28 March 2014

Bank Windhoek Holdings

Impressive interims paving the way for FY14 prospectus beat

Target Price (c)	1145
Current Price (c)	1061

Year End 30 June	2012A	2013A	F2014	F2015	F2016
Net interest income (N$m)	783	914	1,010	1,136	1,202
Non-interest income (N$m)	463	523	687	756	809
Profit (N$m)	414	516	580	659	705
HEPS (c)	87	108	116	131	141
P/E (x)	12.2	9.7	9.2	8.1	7.6
DPS (c)		33	46	49	54
DY (%)		3.1	4.3	4.6	5.1
P/B (x)		2.0	1.8	1.6	1.4

Source: BWH, IJG

Recommendation	BUY
NSX Code	BWH
Market Cap (N$m)	5 350
Shares in Issue (m)	501
Free float (%)	20
52 week high (c)	1065
52 week low (c)	950
Expected Total Return (%)	13.2

Net interest income

BWH increased net interest income after impairments by 17.1% in 1H14 compared to the comparable 1H13. This performance was bolstered by strong growth of 13.4% or N$2.2bn in loans and advances (L&A) over the 12 month period while the bank also managed to further increase its net interest margin.

The quality of the book showed further improvement on top of already high base with impairments remaining at very low levels of N$9.0m on a L&A book of N$18.7bn, translating to a loan loss ratio of 0.1%, while nonperforming loans improved further from 0.90% to 0.76%.

BWH successfully issued two tranches of floating rate notes on the JSE, the first R600m at 3m jibar plus 180bps and more recently R300m at 155bps spread above the 3m jibar.

Non-interest income

Non-interest income increased a significant 30.5% on the comparable period with the CUTM transaction contributing to the gain. On a like-for-like basis non-interest income increased 19.5% on the back of increased business volumes through transactional accounts and electronic banking channels.

Acquisition of Capricorn Asset Management

BWH recently announced the acquisition of Capricorn Asset Management subject to regulatory approval from the Bank of Namibian and Namfisa. BWH will purchase CAM for a cash consideration of N$128m, an implied PE multiple of 7.4x which is reasonable in our view and set to result in a positive bootstrapping effect.

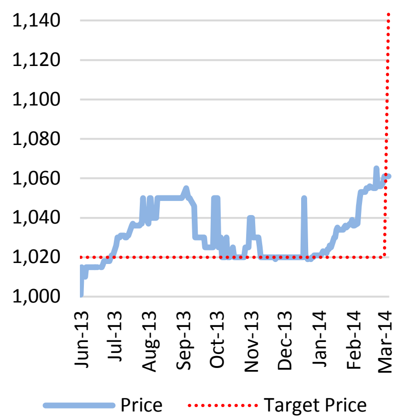
Earnings forecast and outlook

We forecast earnings 116cps and 131cps for FY14 and FY15, respectively with the FY14 numbers marginally ahead of the prospectus forecast. The upbeat forecast and positive outlook is a result of our anticipation of continuing strong growth in domestic demand while BWH is set to benefit from the start of an interest rate hiking cycle throughout FY15.

Target price and recommendation

Based on a justified PE multiple of 8.75x, which is in our view conservative when compared to the current rating of 9.0x and considering the long term re-rating that is playing out amongst NSX Locals, and our FY15 earnings per share forecast of 131cps, we derive a **target price of 1145cps**. Based on our expected 12 month total return of 13.2%, we recommend a **BUY** on BWH.

BWH closing price



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Financial Statement Summary

N$ '000	FY10	FY11	FY12	FY13	FY14	FY15	FY16
INCOME STATEMENT							
Interest and similar income	1,300,366	1,351,539	1,525,912	1,708,096	1,949,719	2,402,176	2,741,300
Interest and similar expense	(732,625)	(680,223)	(742,854)	(793,642)	(939,995)	(1,266,045)	(1,539,702)
Net interest income	567,741	671,316	783,058	914,454	1,009,724	1,136,131	1,201,598
Impairment charges on loans and advances	(22,816)	(27,129)	(25,243)	(26,803)	(29,850)	(40,000)	(45,000)
Net interest income after loan impairment charges	544,925	644,187	757,815	887,651	979,874	1,096,131	1,156,598
Non-interest income	373,668	402,914	463,332	523,191	686,959	755,656	808,553
Operating income	918,593	1,047,101	1,221,147	1,410,842	1,666,833	1,851,786	1,965,151
Operating expenses	(577,965)	(643,275)	(706,511)	(762,759)	(911,000)	(965,660)	(1,023,600)
Operating profit	340,628	403,826	514,636	648,083	755,833	886,126	941,551
Share of JVs' and associates' results after tax	39,437	58,729	55,345	61,636	97,202	82,471	94,842
Profit before income tax	380,065	462,555	569,981	709,719	853,035	968,597	1,036,393
Income tax expense	(98,618)	(134,045)	(167,370)	(216,448)	(272,971)	(309,951)	(331,646)
Profit for the year	**281,447**	**328,510**	**402,611**	**493,271**	**580,064**	**658,646**	**704,747**
BALACE SHEET							
ASSETS							
Cash and balances with central bank	805,761	582,974	881,059	852,636	750,000	850,000	950,000
Government and other debt securities	1,069,042	1,194,761	1,523,800	1,493,165	1,792,826	2,076,973	2,255,249
Loans and advances to banks	403,712	362,238	211,032	251,355	210,000	250,000	300,000
Loans and advances to customers	11,320,292	13,004,405	15,484,932	17,651,962	19,920,287	22,575,796	24,513,573
Other assets	852,339	840,445	820,227	689,490	1,473,630	1,639,278	1,766,117
Total assets	14,451,146	15,984,823	18,921,050	20,938,608	24,146,742	27,392,047	29,784,939
LIABILITIES							
Deposits from banks	-	246,974	237,611	166,959	200,000	240,000	240,000
Other deposits	3,970,799	3,188,906	3,398,657	3,511,815	5,000,000	5,000,000	5,500,000
Debt securities in issue	352,133	767,311	917,322	1,323,976	1,451,330	1,155,500	705,500
Due to customers	8,419,847	9,852,677	12,126,619	13,022,976	12,892,436	15,188,390	16,847,423
Other liabilities	366,364	356,102	353,782	288,824	1,700,586	2,485,291	2,722,632
Total liabilities	13,109,143	14,411,970	17,033,991	18,314,550	21,244,351	24,069,181	26,015,555
Total shareholders' equity	**1,342,003**	**1,572,853**	**1,887,059**	**2,624,058**	**2,902,391**	**3,322,865**	**3,769,384**
	-	-	-	-	-	-	-
CAPITAL RATIOS							
Risk weighted assets	11,523,932	13,198,935	15,718,866	17,556,397			
Tier 1 Capital	1,137,328	1,300,722	1,513,217	2,104,358			
Tier 2 Capital	311,718	443,459	467,480	508,031			
Total regulatory capital	**1,449,046**	**1,744,181**	**1,980,697**	**2,612,389**			
Leverage capital ratio	8.0%	8.3%	8.1%	10.1%			
Tier 1 risk-based capital ratio	9.9%	9.9%	9.6%	12.0%			
Total risk-based capital ratio	12.6%	13.2%	12.6%	14.9%			
OPERATIONAL RATIOS							
Cost:Income Ratio	62.9%	61.4%	57.9%	54.1%	53.7%	51.0%	50.9%
Net Interest Margin	4.3%	4.2%	4.4%	4.5%	4.5%	4.4%	4.2%
NPLs/Average Advances	1.6%	1.6%	1.0%	0.9%	0.8%	1.0%	1.2%
Impairment Ratio	0.21%	0.22%	0.18%	0.16%	0.16%	0.19%	0.19%
RETURN RATIOS							
Return on average assets	2.1%	2.2%	2.3%	2.5%	2.6%	2.6%	2.5%
Return on average equity	22.2%	22.5%	23.3%	23.7%	21.0%	21.2%	19.9%
Current Price				1,061			
Price:Earning Ratio			12.20	9.73	9.17	8.08	7.55
Price:Book Ratio				1.99	1.83	1.60	1.41
Dividend Yield				3.1%	4.3%	4.6%	5.1%

