IJG Securities (Pty) Ltd.
Member of the NSX

Capricorn Investment Group
1H17 Results Review
APRIL 2017

Capricorn Investment Group Limited

1H17 Results Review

Target Price (c)	1829
Current Price (c)	1743

Year End 30 June	2015	2016	F2017	F2018	F2019
Net interest income (N$m)	1,267	1,458	1,882	2,098	2,290
Non-interest income (N$m)	813	954	1,105	1,263	1,442
Profit (N$m)	753	905	972	1,136	1,317
HEPS (c)	150	181	193	225	260
DPS (c)	54	66	69	81	94
DY (%)	3.5	3.8	4.0	4.7	5.5
P/E (x)	10.3	9.5	8.9	7.6	6.6
P/B (x)	2.1	2.0	1.7	1.5	1.3

Recommendation	HOLD
NSX Code	CGP
Market Cap (N$m)	9,009
Shares in Issue (m)	516.9
Free float (%)	28.5
52 week high (c)	1770
52 week low (c)	1685
Expected Total Return	7.2%

Source: CGP, IJG

CGP released its results for the six months ended 31 December 2016. The firm's results reflected the challenging macroeconomic environment in which it operates. Profit for the period remained flat (+0.3%) compared to 1H16. Earnings per share was also relatively unchanged year on year increasing 0.7%. As a result, interim dividends were kept at 30cps, unchanged from 1H16.

In the last year Bank Windhoek Limited underwent big changes. Firstly, the bank renamed itself the Capricorn Investment Group and underwent a rebranding initiative. The group then announced the acquisitions of two banks, one in Botswana and one in Zambia. Additionally, Mr Koos Brandt announced that he will be stepping down as the chairman of the Bank Windhoek and Capricorn Group boards and will be succeeded by Mr Johan Swanepoel, the current vice chairman of Bank Windhoek and CGP, effective 1 July 2017. Finally, the Capricorn Group announced that the GIPF has made a successful bid to acquire a 25% interest in the issued ordinary shares of Capricorn Group. This will take their stake in the listed entity from 1% to 26%.

Net interest income increased by 3.0% to N$749.9m from N$727.9m in 1H16. Interest income increased by 14.9% while interest expense increased by 27.4%. The average cost of funding increased from 5.7% to 7.2%, while the average interest on advances grew from 11.2% to 12.1%, causing a contraction in the net interest margin of 52 basis points.

Non-interest income decreased by 3.1%, which is a disappointment versus our expectations. However, on a normalized basis, excluding once-off Kwanza trading income and the income of Welwitschia Insurance Brokers (WIB) sold in July 2016, non-interest income increased by 11.6%. Non-interest income now makes up 39.2% of total operating income, from 40.9% in the preceding year.

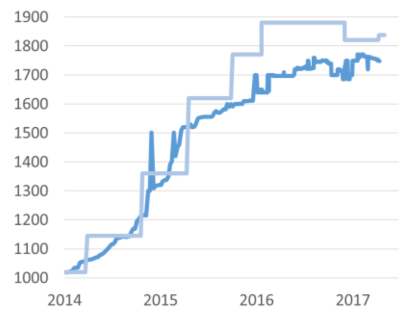
While top line growth was relatively sluggish, operating expenses were well contained, growing at only 0.7%. Normalising this figure for the sale of WIB, yields an increase of 4.5% in expenses. While other Namibian financial institutions have been affected by increasing compliance costs, CGP has done well to keep the cost to income ratio stable at 49.0%.

Total assets grew by 3.1%. Loans and advances growth was similarly muted, growing by 6.2%, from N$25.5bn to N$27.1bn. Once again growth in advances was mostly driven by increases in overdrafts and mortgages, while loans to other banks decreased by a massive 81.4% to N$268.4m from N$1.4bn in the previous reporting period.

Funding growth was also muted increasing by 1.5%. Deposits from customers increased by 2.9%, from N$26.6bn to N$27.3bn. Loans from other banks decreased by 48.1% or N$197.9m, while debt securities in issue increased by N$296.2m. The slowdown in funding was largely due to a decline in market liquidity and an overall challenging economic environment. According to the bank, despite the challenging environment the group has managed to increase its maturity profile and decrease dependency on short term funding.

The group remains well capitalized with a total risk-based capital adequacy ratio of 15.6%, up from 14.5% in 1H16, well above the minimum regulatory requirement of 10%.

CGP Share Price



Dividends

An interim dividend of 30 cents per ordinary share was declared on 22 February 2016 for the period ended 31 December 2016.

- LDT: 3 March 2017
- Ex Date: 6 March 2017
- Record date: 10 March 2017
- Payment date: 24 March 2017

Analyst

Dylan van Wyk
+264 383 521
dylan@ijg.net

The company announced an interim dividend of 30 cents per share, unchanged from the interim dividend of 1H16. This implies a payout ratio of 32.7% slightly lower than the 32.9% witnessed in 1H16.

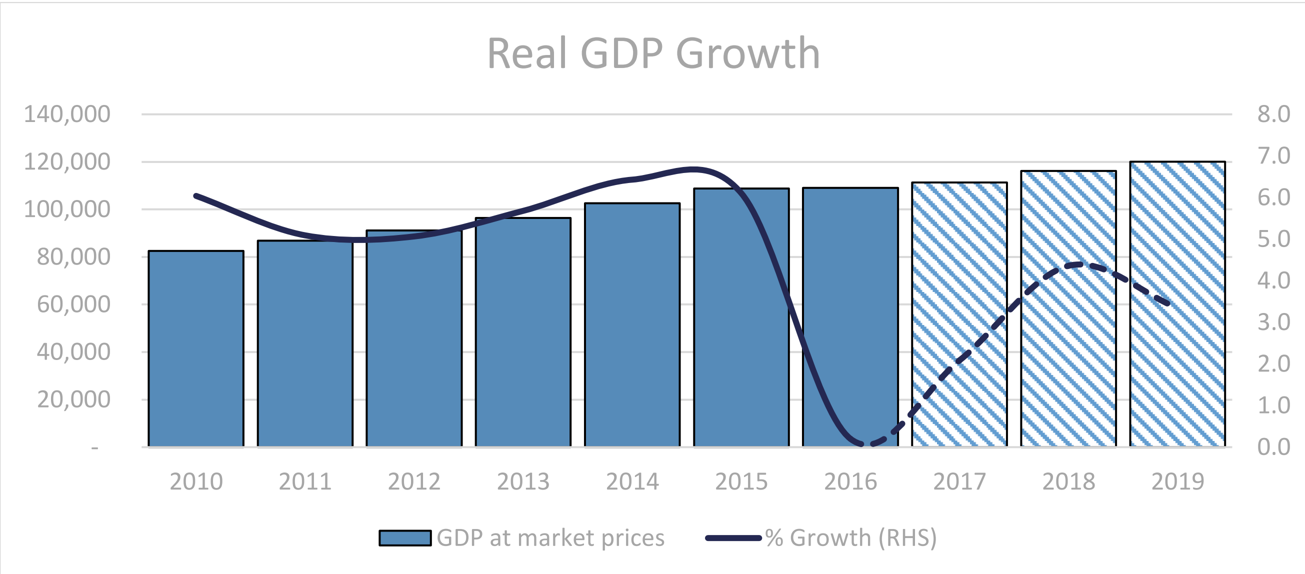
For the purpose of valuing the company, we establish a **cost of equity, of 14.9%,** which consist of a risk-free rate of 10.9%, an equity risk premium of 3.0% and a liquidity premium of 1.0%. Based on this cost of equity, a highly conservative **long-term growth rate for the company of 9.3%,** and a **long term sustainable Return on Equity of 19.8%** we believe a **Price to Book multiple of 1.84x can be justified** on this share. Given **expected book value per share of 992 cps in FY17**, we derive **a target price of N$c1829 per share**. Coupled with an **expected final dividend of 40cps**, we expect a **total return of 7.2% in 2H17.** Due to the low expected return and tough economic environment, which may continue for an extended period of time, we **revise our recommendation to a HOLD for the Capricorn Investment Group**.

