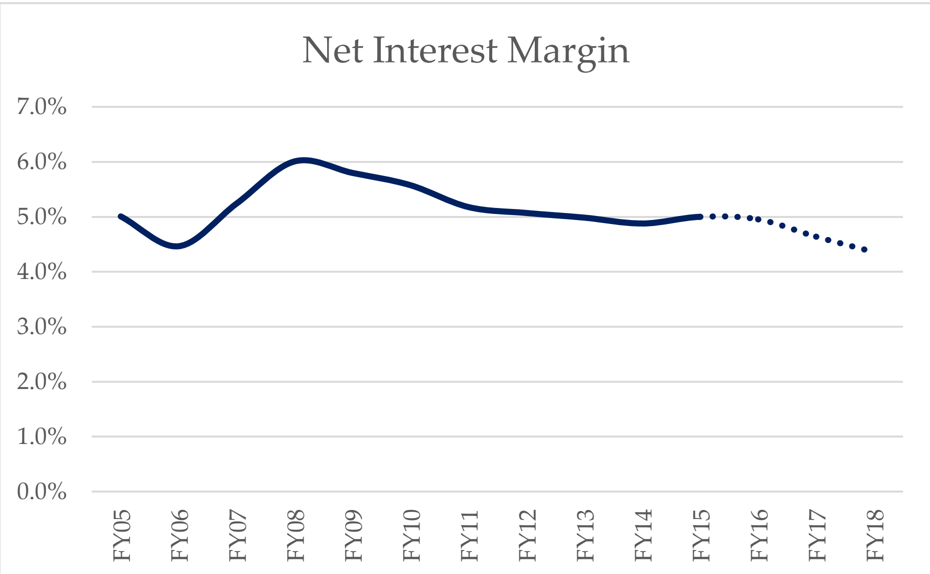
From a net-interest income perspective, the marginal cost of funding increased through FY15, with net interest income growth falling below interest income growth for the first time in five years. This was largely due to the funding position of the bank, and the low liquidity environment. This comes as little surprise after many years of expansive monetary policy, which is by nature designed to disincentivise saving and incentivise spending. As such, demand for borrowing has far exceeded growth in deposits at commercial banks, meaning that banks have not only increased competition for deposits (by raising deposit rates) but have also turned to other sources of funding such as debt instruments, which come at a relatively high cost when compared to customer deposits. Going forward, we expect to see liquidity remain tight for the next year to 18 months, which is likely to keep the cost of borrowing relatively high, and interest margins under some, but not drastic, pressure.



As such, we expect to see growth in net interest income slowing from the FY15 level of 19.9%, to 16.3% in FY16. Thus, while interest income will normalise over the next few years, the interest expense will also see similar or greater increases, resulting in a decline in net interest income relative to gross interest income. It is worth noting, that a high base has been created through the bottom of the interest rate cycle with regards to credit issuance and for the first few years of this cycle, the net interest margin. As such, we forecast net interest income of N$1.47 billion in FY16, N$1.64 billion in FY17 and N$1.82 billion in FY18, up from N$1.27 billion in FY15.

Net interest margin

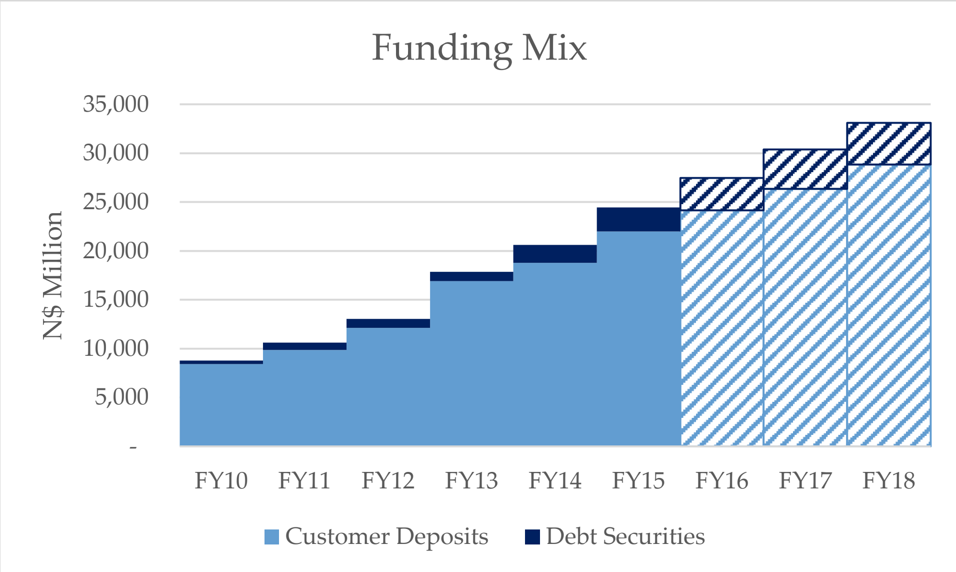
As of the end of FY15, Bank Windhoek had a net interest margin on lending of 5.0%, slightly above the FY14 level of 4.9%. Going forward, we expect to see this margin remain largely unchanged through FY16 before declining to 4.6% in FY17, and 4.4% in FY18, as interest rates in South Africa catch up with those of Namibia. In addition, increased competition for deposits in the local space is likely to increase the cost of funding to all of the commercial banks, as will pressure from the central bank on commercial banks to increase deposit rates as interest rates increase in Namibia.