Interest income and the asset base

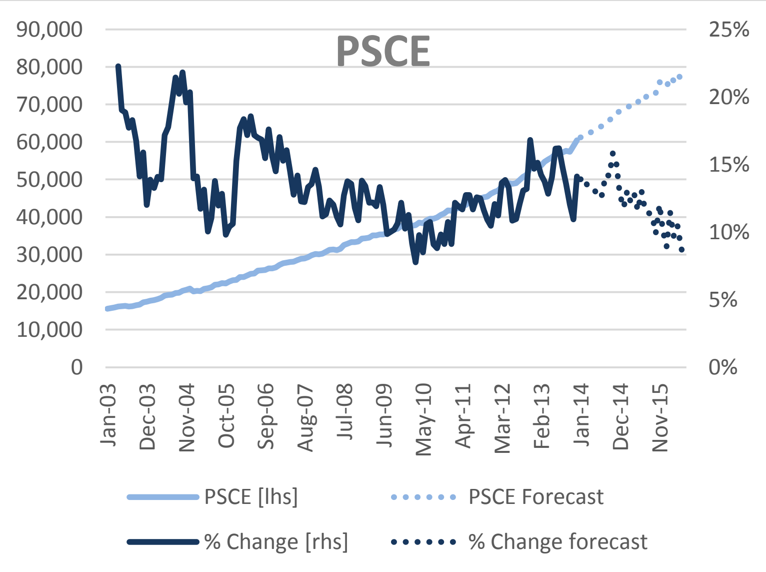
Macro backdrop for PSCE and interest rates

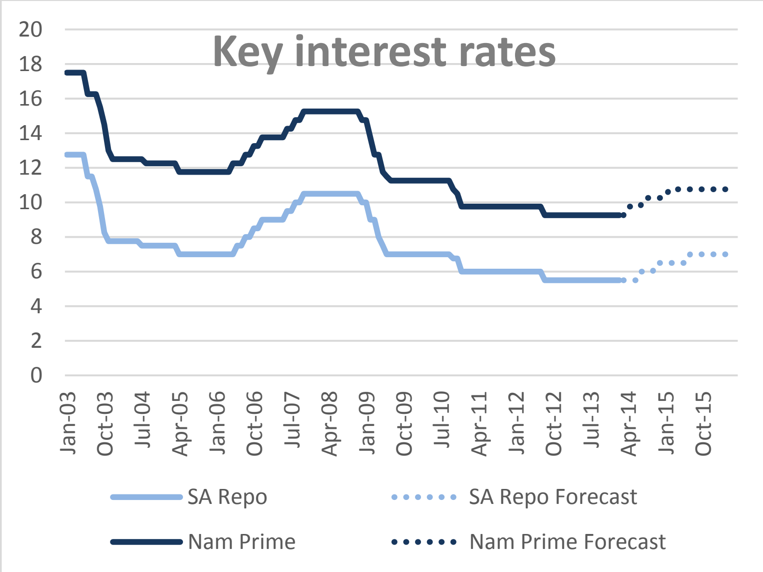
Growth in PSCE bottomed out in March 2010 and has since been on a fairly strong upward trend driven by strong growth in disposable income and declining interest rates to record lows. In the space of 48 months credit extended to the private sector increased N$22.6bn or 64%. Stated in terms of a compounded annual growth rate growth was 13.3% compared to nominal growth in GDP over the period of 10.6%.

BWH managed to secure additional market share over the period with loans and advances to customers growing at an estimated faster CAGR of 14.3%. Market share in terms of total advances outstanding increased from 29.2% as at June 2010 to 30.9% as at December 2013.

IJG's view is that growth in PSCE is likely topping out after almost four years of trending higher. This view is justified below:

- ✓ The marginal benefit of lower rates and cheaper money has been diminishing as is evident in credit demand slowing from low twenties to sub fifteen percent;
- ✓ The economy is at the start of an interest rate hiking cycle, with borrowers expected to be cautious going forward in light of this; and
- ✓ Increased focus by BoN on PSCE and the likely introduction of alternative measures to curb credit growth.
- × The main risk to our view however is the latest expansionary budget announced by Government, with a 25% increase in the wage bill likely to underpin credit demand.