Macro backdrop

Growth environment:

The Namibian economy performed very well over the first half of this decade. Over this period, real growth averaged around 5.7%. This abnormally strong growth was driven by three key factors, namely, accommodative monetary policy which fuelled the uptake of private credit; major fiscal expansion from 2011 until now, driving money into the pockets of the public, as well as major civil works programmes; finally, unprecedented levels of foreign direct investment into the country, driven by the consecutive construction of three FDI funded mines. These factors resulted in a consumption and construction boom, which saw a major expansion in the local economy.

However, the picture has changed significantly and the growth environment in Namibia has deteriorated significantly over the last two years. After running expansive monetary and fiscal policy for the first half of the decade, the Ministry of Finance started to close the taps in the mid-term budget in October last year. The full year 2017/18 budget confirmed that consolidation will be the course of action in Namibia for the foreseeable future.

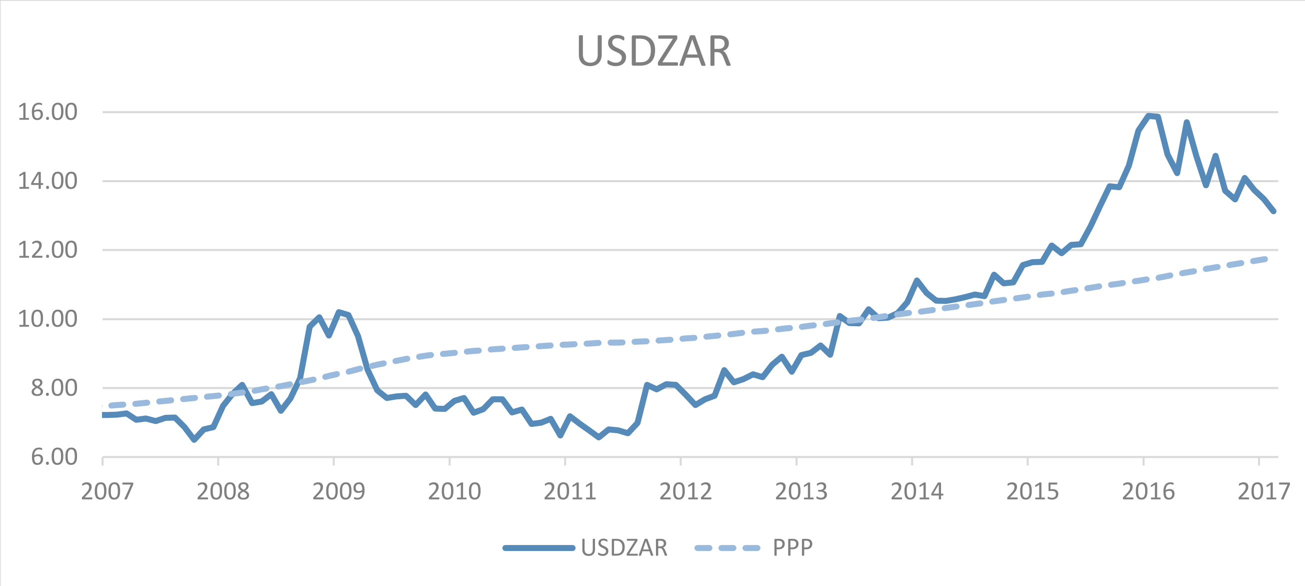


Source: NSA, IJG Securities

While external factors were largely to blame for causing the economic slowdown, slow recognition of these factors and failure to plan accordingly, exacerbated these economic headwinds. Pro-cyclical monetary and fiscal policy effectively ramped up the business cycle and now that Namibia needs stimulus, many of the avenues previously available have been exhausted.

In addition to the slowing local economy, the downgrade of the South African credit rating has added another headwind for the economy. S&P were quick to respond with a downgrade of the foreign currency rating following the axing of the well-respected Minister of Finance Pravin Gordhan and his deputy. Fitch was soon to follow, downgrading both the foreign and local currency ratings. This has negative implications for Namibia's credit rating, the exchange rate, interest rates and inflation.

Exchange Rate

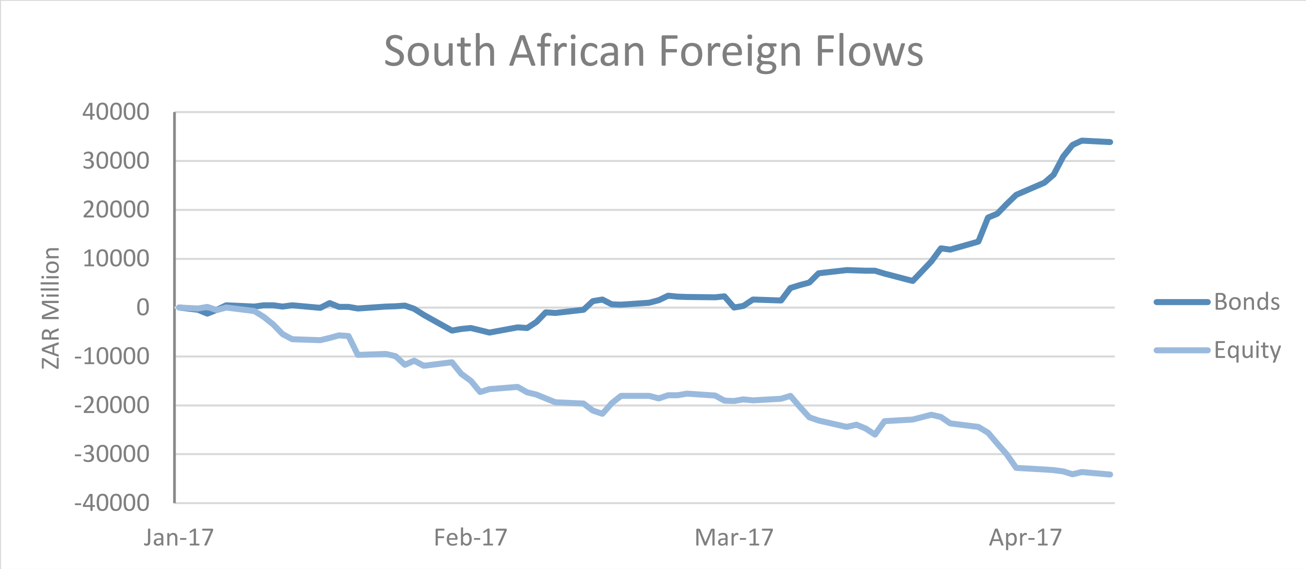


Source: Bloomberg, IJG Securities

One of the first victims of the downgrade was the exchange rate. After major weakness through 2015, the rand recovered strongly in 2016. This was largely due to the fact that the rand had depreciated quite far from fair value on a long term purchasing power parity (PPP) metric. Based solely on PPP, the currency should be trading at around the R11.80/USD level.

While South African government officials insist the rand's ups and downs are not tracking political turmoil in the country, the evidence points to the contrary. Following the announcement of the cabinet reshuffle, the rand has depreciated from a low of R12.36 to the US dollar to highs of around the R14.00 level, or around 13.3%. However, these levels are well below the lows of R16.89 last seen when the previous finance minister was replaced, and we have seen some strength in the currency again quite recently.