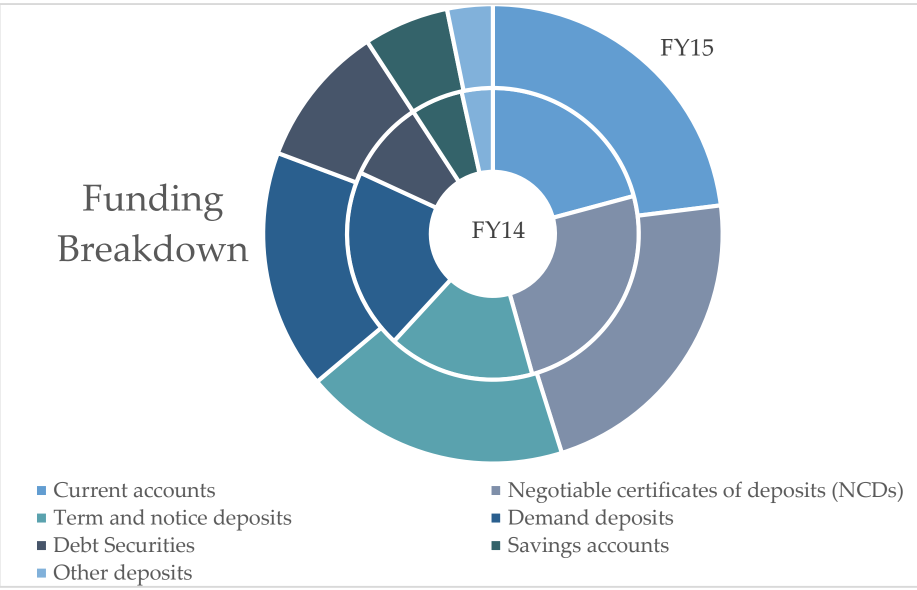
Funding the BWH asset base

Funding mix

In FY15, Bank Windhoek's deposits due to customers increased by 17.1%, while debt securities in issue increased by 33.7%. As such, total funding now stands at N$24.5 billion, with deposits making up N$22.0 billion of the total. At N$2.5 billion, debt securities still make up just 10% of total funding. Going forwards, we expect to see a continuation of the trend of increases in debt securities at a faster rate than deposits. By FY17 and FY18, we expect to see debt securities making up approximately 13% of total funding. However, growth in deposits in FY15 was largely driven by current accounts, particularly when assessed on a weighted basis. This is a highly positive move given that the average cost of current accounts is around 50% of that of many of the other funding instruments, with the exception of saving deposits. As such, this has a positive impact on the net interest margin of the bank. Going forward however, liquidity challenges and low Government cash balances are likely to put conventional deposit supply growth under pressure. This is likely to be particularly hard felt by Bank Windhoek, as the bank is partially dependent on deposits from Government to fund its loan growth.