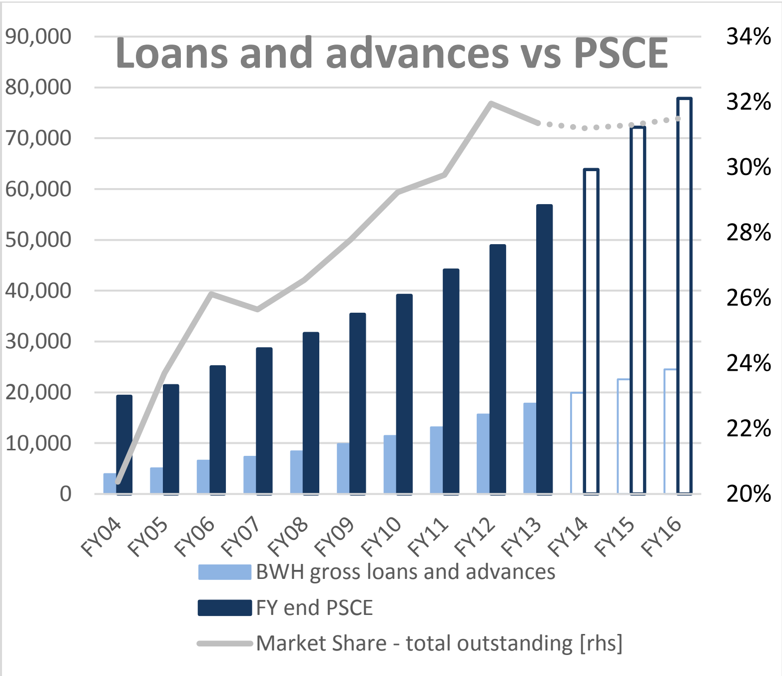
Source: Bank of Namibia; IJG Research

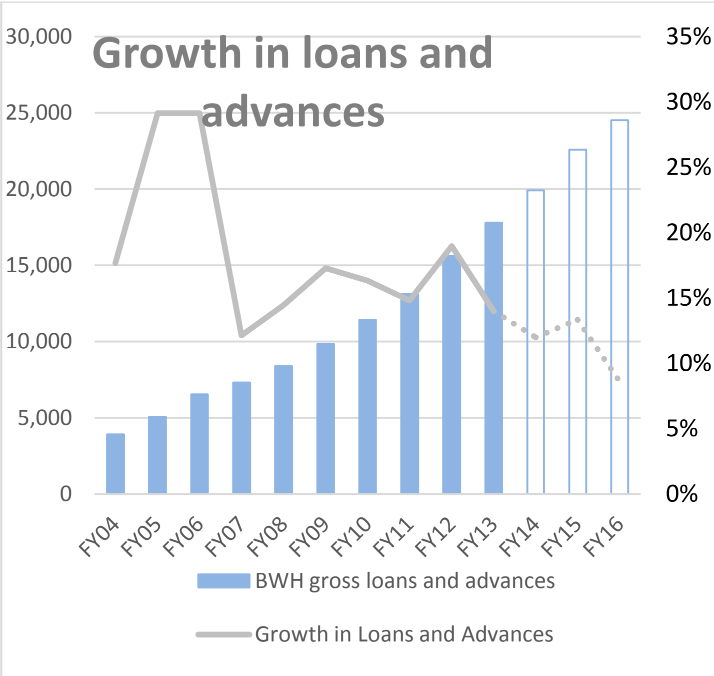
Asset growth

After a decade of continuous gains in market share BWH saw a slight pullback in market share numbers in FY13 to 31.3% from 32% as at end FY12. Our forecasts of BWH loans and advances are based on the assumption that the bank's market share will stabilise at 31.2% by the end of FY14, after which we expect it to slowly tick up to 31.3% and 31.5% in FY15 and FY16, respectively. The market share assumption is based on management's guidance and focus to maintain market share going forward.

The loans and advances forecasts are a function of IJG's projections of PSCE over the next 3 years and our market share assumptions. Based on this we foresee that BWH loans and advances will increase to N$19.9bn in FY14, N$22.6bn in FY15 and 24.5bn in FY16.

This implies that growth in advances will be slowing down to 12.0% in FY14, rebound slightly to 13.3% in FY15 after which we foresee a slowdown to 8.6%. The "slowdown" must be viewed in the context of the high base which has been established over the past couple of years, thus although there exists a downward trend in growth, absolute change in loans and advances will amount to N$2.1bn, N$2.7bn and N$1.9bn for FY14, FY15 and FY16, respectively.





Source: BWH annual reports; IJG Research

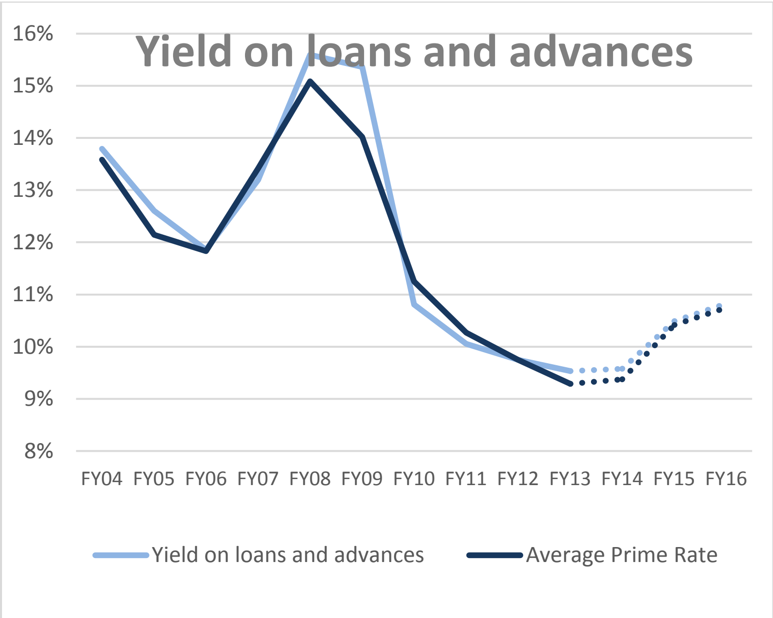
Yield on earning assets and interest income