Initially expectations were that falling out of global bond indices, due to a sub investment grade rating, would trigger selling of around R134 billion by index funds and which would drive rand weakness. However, it seems the downgrade has attracted even more foreign direct investment into the country as carry traders become enticed by higher yields. In our opinion, this is what is currently supporting the currency.



Source: Bloomberg

Inflation

Inflation expectations for the upcoming fiscal year are notably higher than was the case in 2016. Annual inflation in Namibia was running at 7.8% in February and we expect this figure to remain high for the rest of the year. There are several reasons for this.

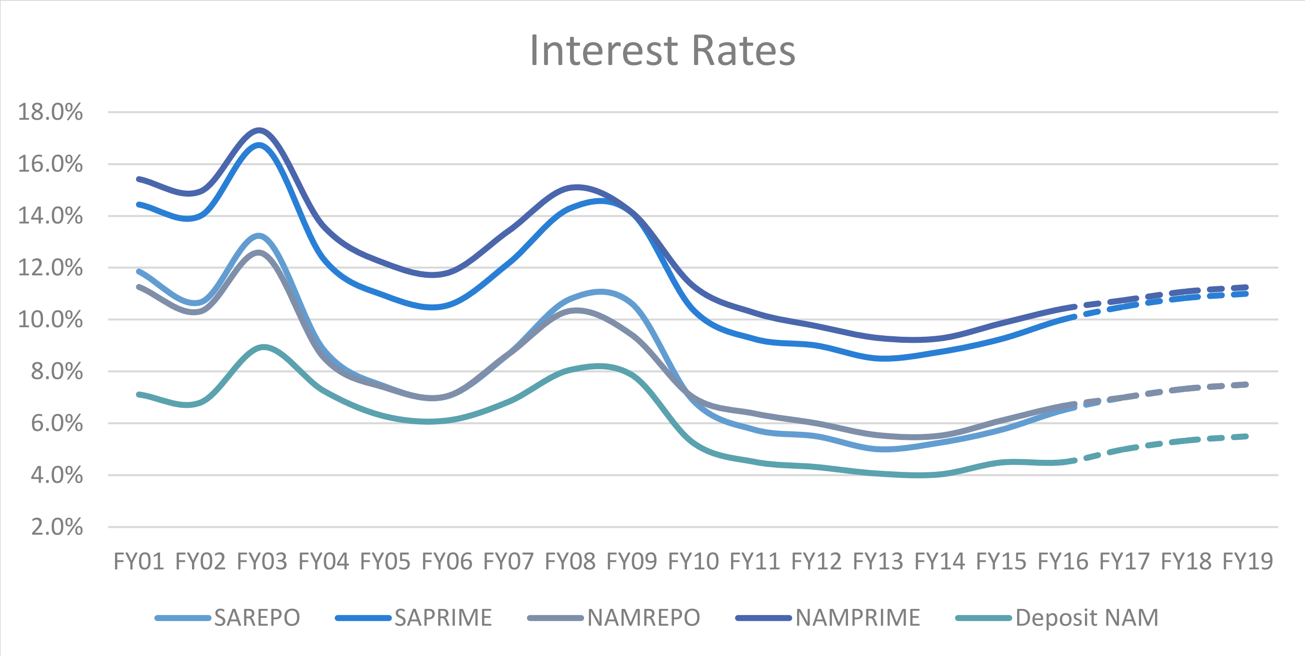
Firstly, the NSA recoded a 9.7% increase in the cost of rentals, which represents 23.3% of the total inflation basket. This is normally a once off rebasing effect that takes place in January, thus this increase will affect the NCPI number for the rest of 2017. Whether or not this is an accurate measurement of the increase in housing costs remains up for debate.

Secondly, petrol prices have been increased twice this year. Despite the oil price in rand having been flat year to date, the ministry of mines and energy continue to report under recoveries. Additionally, an increase in the fuel levy has been announced in this year's budget, however the magnitude of the increases has yet to be announced. Furthermore, rising tensions in the middle east have triggered a rise in the price of oil, which may spike further. The increased cost on transport and the second round effects this might have on other goods will likely keep inflation high.

Finally, we expect increases in the prices of utilities, which are normally adjusted mid-year, which should put further pressure on an already high inflation number. The only exception to the trend of increasing prices is the food category. After a good rainy season, we expect food inflation to moderate from the current double digit figures.

Again, the downgrade has exacerbated already high inflation numbers. A weaker exchange rate is likely to drive up the cost of imported goods and inflation expectations are already on the increase. All in all, due to the increased cost of living, the real value spend of consumers is likely to be reduced, as disposable incomes come under pressure. This pressure is likely to drive increased demand for credit, as well as large wage settlement demands, both in the private and public sectors.

Interest Rates



Source: Bloomberg, IJG Securities

Interest rate expectations have changed considerably following the downgrade. Before the "political shenanigans" began, the South African Reserve Bank announced a possible end to the rate hiking cycle after being have being on hold for nearly a year. In fact, the FRA market was starting to price in a possibility of an interest rate cut.

Following the announcement, the chances of any rate cuts have all but disappeared. In fact, the forward curve is pointing to one rate increase of 25 points before the end of the year. The South African reserve bank will likely have to react to the depreciating currency, albeit only once inflation expectations increase due to the pass-through effect of a weaker rand

The Bank of Namibia is likely to follow the SARB quite closely. Growth in Namibia remains low and the central bank would not like to increase interest rates unnecessarily. Chances are that the South African MPC will take a wait and see approach, to better assess the true impact the downgrade will have. For the time being we have pencilled in two rate hikes over the next twelve months.

Funding costs

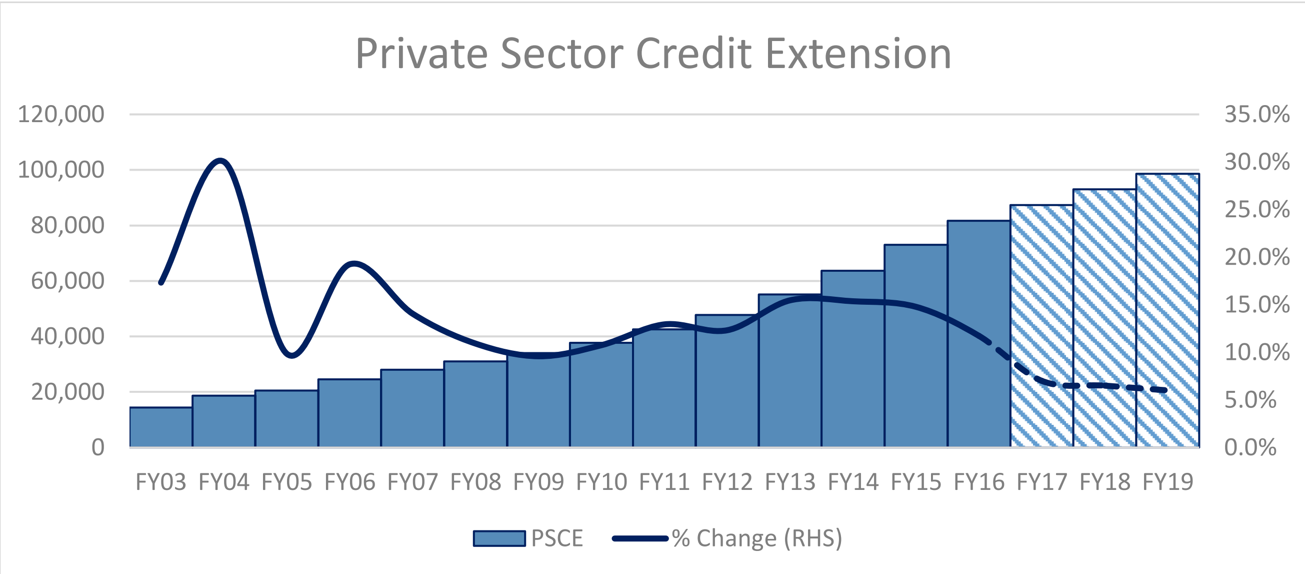
For years, Namibia has been running budget deficits and forecasting consolidation in later years which never materialised. Budgets become more and more expansive, growing more and more rapidly. As a result, large deficits were run in 2014/15 and 2015/16, funded by domestic and foreign debt issuance.