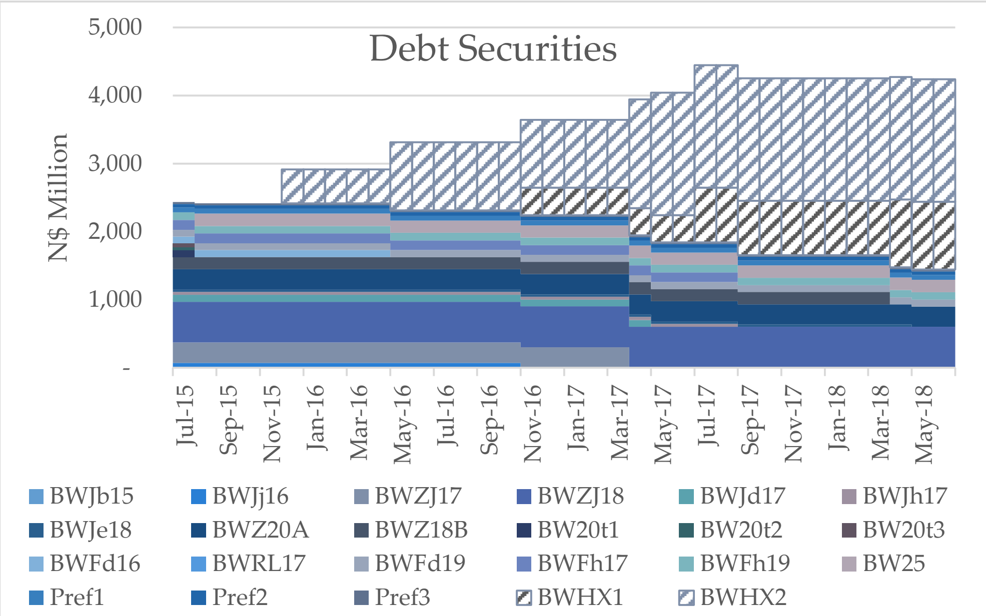
	Average Interest Cost
Demand Deposits	5.5%
Term and notice deposits	5.5%
NCDs	6.7%
Cheque deposits (current)	2.9%
Debt securities	7.1%
Saving deposits	1.7%



Historically, Bank Windhoek has had a higher cost of funding than many of its competitors, largely due to the lack of big-brother backing, and the higher percentage of funding sourced through negotiable certificates of deposit (NCD) and debt securities than the other major players. Going forward, we expect this to remain the case, as we expect the bank to remain partially reliant on debt securities to fund its loan growth into the future. In addition, with the upcoming (2018/19) introduction of Basel III in Namibia, we expect to see the bank looking to secure longer term funding, primarily from the debt markets. This is likely to be relatively expensive, due to the long-duration requirement. It should be noted, however that all of the commercial banks are likely to have to do the same, meaning that the playing field should be fairly level on this issue, and that one can expect some issuer competition with regards to long-duration debt issuance.

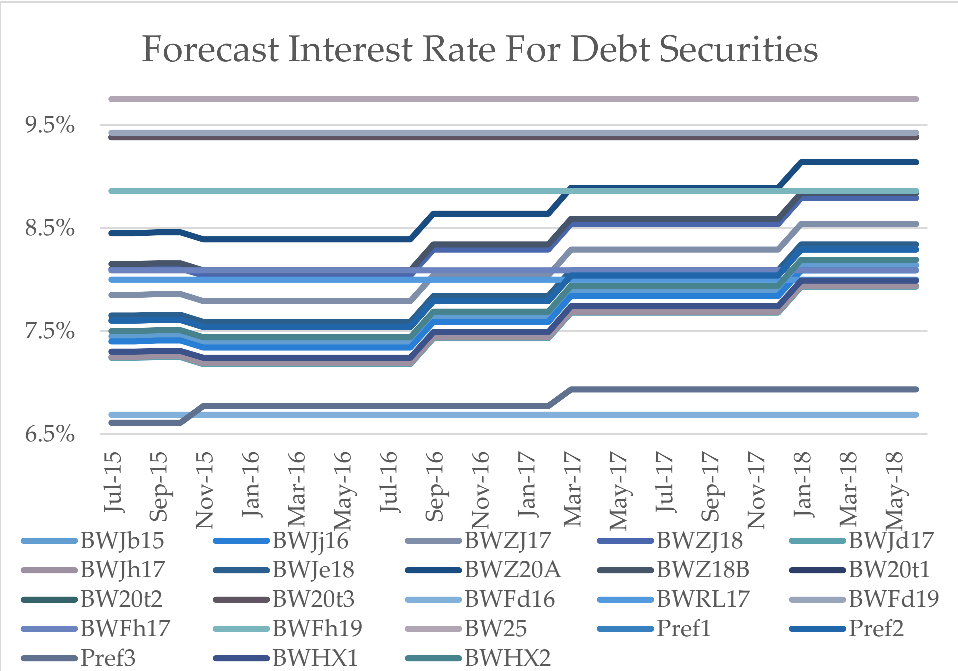
In FY15, the average cost of funding for Bank Windhoek was just under 5.0%. This is expected to increase to 5.3, 5.6 and 6.0% in FY 16, 17 and 18, partially on account of increasing interest rates, and partially due to the gradual change in funding mix for the bank.