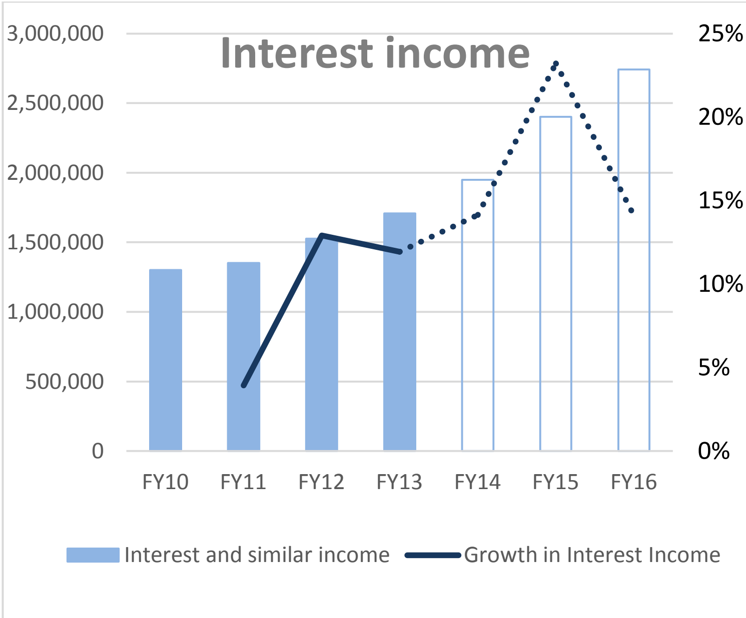
During FY13 the average yield on BWH loans and advances was an estimated 9.5% in line with the average prime rate during the financial year of 9.5%. Analysing the previous hiking cycle suggest that the average prime rate usually surpass the average yield on loans and advances in the early stages of the hiking cycle. However when considering the funding mix of BWH together with the marginal cost of funding, we are of the opinion that BWH will be increasingly focused on maintaining a yield of prime plus. In our view this will be achieved through pricing new credit at prime plus terms.

On the back of continuing growth in the asset base (as illustrated on the previous page) and the initiation of an interest rate hiking cycle, the macro environment bodes well for interest income. We forecast interest income at N$1.95bn in FY14, N$2.4bn in FY15 and N$2.74bn in FY16. This implies that growth will accelerate from 11.9% in FY13 to 14.1% in FY14 and 23.2% in FY15 after which it is expected to slow down to 14.1%.

96% of our forecasted increase in FY14 interest income is attributed to asset growth while the remainder is explained by an increase in average yield. This however does change going forward as a result of the hiking cycle. 60% of our projected FY15 increase is explained by asset growth, while in FY16 the significance of asset growth increases to 70%.
Risks to our forecast of interest income are both to the up- and down side.

- ✓ Our forecast is based on 150bps hiking cycle over the next 12 months, thus the upside risk is that of a more aggressive cycle.
- × Increased intervention by the Bank of Namibia and an outside probability to align the mortgage lending rate with prime.





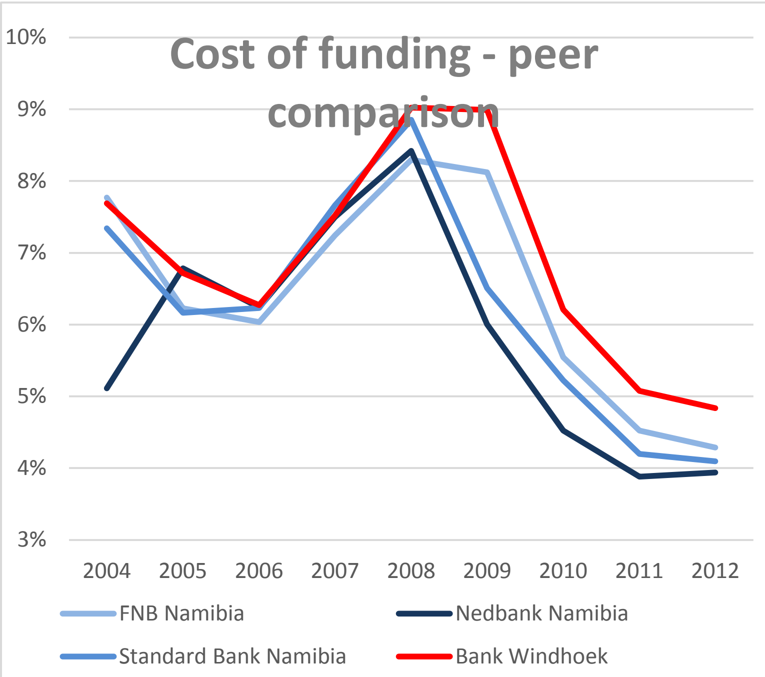
Source: BWH annual reports; IJG Research