The large amount of government debt issuance combined with lower government spending has resulted in a difficult funding environment for banks. Firstly, the fiscal positon of government has become more strained, the management of government cash balances and payments have become more stringent. As a result, payments to government entities and parastatals, as well as payments to service providers have become throttled, resulting in less money finding its way into the banking system as retail deposits.

Secondly, the large budget deficits, and the subsequent increase in public debt has had a crowing out effect on short term institutional funding. Government has resorted to funding their deficits using short term treasury bills, as the demand for longer term bonds has started to fall away. The effective yields on Treasury bills have in some cases become higher than NCDs of the same tenor. For example, the 364-day treasury bill cleared at an average yield of 9.84% recently while the average NCD rate is around 9.09%. Most banks simply refuse to compete with the unreasonably high yields paid on short term government securities, as they cannot earn an acceptable margin on loans.

Finally, a difficult environment has been made even tougher due to the political instability in South Africa, as benchmark yields continue to climb. The yield on the South African ten-year bond weakened from its low of 8.30% to the current level of around 9.00%. This will likely lead to higher funding costs on long term debt for corporates as well. However, the reaction thus far has been relatively subdued when compared with reactions in the capital markets of Brazil and Russia following downgrades to junk. Should Namibia be downgraded, it is likely the Namibian credit spreads may open, pushing Namibia's cost of funding up further.

Credit demand and supply



Source: Bank of Namibia, IJG Securities

As mentioned, the current environment is not conducive to healthy private sector credit extension. The catalysts driving the uptake of credit, such as low interest rates and a healthy growth environment, have started to dissipate.

The consumer is becoming increasingly pressed, and demand for credit in the form of overdrafts and other short term personal loans are ticking up slightly, the demand for long term loans will be subdued due to the fears of higher future interest rates. Lower disposable incomes and lower escalations in public wages will also reduce the affordability of these assets. Corporates have also become more weary of expansion and are borrowing less to expand their businesses, as evidenced by lower industrial vehicle sales and decreased corporate instalment and mortgage credit uptake.

From the supply perspective, banks are having a difficult time sourcing the funding for loans, as retail deposits have been decreasing or stagnating, while the cost of short term institutional and debt financing are becoming increasingly expensive. As a result, we see a marked slowdown in private sector credit extension over the next three years. We expect PSCE to moderate from the current growth of 8.8% y/y witnessed in 2016 to approximately 5.0% y/y in FY19.

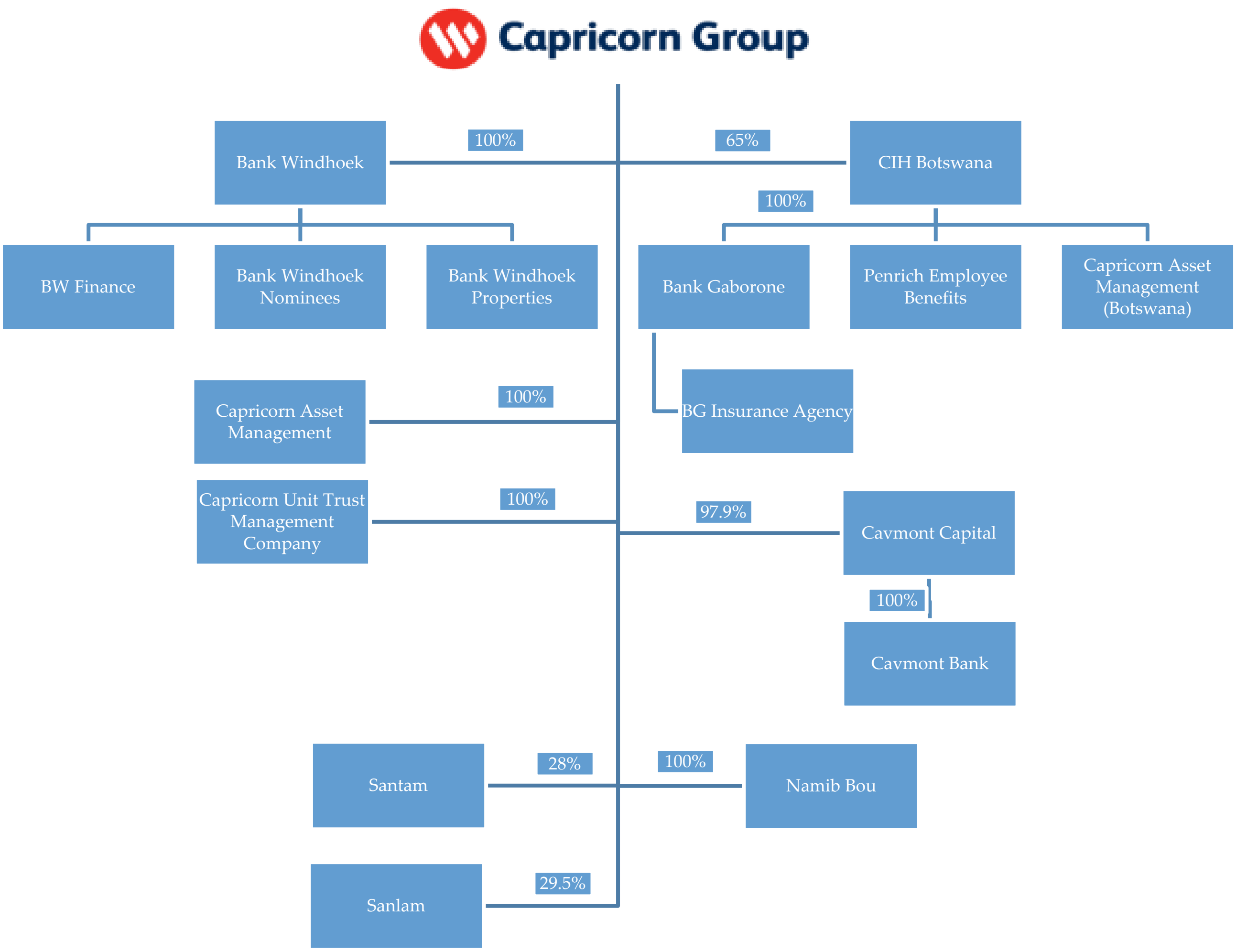
New developments at Capricorn Group

Last year Bank Windhoek Limited underwent big changes. Firstly, the bank renamed itself the Capricorn Investment Group and underwent a rebranding initiative. The rationale for the name change was "to better reflect the underlying businesses and investments of Bank Windhoek Holdings going forward." It soon became apparent that the company indeed has intentions set on becoming a group when it announced the acquisitions of two banks, one in Botswana and one in Zambia.

Secondly, Mr Koos Brandt announced that he will be stepping down as the chairman of the Bank Windhoek and Capricorn Group boards and will be succeeded by Mr Johan Swanepoel, the current vice chairman of Bank Windhoek and CGP, effective 1 July 2017. Lastly, the Capricorn Group recently announced that the GIPF has made a successful bid to acquire a 25% interest in the issued ordinary shares of Capricorn Group. This will take their stake in the listed entity from 1% to 26%.