Debt securities in issue



Shortly after the end of the FY15, the bank redeemed the BW20 notes, and issued a BW25 note. Otherwise, the BWJb15 floating rate note matured in FY15, and the BWZ18B, BWZ20A and BWJe18 were all issued through the second half of the FY15.

As such, at the time of writing, the company's listed debt breaks down to 28.3% fixed rate, and 71.7% floating. All of the floating rate debt is JIBAR linked, meaning that it re-prices in the build up to interest rate moves, and more regularly, than the company's loans to customers. Moreover, as interest rates increase, the cost of floating rate debt will increase, however we expect this to be partially offset by the bank being able to issue with a more attractive spread over JIBAR as it becomes more established and trusted within the listed debt space, both in Namibia and in South Africa. Going forward, longer duration debt issuance can be expected, which is likely to come at a premium over shorter duration paper. We expect to see Bank Windhoek issuing relatively large volumes of debt in the local and regional markets in FY16 and FY17, both to cover maturing debt, and to fund growth in consumer loans.



Series	Type	Issue date	Call date/ Expect maturity	Final Maturity	Coupon	Issue spread	Issue rate	Benchmark	Amount Issued (N$ Million)
BW20	Subord/unsec	Aug-10	Aug-15	Aug-20	9.38%	174	9.38%	R157	100.0
BW20	Subord/unsec	Oct-10	Aug-15	Aug-20	9.38%	169	8.88%	R157	50.0
BW20	Subord/unsec	Jun-11	Aug-15	Aug-20	9.38%	167	9.15%	R157	50.0
BWRL17	Replica/unsec	Feb-13	Oct-17	Oct-17	8.00%	68	7.21%	GC17	5.5
BWFd16	Senior/unsec	Apr-13	Apr-16	Apr-16	6.69%	140	6.69%	R157	100.0
BWFd19	Senior/unsec	Apr-14	Apr-19	Apr-19	9.43%	164	9.43%	R204	100.0
BWFh17	Senior/unsec	Aug-14	Aug-17	Aug-17	8.09%	107	8.09%	R203	145.0
BWFh19	Senior/unsec	Aug-14	Aug-19	Aug-19	8.86%	125	8.86%	R207	110.0
BW25	Subord/unsec	Aug-15	Aug-20	Aug-25	9.75%	200	9.75%	R208	181.0
Total Fixed Rate (Oct 2015)									641.5