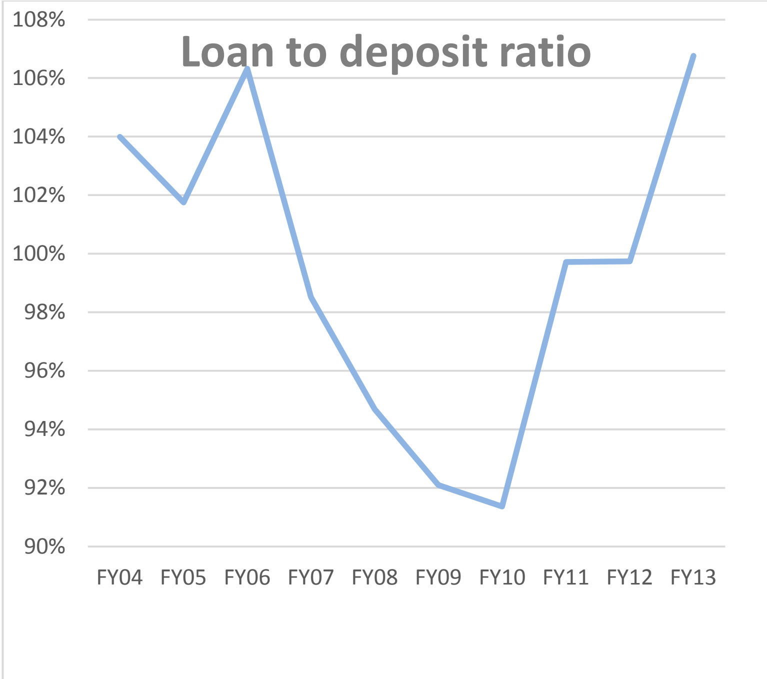
Funding the BWH asset base

Funding mix

Given the nature of the BWH business, which entails, one: no South African parent company, two: an uncompetitive international footprint/association (when compared to the likes of FirstRand and Standard Bank), three: a stronger presence amongst Namibian businesses as opposed to multinationals, and four: a stronger focus towards retail as opposed to corporate business, high asset funding ratio has been a nature of the bank.

This statement is reflected in Bank Windhoek's cost of funding when compared to peers in the Namibian market and the bank's lending ratio over time.



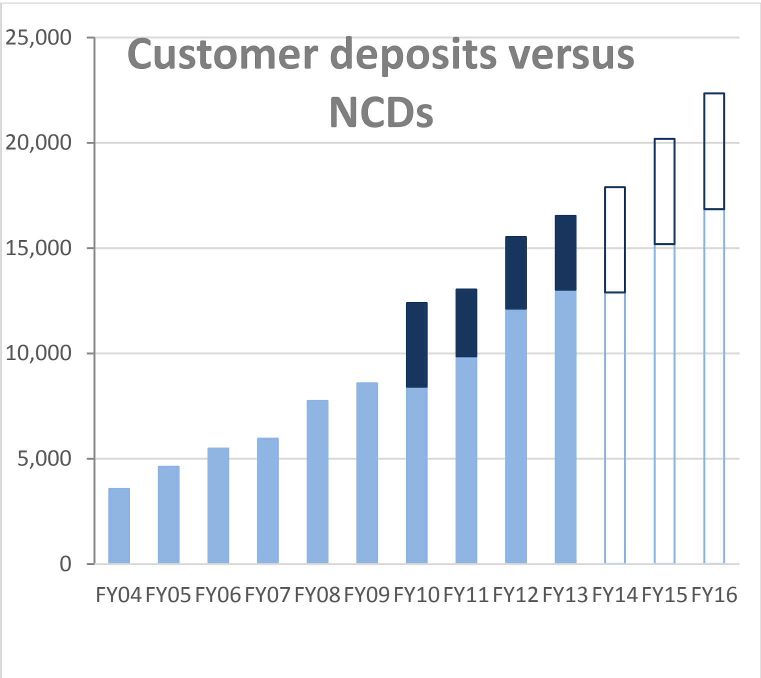


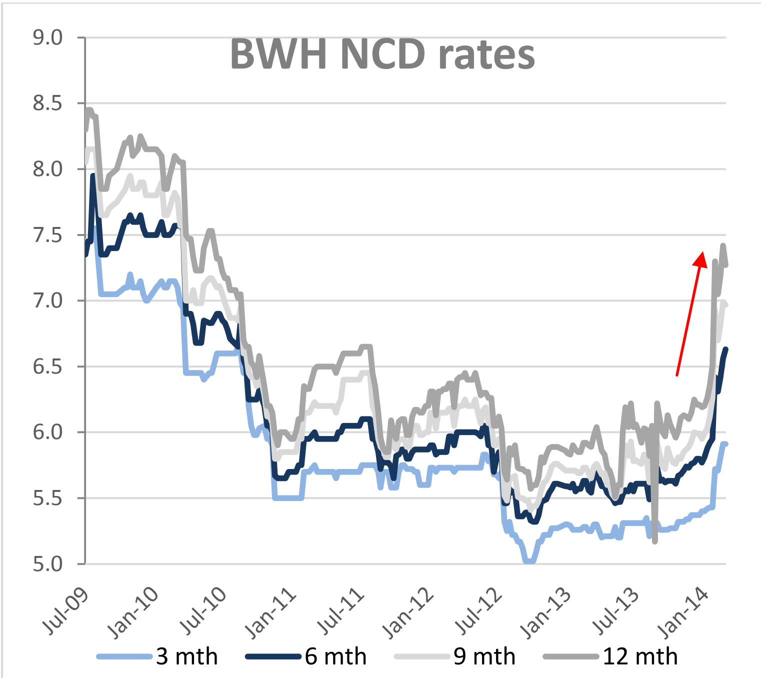
Source: BWH annual reports; IJG Research

Deposits gross of NCD's decreased over the past six months from N$13,023m to N$12,980m. The interim results show that BWH continued to managed funding through a combination of customer deposits and the issuance of NCD's.

The ratio of NCD's to customer deposits tend to vary over time, and for a number of years the NCD component of BWH's financing has been on the decline for a number of years, from 32.0% in FY10 to 24.5% in FY11, 21.9% in FY12 and 21.2% in FY12. The interim results however showed that NCDs increased to 25.2% of deposits in the first half of FY14.

NCD rates have increased significantly as of late with the securities starting to price in interest rate hiking cycle. Since the beginning of 2014 the 3 month NCD has increased 51bps, the month NCD 86bps, the 9 month NCD 1.02% and the 12 month NCD 1.08%.





Source: BWH annual reports; Bank Windhoek Treasury; IJG Research

Debt securities in issue

Bank Windhoek announced a revised ZAR/NAD 5 billion medium term note (MTN) programme November 2013. Following the announcement BWH managed to successfully raise R600m through the issue of a 5 year floating rate note on the JSE at issuance rate of 3m jibar plus 180bps.

BWH recently announce another issue on the MTN programme, raising R300m through the issuance of a 3 year floating rate note on the JSE. BWH also issued two promissory notes with a nominal value of N$50m each and interest rates of 6.15% and 6.10% during the interim period.