Acquisition of two banks

In December of last year, CGP announced their intentions to acquire the controlling issued share capital of Capricorn Investment Holdings Botswana Limited (CIHB) and Cavmont Capital holdings Zambia PLC (CCHZ). In terms of the agreement, CGP acquired 65% of the issued share capital of Capricorn Investment Holdings (Botswana) Limited, which owns 100% of the share capital of Bank Gaborone, and 97.9% of Cavmont Capital Holdings Zambia Plc., which owns 100% of the share capital of Cavmont Bank. The effective date of the acquisition is 1 January 2017. The total consideration amounted to of 240.9 million pula and 81.0 million kwatcha, for Bank Gaborone and Cavmont Bank, respectively. This translates into a total consideration of N$420.5 million using 31 December's exchange rates, which was settled on a 50:50 split between debt and equity. This means a price to book multiple of 0.70x was paid for Cavmont, while a multiple of 1.29x was paid for Bank Gaborone.

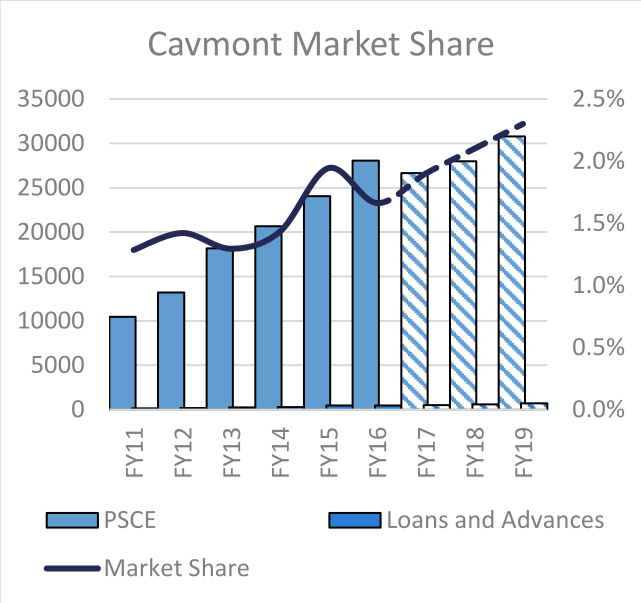


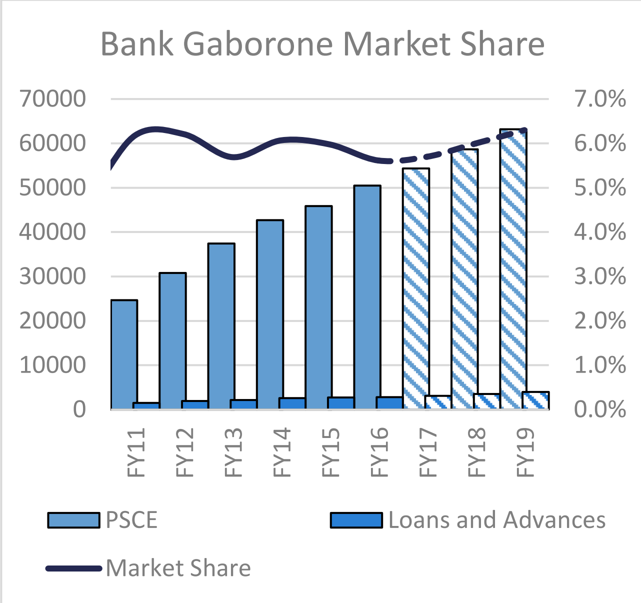
Source: CGP, IJG Securities

The majority of the shares were sourced from Capricorn Investment Holdings (CIH), the ultimate holding company of CGP, which held 80.6% and 73% of CIHB and CCHZ respectively. These holdings have now declined to 15.6% and zero respectively. According to the company's announcement, the retention of 15.6% shareholding in CIHB is to honour a commitment to a local Botswana investor. The additional 24.9% in CCHZ was acquired from other minority shareholders, on the same terms as the CIH deal.

As mentioned these two banks were previously part of CIH, and as a result have been closely aligned with strategy, branding and the operational practises of the group. From the perspective of the Capricorn Group, the acquisition will be low cost and relatively seamless. Management are quite positive about the prospects of these banks as they represent a runway for future growth. This seems sensible as the compound annual growth rate in private sector credit extension from FY11 to FY16 amounts to 21.8% in Zambia and 15.4% in Botswana.

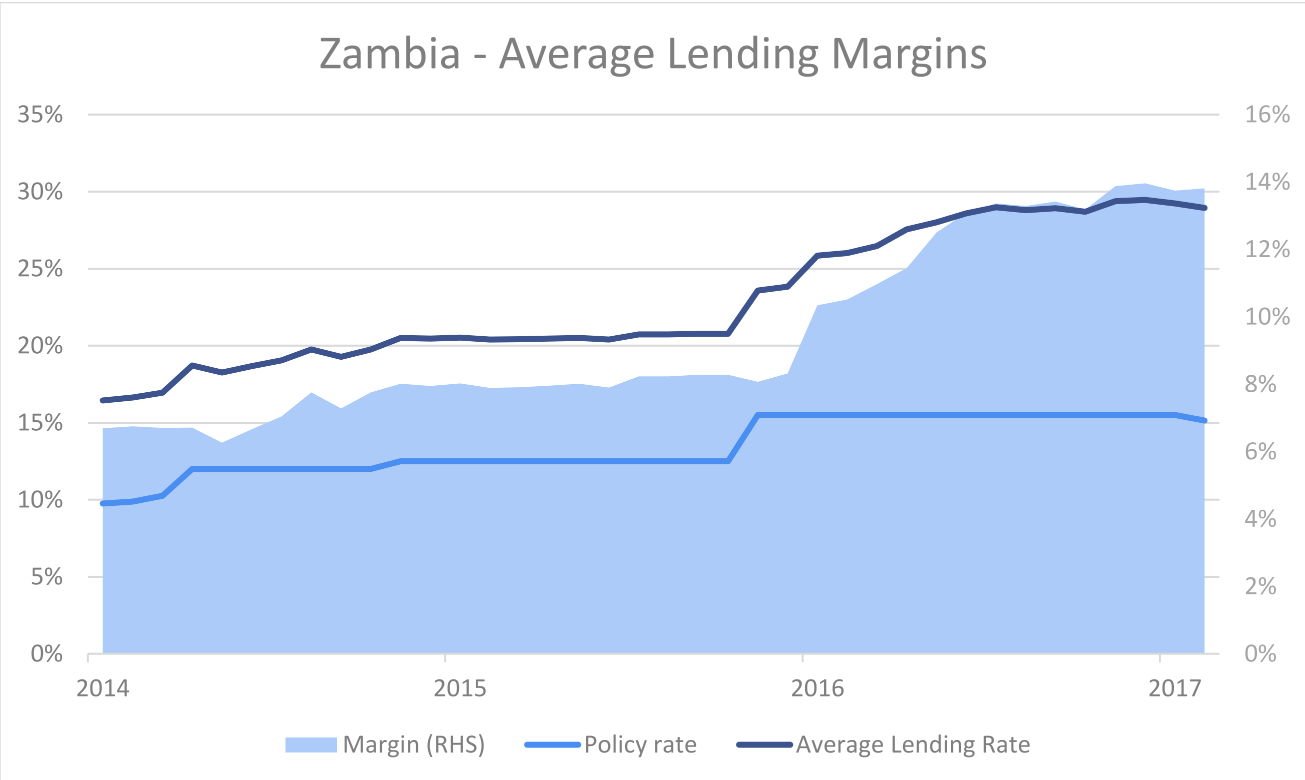
Cavmont and Bank Gaborone have managed to grow their advances by 28.3% and 13.2% over the same period. However, the current market share held by these two banks is still quite low. We estimate that Cavmont has a market share of around 1.7% while bank Gaborone has about 5.6%. Thus, there is quite a bit of upside if they can grow market share.