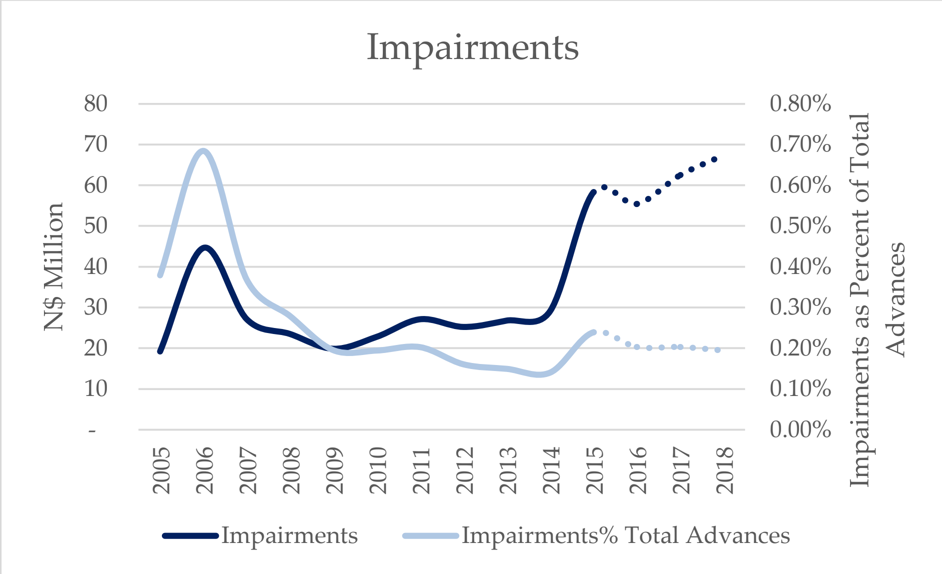
BWJb15	Senior/unsec	Nov-11	Feb-15	Feb-15	3mJ+115	115	6.73%	3m Jibar	100.0
BWJj16	Senior/unsec	Apr-13	Oct-16	Oct-16	3mJ+110	110	6.23%	3m Jibar	70.0
BWZJ18	Senior/unsec	Nov-13	Nov-18	Nov-18	3mJ+180	180	6.99%	3m Jibar	600.0
BWZJ17	Senior/unsec	Mar-14	Mar-17	Mar-17	3mJ+155	155	7.28%	3m Jibar	300.0
BWJd17	Senior/unsec	Apr-14	Apr-17	Apr-17	3mJ+94	94	6.72%	3m Jibar	100.0
BWJh17	Senior/unsec	Aug-14	Aug-17	Aug-17	3mJ+95	95	7.03%	3m Jibar	45.0
BWZ18B	Senior/unsec	Mar-15	Mar-18	Mar-18	3mJ+185	185	7.96%	3m Jibar	180.0
BWZ20A	Senior/unsec	Mar-15	Mar-20	Mar-20	3mJ+215	215	8.26%	3m Jibar	299.0
BWJe18	Senior/unsec	May-15	May-18	May-18	3mJ+135	135	7.48%	3m Jibar	32.9
Total Floating Rate (Oct 2015)									1,626.9

Source: BWH Treasury, BWH Annual Reports, IJG Research

Note: Red – Listed in FY15; Note: Blue – Listed in FY16 to date; Note: Grey – Matured in FY15/FY16

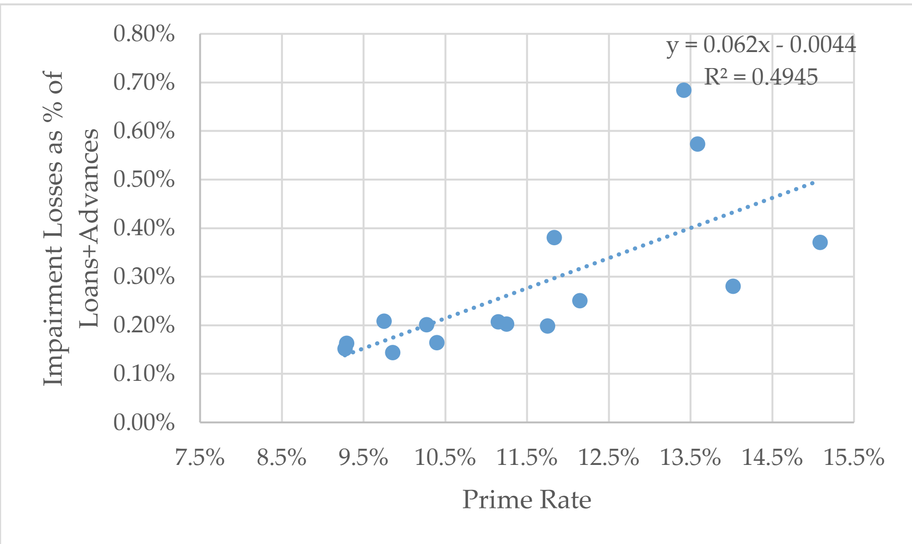
Impairment Losses

As interest rates declined, impairments on the Bank Windhoek book fell to historically low levels when compared to loans and advances. As such, total impairments stood at 0.14% of loans and advances to customers, or N$29.1 million as of the FY14 year-end. However, with interest rates starting to pick up again, impairments have once again started to tick up, returning to 2009/2010 levels when compared to the loan book. As of the end of FY15, impairments stood at 0.24% of the total loan book, totally N$58.3 million.