The gray text in the table below shows debt securities maturing in FY14 and FY15, amounting to approximately N$949m in nominal value, thus implying that the new issuances is mainly to redeem existing debt securities. An interesting point of note is the step up in rates, with the average new issuance (at current jibar) yielding 6.92% versus 6.57% average yield for debt maturing thus implying a 36bps increase in the cost of debt securities.

Fixed Rate Notes

Codes	Issue Date	Maturity date	Coupon	Yield	Nominal Outstanding
BW19	04-Feb-09	04-Feb-14	10.16	10.16	100,000.00
BW20 t1	16-Aug-10	16-Aug-15	9.38	9.38	100,000.00
BW20 t2	29-Oct-10	16-Aug-15	9.38	8.40	50,000.00
BW20 t3	17-Jun-11	16-Aug-15	9.38	8.25	50,000.00
BWFd16	15-Apr-13	15-Apr-16	6.69	6.69	100,000.00
BWRL17	11-Feb-13	15-Oct-17	8.00	8.00	5,500.00

Floating Rate Notes

Codes	Issuance date	Maturity date	Spread on 3mth Jibar		Nominal Outstanding
BWJh14	15-Feb-11	15-Aug-14	1.00	6.19	100,000.00
BWJd14	14-Apr-11	14-Apr-14	1.02	6.16	100,000.00
BWJb15	23-Nov-11	23-Feb-15	1.15	6.34	100,000.00
BWJj16	15-Apr-13	14-Oct-16	1.10	6.24	100,000.00
BWZJ18	19-Nov-13	19-Nov-18	1.80	6.99	600,000.00
BWZJ17	17-Mar-14	16-Mar-17	1.55	7.05	300,000.00

Preference Shares

Codes	Issuance date	Maturity date	Spread		Nominal Outstanding
Bank Windhoek Corporate Fund	01-Dec-12	01-Dec-15	1.30	6.49	70,000.00
Bank Windhoek Selekt Fund	01-Dec-12	01-Dec-15	1.30	6.49	55,000.00
Santam Namibia	01-Dec-12	01-Dec-15	64.5%	5.97	25,000.00

Promissory Notes

	Issuance date	Maturity date		Rates	Nominal Outstanding
	03-Aug-11	02-Aug-12		6.55	53,275.00
	29-Mar-12	28-Mar-13		6.50	100,000.00
	15-Nov-12	12-Dec-13		5.95	106,390.00
	25-Jan-13	24-Jan-14		5.86	50,000.00
	28-Mar-13	31-Mar-14		5.98	79,530.00
	28-Mar-13	24-Mar-14		5.98	79,440.00
	19-Apr-13	22-Apr-14		5.85	80,000.00
	07-Aug-13	07-Aug-14		6.15	50,000.00
	12-Dec-13	12-Dec-14		6.10	50,000.00

Source: BWH Annual Reports, IJG Research

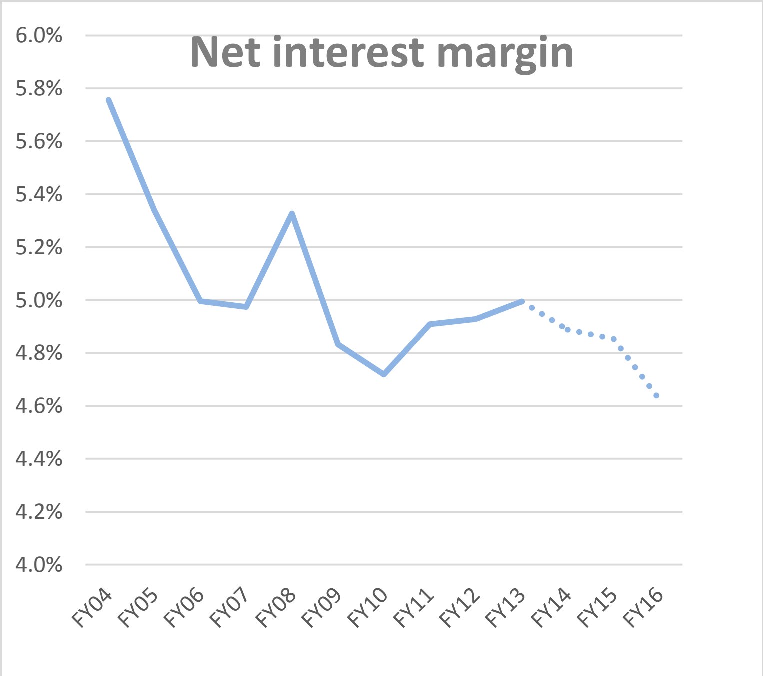
Note: Red – Newly issued

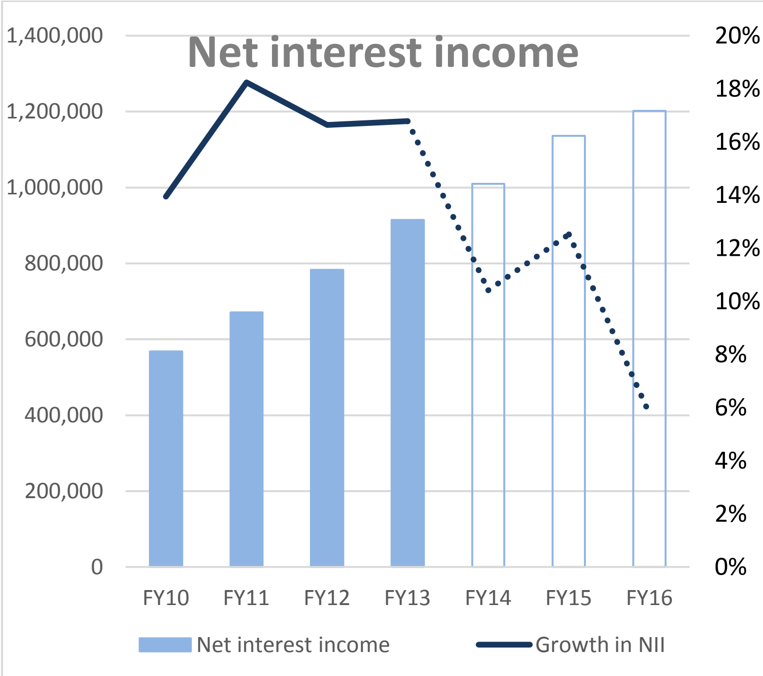
Note: Gray – Mature in FY14 and FY15

Net interest margin

Following an expansion of the net interest margin over the past 3 years, we forecast margin compression over the next 3 years based on our aforementioned views which entail funding continuing strong growth in assets at a marginal rate of funding.