Source: Bank of Zambia, Bank of Botswana, CGP, IJG Securities

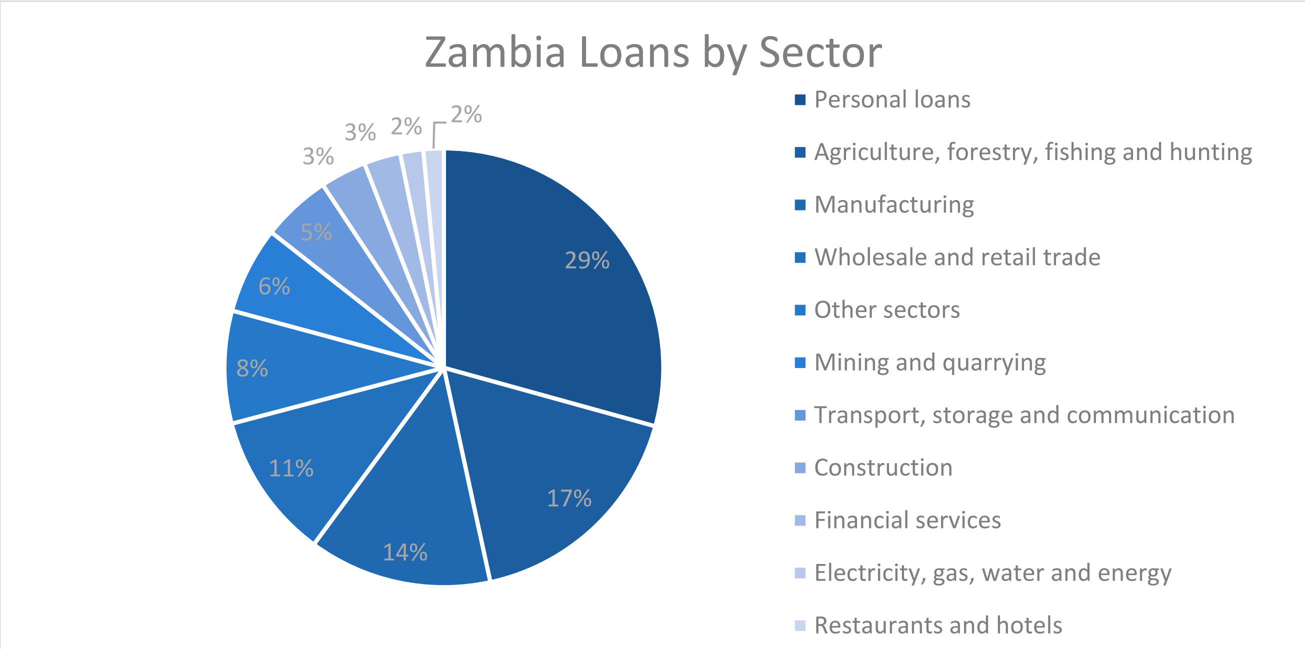
The two new markets pose their own challenges and opportunities. Zambia currently has 19 operating commercial banks with approximately 280 branches. Eight of these are subsidiaries of foreign banks, nine locally owned private banks, and two partly owned by Government. Market concentration is high, with the five largest banks accounting for roughly two thirds of total banking assets. However, penetration is still very low. According to MFW4A, access-to-finance in Zambia is significantly lower than the African average, with more than 65% of the population lacking access to financial services. Additionally, Zambia has very attractive lending margins (as measured by the difference between the monetary policy rate and the average lending rate).



Source: Bank of Zambia

Zambia's economy remains under stress after the fall in commodity prices, especially copper as Zambia is Africa's second largest producer, strained public finances, continued electricity shortages, and subdued consumption and investment. Liquidity in the country has also been an issue for the last couple of years, as evidenced by the high interbank rates. However, this has been improving as commodity prices have recovered somewhat.

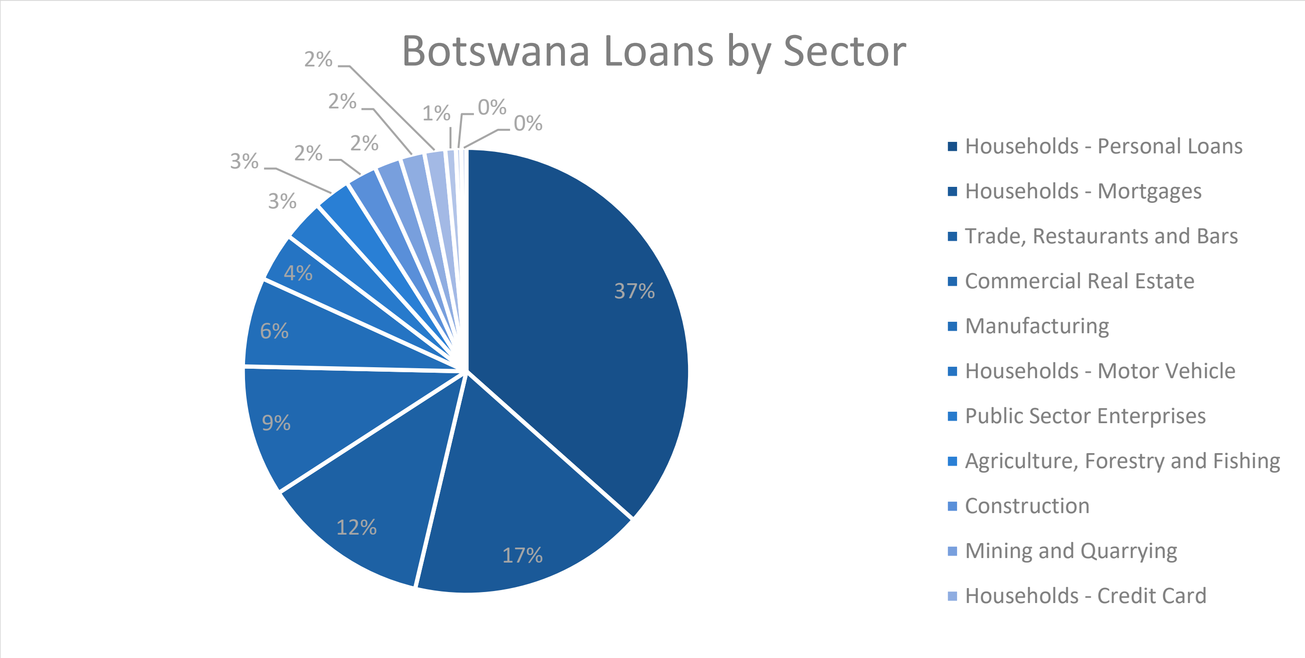
Although the country is heavily dependent on mining, personal loans make up the largest share of advances. These are followed by Agriculture and Manufacturing. These loans are funded largely from deposits, which constitute the largest component (82.7%) of the sector's total liabilities. In terms of deposit composition, demand deposits continued to account for the largest share at 60.1%. Time deposits and savings deposits accounted for 29.4% and 10.5%, respectively.