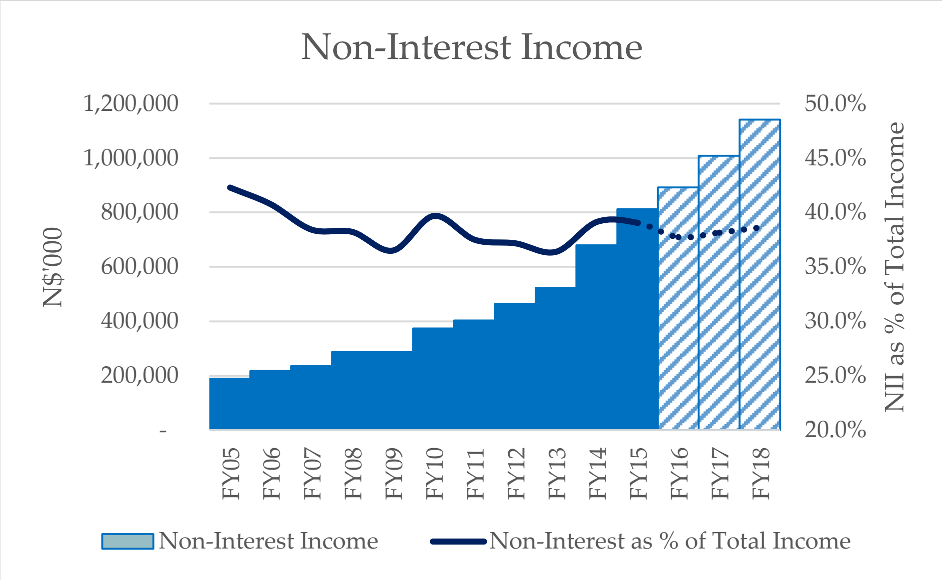
Going forward, we expect impairments to remain above the FY12, 13 and 14 levels, however do not foresee a major blowout in impairments over the three year forecast period. We do, however, remain cautious when it comes to the activities of Government, and should a major spending slowdown occur at the same time and interest rates pick up, the outlook for impairments could change with little warning. Nevertheless, we expect a slight recovery in impairments in FY16, as some of the impairment of FY15 is likely to remain recoverable, and new impairments are not expected to be sizable. Thereafter, we expect an impairment ratio of approximately 20 basis points for FY17 and FY18, illustrating the strong asset quality of the bank.

This low level of impairment loss speaks, to the prudential approach taken by Bank Windhoek when it comes to the extension of loans and advances to customers. At 0.2%, impairments remain negligible on the Bank Windhoek book.



There exists a fairly strong relationship between interest rates (particularly the delta of interest rates) and impairments and should we see rapid and dramatic increases in the interest rate, we can expect to see an increase in non-performing loans and impairments due to the high levels of household debt in Namibia at present, after the major credit uptake seen through the trough of the interest rate cycle. However, as the Bank of Namibia is cognisant of these levels of debt, and as global economic softness allows for slow increases in interest rates, we doubt that rates will increase aggressively in the near future.

Non-interest income



Non-interest income has been a significant contributor to BWH overall revenue over recent years, and is likely to remain so as net-interest income growth slows due to margin compression. As of the end FY15, Bank Windhoek's non-interest income stood at N$812 million, representing 39.1% of total income. Of this income, approximately 69.5% comprises fee and commission income, while the remainder is made up of foreign exchange gains and losses, brokerage fees, and asset management and administration fees, primarily.

Going forward, we are expecting to see continued growth in non-interest income, as the bank tries to diversify its revenue sources further. In this regard, the company has been investing heavily in IT systems, allowing for improved digital service provision. Nevertheless, we are cognisant of the fact that the regulator is in the process of attempting to reduce fee and commission income earned by commercial banks, particularly through regulating cash deposit fees. That said, we continue to believe that commercial banks will be able to innovate and generate new products and charges to make up for lost revenue. However, in FY15, Bank Windhoek saw huge growth in trading income (103% growth), both on account of Kwanza trading in the last two weeks of the financial year, and favourable markets for currency trading more generally. Given the magnitude of the step up, we do not see it as likely that this trading income will remain at such elevated levels going forward. As such, we are looking at a decline in trading income of 22% in FY16, before stabilising at this level in FY16 and FY17. This will have a temporary dampener effect on non-interest income growth in FY16.