We foresee that strong growth in loans and advances, on the back of a buoyant Namibian consumer benefitting from the pro-cyclical monetary and fiscal policies, will be partially offset by margin compression and as such we expect growth in net interest income to taper off over the next three years.





Source: BWH Annual Reports, IJG Research

Nonperforming loans and impairments

The IJG Housing Affordability Index indicate that the Namibian consumer is in a very strong financial position with mortgage payments being the most affordable that they have been in the last 10 years, despite the growth seen in house prices. The reason for the relative affordability is on account of multi year low interest rates and significant growth in disposable income (the strongest contributor).

Below we illustrated 3 interest rate scenarios, namely flat interest rates, a moderate 100 bps increase and a more aggressive 200bps interest rate hiking cycle's effect on affordability. What is evident from the analysis is that none of the scenarios come close to resulting in broad based unaffordability of mortgages.

We expect to see continuing strong growth in national disposable income in mind of the fact that the economy is growing strongly, and that government (the single biggest employer in the country) is budgeting to increase its wage bill by 25.4% in 2014/15.

The Affordability Index has a very strong inverse correlation with the Namibian banking sector's nonperforming loans, thus given the expectation of "moderate" hiking cycle, we do not foresee a significant (concerning) increase in nonperforming loans.

Source: IJG Research

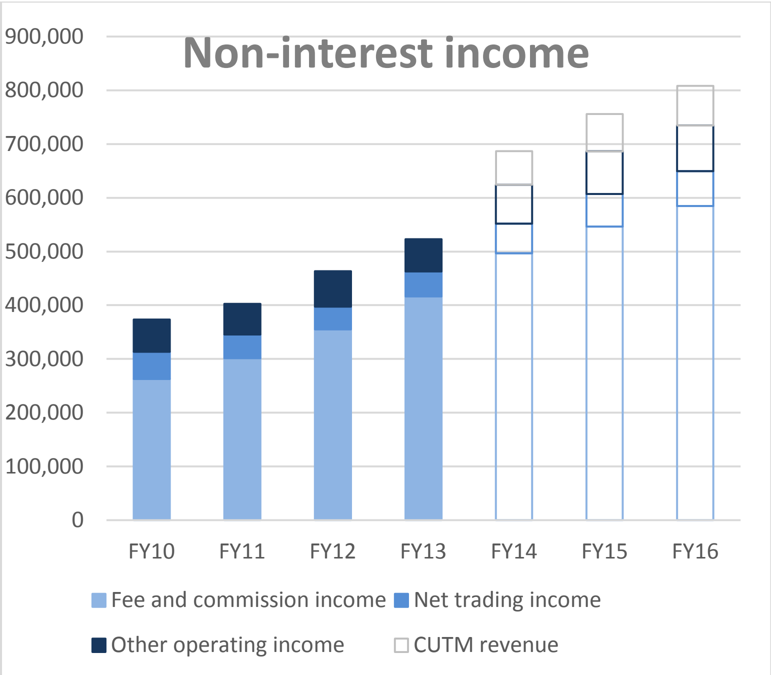
Non-interest income

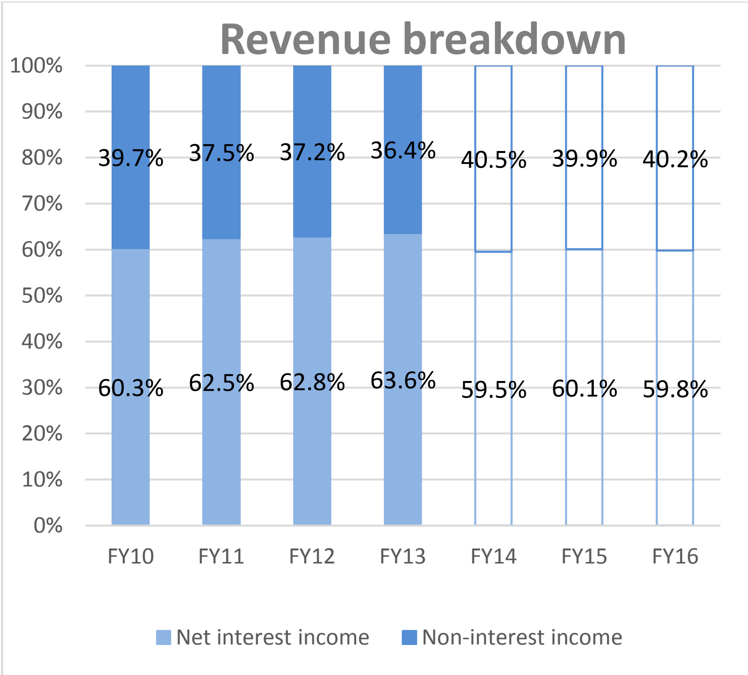
Non-interest income has been a significant contributor to BWH overall revenue over recent years, increasing at a CAGR of 11.9% from FY10 to FY13. However, despite this, growth non-interest income as a percentage of total revenue has been on the decline due to stronger underlying growth at net interest income level, declining from 39.7% in FY10 to 36.4% in FY13.

BWH's recent acquisitions of Capricorn Unit Trust Company (CUTM) and Capricorn Asset Management (CAM) – pending regulatory approval - will however reverse this trend. The CUTM transaction will see an approximate increase in non-interest income to 40.5% of total revenue. Due to limited information disclosed in the announcement regards to the CAM acquisition we have only factored in net profit for CAM in our forecasts, however CAM revenues will further add to non-interest income and the diversification away from net interest income.

The CUTM numbers are already evident in the interim results which saw CUTM contributing to the 30.4% increase in non-interest income to N$340m.