Source: Bank of Zambia

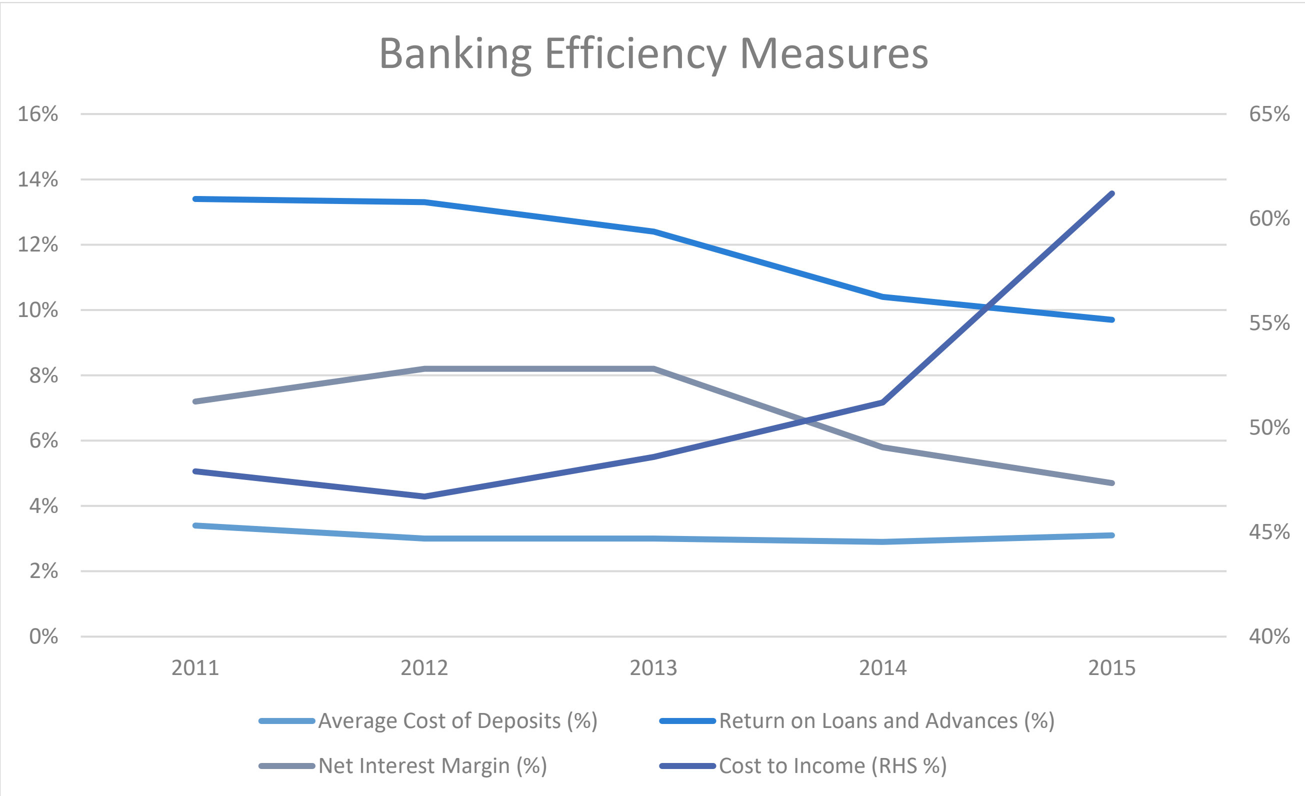
Botswana also poses quite a competitive landscape and currently has 10 operating commercial banks with 114 branches. The banking sector is dominated by five banks, which account for 90% of total banking assets. Access to banking services can be estimated by the number of bank accounts opened relative to the adult population, which stood at 75.9% in 2015. This would indicate that there is a much smaller unbanked market in Botswana. However, although the Botswanan government has actively pursued reforms to facilitate private sector access to credit, many domestic entities, and especially small and medium sized enterprises, still face significant difficulties accessing capital, which may be an opportunity going forward.

Generally, commercial banks have strong balance sheets in Botswana, characterized by healthy liquidity positions, strong capital levels and good quality of banking assets as well as prudent lending. As with Zambia, Botswana's banks are significantly exposed to households, who account for approximately 59% of bank lending to the private sector.



Source: Bank of Botswana

These loans are mainly funded from retail deposits which make up 78% of total liabilities. This remains most banks primary source of finance for asset growth, and these deposits are split evenly between long term deposits (time and savings deposits) and short term (call and current accounts).



Source: Bank of Botswana

The net interest margin in Botswana is far less attractive than Zambia and has been contracting over recent years. This has resulted in lower returns on assets and as a result lower returns on equity. Additionally, cost to income ratios have increased to over the 60% level. The deterioration of the key banking metrics lead us to believe that this is a tough operating environment.

Currently the total assets of these banks are quite small relative to the size of Bank Windhoek and the banks are not very profitable. Thus, in the short term, the results of these two banks will not materially affect the results of Capricorn Group. However, looking forward, these banks have the potential to grow quite quickly and represent a large portion of the future growth of the group. We will continue to monitor the progress of these banks closely going forward.

Changes to the Board

In February this year, Capricorn Group confirmed the retirement of Koos Brandt as the chairman of the Bank Windhoek and Capricorn Group boards, effective 30 June 2017. Mr Brandt will remain a non-executive director on both boards and will continue to be the chairman of Capricorn Investment Holdings ("CIH"). CIH holds 40% of the issued shares in CGP. This is a decision Mr Brandt has made some time ago and as a result a succession plan was put in place to ensure a responsible and smooth transition of leadership.

Johan Swanepoel, the current vice-chairman of Bank Windhoek and Capricorn Group will, in terms of the succession plan, become the chairman of these boards, effective 1 July 2017. Swanepoel is a qualified Chartered Accountant (CA) and was the managing partner of Coopers & Lybrand (now PricewaterhouseCoopers) before being appointed as the managing director of Bank Windhoek in July 1999. In 2005, he took up the position of the group managing director of the CIH group.

Mr Swanepoel has a wealth of experience in the financial services sector and is a seasoned director. He will remain a director of the CIH group but will relinquish a number of other group board positions, including those on the Bank Gaborone and Cavmont Bank.

Government Institutions Pension Fund ("GIPF")

GIPF's bid to acquire 25% of the issued share capital of Capricorn Group, can only be described as a game changer for the Capricorn Group, and specifically Bank Windhoek. Overall the new relationship between the GIPF and Capricorn group should be a very symbiotic one. Generally, in banking, shareholding above 10% confers a status known as shareholder of reference, which has serious implications for the group going forward.

Minority shareholders can take solace in the fact that a shareholder of reference has the means to support the bank in its time of need — for example by following their rights in a rights issue, or even injecting additional capital or debt financing if necessary. The GIPF has already demonstrated their ability and commitment to fulfil this role by offering immediate long-term senior debt funding of N$1.3 billion to the group. As part of the transaction, CIH similarly will also be making long-term funding of N$900 million available.