Financial Statement Summary

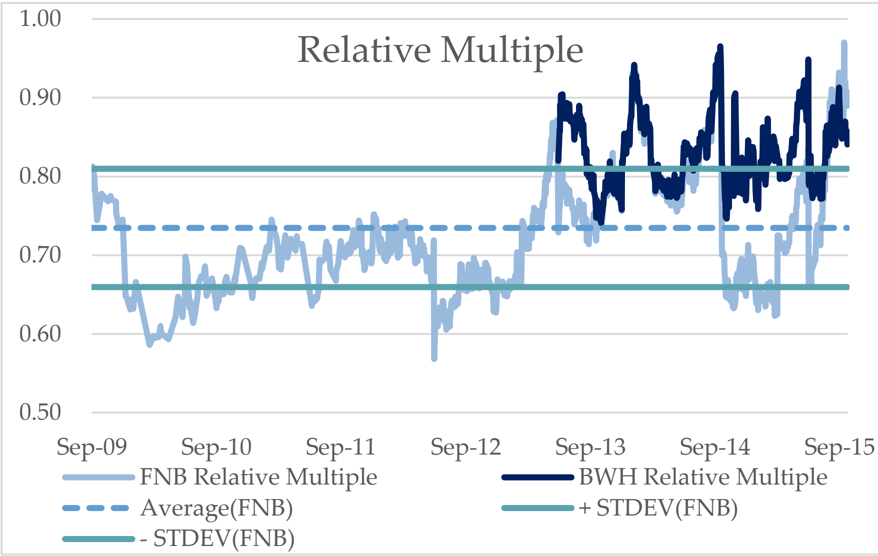
Income Statement

	Actual			Forecast	
in N$ 000s	**2014**	**2015**	**2016**	**2017**	**2018**
Interest and similar income	1,944,847	2,425,239	2,844,598	3,260,063	3,721,935
Interest and similar expense	(887,949)	(1,158,278)	(1,371,127)	(1,624,159)	(1,907,392)
Net interest income	**1,056,898**	**1,266,961**	**1,473,470**	**1,635,905**	**1,814,543**
Impairment losses	(29,115)	(58,305)	(55,425)	(62,519)	(67,379)
Non-Interest Income	**679,732**	**811,891**	**892,638**	**1,008,850**	**1,141,594**
Operating expenses	(914,641)	(1,042,231)	(1,141,243)	(1,249,661)	(1,368,379)
Operating profit	**792,874**	**978,316**	**1,169,441**	**1,332,575**	**1,520,379**
Share of profit from joint ventures	1,151	1,667	1,917	2,205	2,535
Share of profit from associates	84,264	87,159	100,233	115,268	132,558
Profit before tax	**878,289**	**1,067,142**	**1,271,591**	**1,450,047**	**1,655,472**
Income tax expense	(253,374)	(314,140)	(381,477)	(435,014)	(496,642)
Profit for the year	**624,915**	**753,002**	**890,113**	**1,015,033**	**1,158,831**
Other Comprehensive Income	**14,244**	**28,486**	**28,486**	**28,486**	**28,486**
Total comprehensive income	**639,159**	**781,488**	**918,599**	**1,043,519**	**1,187,317**
Headline Earnings	606,221	753,218	890,113	1,015,033	1,158,831
EPS (c)	**124.7**	**150.4**	**177.8**	**202.8**	**231.5**
HEPS (c)	**121.0**	**150.5**	**177.8**	**202.8**	**231.5**
Dividends declared per share (c)	**44.0**	**54.0**	**64.0**	**73.0**	**83.0**