An important consideration is that non-interest income is not purely arising from the banking business with Welwitschia Nammic Insurance Brokers and Namib Bou (through its affordable housing projects) also contributing to the growth.
The key risk to non-interest income remains possible regulatory impact from the Bank of Namibia.





Source: BWH Annual Reports, IJG Research

Capricorn Asset Management acquisition

BWH recently announcement the acquisition of Capricorn Asset Management subject to regulatory approval from the Bank of Namibian and Namfisa. BWH will purchase CAM for a cash consideration of N$128m, an implied PE multiple of 7.4x which is reasonable in our view and set to result in a positive bootstrapping effect, applying the higher acquiring (BWH) PE on the lower targeted (CAM) PE. The bootstrapping effect is approximately worth N$27m or 5.3cps to BWH shareholders.

CAM points worth taking note of:

- ✓ N$10.4bn in assets under management (AUM) as at 31 December 2013
- ✓ Manages and administers 13 unit trust funds
- ✓ Manages and administers a number of segregated portfolios which includes pension fund mandates
- ✓ The Bank Windhoek Unit Trust funds constitute the largest portion of AUM
- ✓ Net asset value of N$5.7m, thus the acquisition will dilute BWH's NAV but will however be enhancing BWH return on equity
- ✓ Net profit after tax 6 months ended December 2013 amounted to N$8.6m

BWH's motivations for acquiring CAM are as listed below:

i. Synergies between BWH and CAM
ii. Diversification of BWH income streams
iii. Growth potential

JVs and associates

Share of associates' results after tax increased significantly on the comparable period, up from N$27.8m in 1H13 to N$51.8m in 1H14. It should however be noted that a significant once off gain is reflected in the Sanlam numbers following the sale of CUTM to BWH.

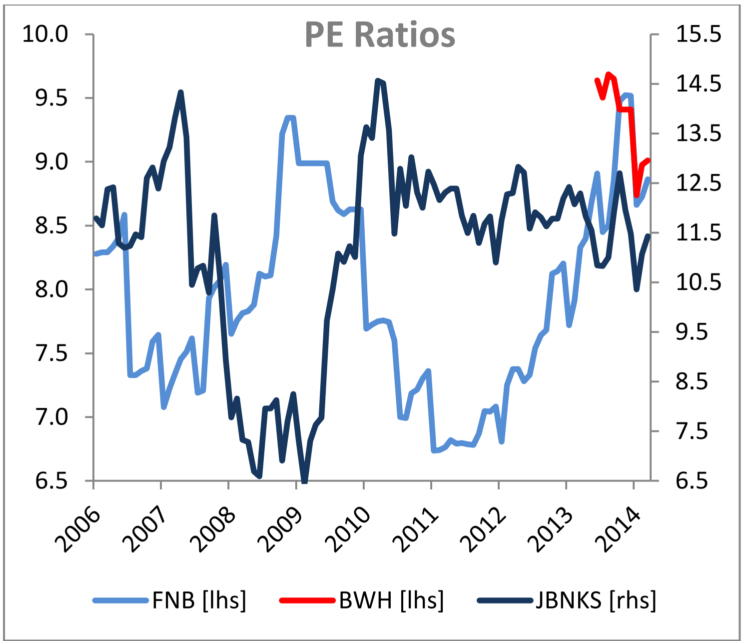
Valuation and recommendation

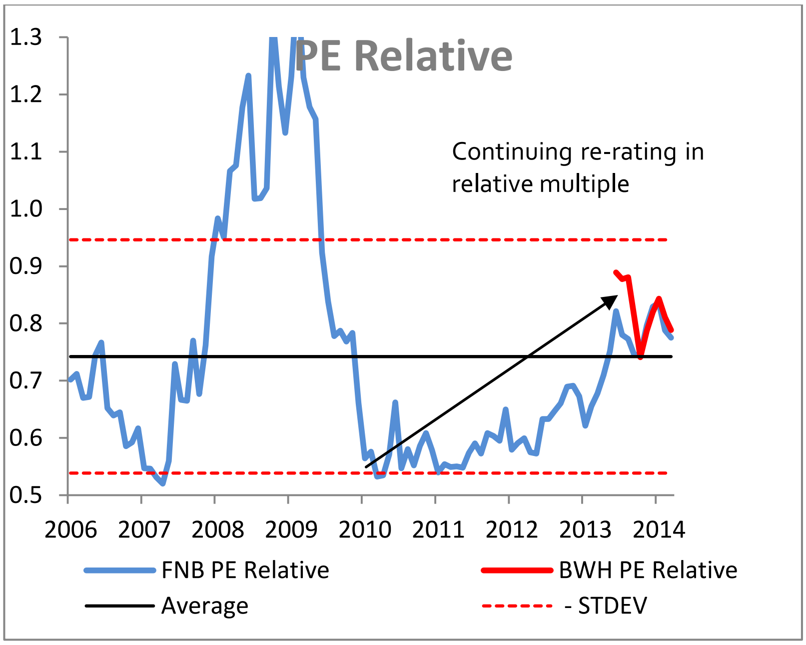
The combined effect of a stabilizing share price and continuing growth in earnings has seen the BWH PE ratio come down to 9.0x from 9.6x end June 2013. This has also seen the premium rating relative to FNB's PE come down from 8.2% end June 2013 to 1.7% currently. This is evident in the graphs below and is pointing to some relative attractiveness in the stock.

BWH is also trading at more attractive levels relative to the South African banking sector (JBNKS), trading at a 21% discount relative to the JBNKS PE compared to an 11% discount 10 months ago. Although this rating is still at a premium to the long run FNB average, we are not concerned.

The recent changes to regulatory requirements regarding local asset holdings in pension funds and long term insurance companies will see a growing demand/supply mismatch over the coming years and as a result will see a continuing re-rating in valuation multiples for Namibian companies. This trend is already evident in the relative PE graphs shown below.

Based on a justified PE multiple of 8.75x, which is in our view conservative when compared to the current rating of 9.0x and considering the long term re-rating that is playing out, and our FY15 earnings per share forecast of 131cps, we derive a **target price of 1145cps**. Based on our expected 12 month total return of 13.2%, we recommend a **BUY** on BWH.





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