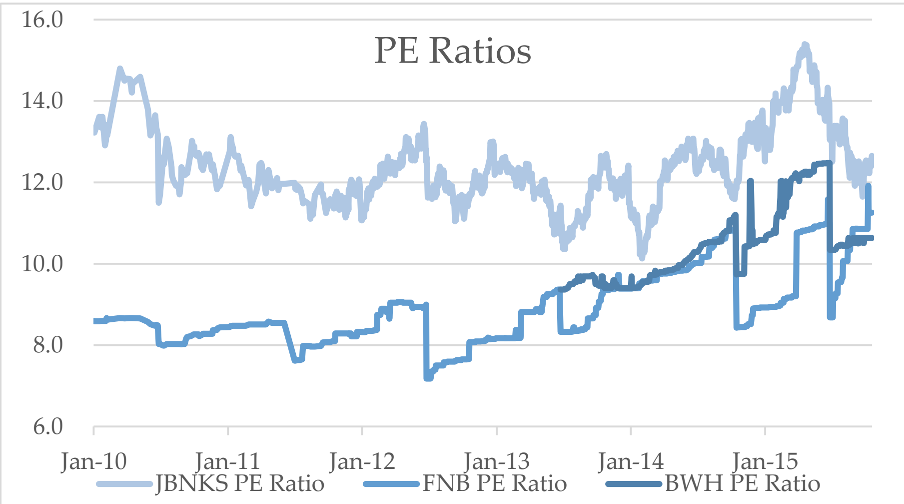
Balance Sheet

in N$ 000s	*Actual*		*Forecast*		
	2014	2015	2016	2017	2018
ASSETS					
Cash and balances with central bank	709,431	619,907	885,158	868,517	412,607
Financial assets designated at fair value	2,104,938	2,587,461	3,139,475	3,139,475	3,139,475
Investment securities	72,047	100,533	120,000	120,000	120,000
Derivative financial instruments	2,190	977	0	0	0
Due from other banks	472,972	740,321	546,163	616,075	692,453
Loans and advances to customers	20,245,395	23,621,871	26,761,973	30,187,673	33,930,195
Investment in associates	209,364	233,157	283,273	340,907	407,186
Other assets	501,931	363,680	407,322	456,200	510,944
Total assets	**24,318,268**	**28,608,842**	**32,315,892**	**35,922,079**	**39,425,415**
LIABILITIES					
Derivative financial instruments	138	1731	0	0	0
Due to other banks	282,664	130,151	212,872	206,051	230,778
Debt securities in issue	1,841,287	2,461,212	3,313,777	4,043,777	4,240,877
Deposits	18,782,411	21,993,998	24,171,750	26,358,549	28,856,697
Other liabilities	317,610	359,015	393,284	434,602	473,222
Total liabilities	**21,224,110**	**24,965,469**	**28,091,683**	**31,042,979**	**33,801,573**
EQUITY					
Share capital and premium	532,435	530,050	532,435	532,435	532,436
Non-distributable reserve	170,354	196,486	226,211	251,455	275,978
Distributable reserve	2,391,369	2,916,837	3,465,563	4,095,210	4,815,428
Total shareholders' equity	**3,094,158**	**3,643,373**	**4,223,599**	**4,878,440**	**5,623,837**

Valuation and recommendation



Both of the domestically listed banks have seen large moves in share prices over the past year, and despite strong earnings growth, have repriced on a multiple basis. As such, the multiples on both FNB Namibia and Bank Windhoek Holdings have increase well beyond one standard deviation of the norm, when compared to the South African JBanks Index. Nevertheless, it can be argued that the Namibian banks were undervalued historically from a multiple perspective, usually trading on PEs of approximately 75% of those of the JBanks Index. Given the relatively strong earnings growth of the two domestically listed banks, this relatively low PE multiple makes little sense. As of mid-October, however, both FNB Namibia and Bank Windhoek Holdings were trading more-or-less in line with the JBanks multiple, with Bank Windhoek Holdings being at a slight discount.



At the time of writing, Bank Windhoek Holdings was trading on a historic PE of 10.6x, which we feel is a cheap-to-fair price for the company. This ratio is well below that of the South African JBank Index (at 12.7x), and FNB Namibia (11.3x). Despite the strong growth in the share price over recent years, at a PE multiple of 10.6x and earnings growth exceeding 20% in FY15, we remain more than comfortable with the share price, and see some further headroom for growth going forwards.

For the purpose of valuing the company, we establish a required rate of return, or **cost of equity, of 14.12%,** up from 11.6% in 1H15, largely on account of a major increase in the risk-free rate, as the yield on Government securities have spiked up over recent months. Based on this cost of equity, a highly conservative **long-term growth rate for the company of 10.5%,** and a **dividend pay-out ratio of 36%**, broadly in line with historic pay-out ratios, we believe a **PE of 9.9x can be justified** on this share. Given **expected earnings growth of 18.3% in FY16**, taking **total earnings to c178/share**, we derive **a target price of c1770/share**. Coupled with an **expected dividend of 64cps**, we expect a **total return of 14.6% in FY16**. This price and dividend means a **dividend yield of 4.0%.**

Based on an expected total return that exceeds our required rate of return, the limited equity options available in Namibia, the relatively expensive nature of many of the listed tickers on the Namibian stock exchange, regulation that forces long term savings into the domestic market and the strong management team at Bank Windhoek Holdings, **we change our HOLD recommendation to a BUY recommendation**.

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