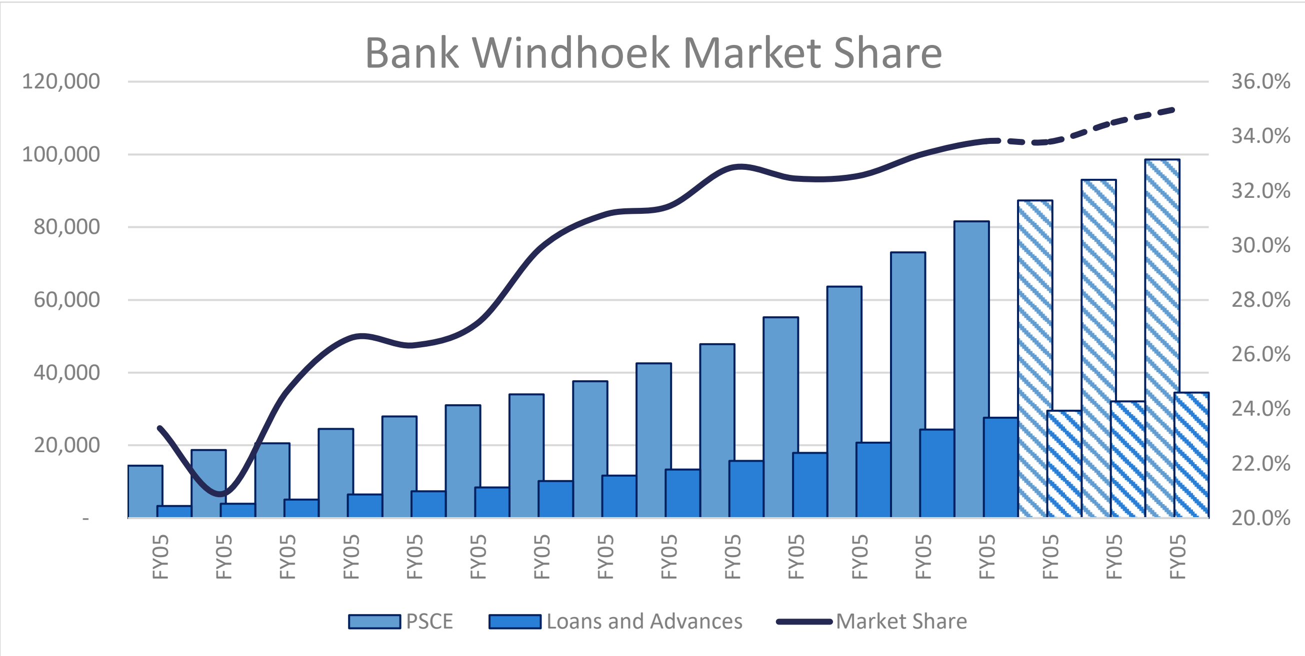
Details surrounding the N$2.2 billion funding are scarce, but should be disclosed in the full year statements. Management has however pointed out that the funding is long term in nature and that the issue was done at a favourable rate. This should provide the Capricorn Group with a more stable, longer duration, funding base, which would make the bank less reliant on expensive short term institutional funding in the form of NCDs.

This injection of liquidity, in a time of liquidity shortage in the Namibian market, will give the bank an upper hand when it comes to the ability to supply new loans. More importantly, the commitment of continued support will play a pivotal role in the future of Bank Windhoek. The funding will also play a pivotal role in the operations of the two newly acquired banks, as the funding has been secured at group level, and can be deployed where necessary.

Furthermore, there is the comfort that the oversight a larger shareholder, with more of a stake in the bank, is likely to exercise. An investor holding just a couple of percent is likely to walk away if the going gets tough. A larger one has an incentive to keep a careful eye, and to intervene if needed. Through their representation on the board, GIPF should be in a good position to execute this goal.

Interest income and the asset base

Asset growth



Source: Bank of Namibia, CGP, IJG Securities

Total assets grew by 3.1% over the last twelve months, while loans and advances grew by a 6.2% to N$27.1 billion. The fairly modest growth of 6.2% is mainly due to growth in overdrafts, term and mortgage loans. Mortgage loans increased by 10.1% to N$14.2 billion on the back of strong growth in residential mortgage loans of 13.1%, with overdrafts and term loans increasing by 4.8% and 4.3% respectively.

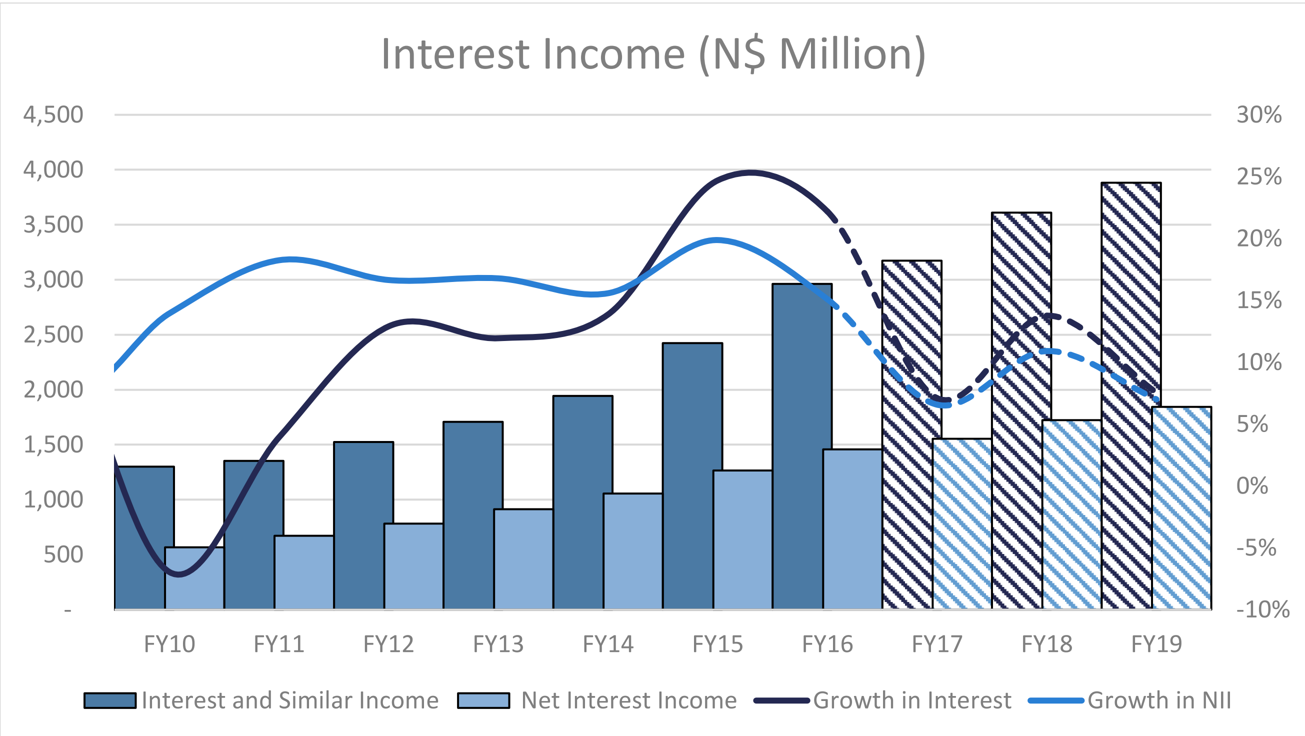
Bank Windhoek's largest constraint had always been the limited availability of funding. Previously we have expressed the view that Bank Windhoek has been at a disadvantage compared to the banks with "big brother" backing, due to the availability of liquidity and funding via the parent company. However, on-boarding GIPF as a shareholder of reference has levelled the playing field in this regard between the local and foreign owned banks. As a result, we expect Bank Windhoek to be able to increase their market share slightly, from the current 33.8% to 35.0% over the course of three years. Furthermore, we also expect market share in Botswana and Zambia to start gaining ground going forward. Again, the support these banks will be able to receive from the parent will give them a distinct advantage when liquidity and funding is hard to come by.

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, stemming from slower economic growth and higher future interest rates. Additionally, 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 strong growth in market share for the major commercial banks.

Due to the tighter funding conditions within the banking sector, as well as an increasing reluctance of commercial banks to lend to highly indebted households in an ever less accommodative interest rate environment, we expect to see a notable slowdown in credit extension to households over the next three years. At the same time, however, we expect to see a sustained willingness to lend to corporates, which are likely to gain preference over households during this period. We forecast year on year growth in advances of 7.6%, 8.8% and 6.8% for FY17, FY18 and FY19, respectively, for Bank Windhoek.

Net Interest Income

Net interest income increased by 3.0% y/y to N$749.9m in 1H17 from N$727.9m in 1H16. The muted growth is mainly due to a significant increase in the cost of funding because of the current liquidity shortage experienced in the Namibian market, combined with a lower growth in interest bearing assets.

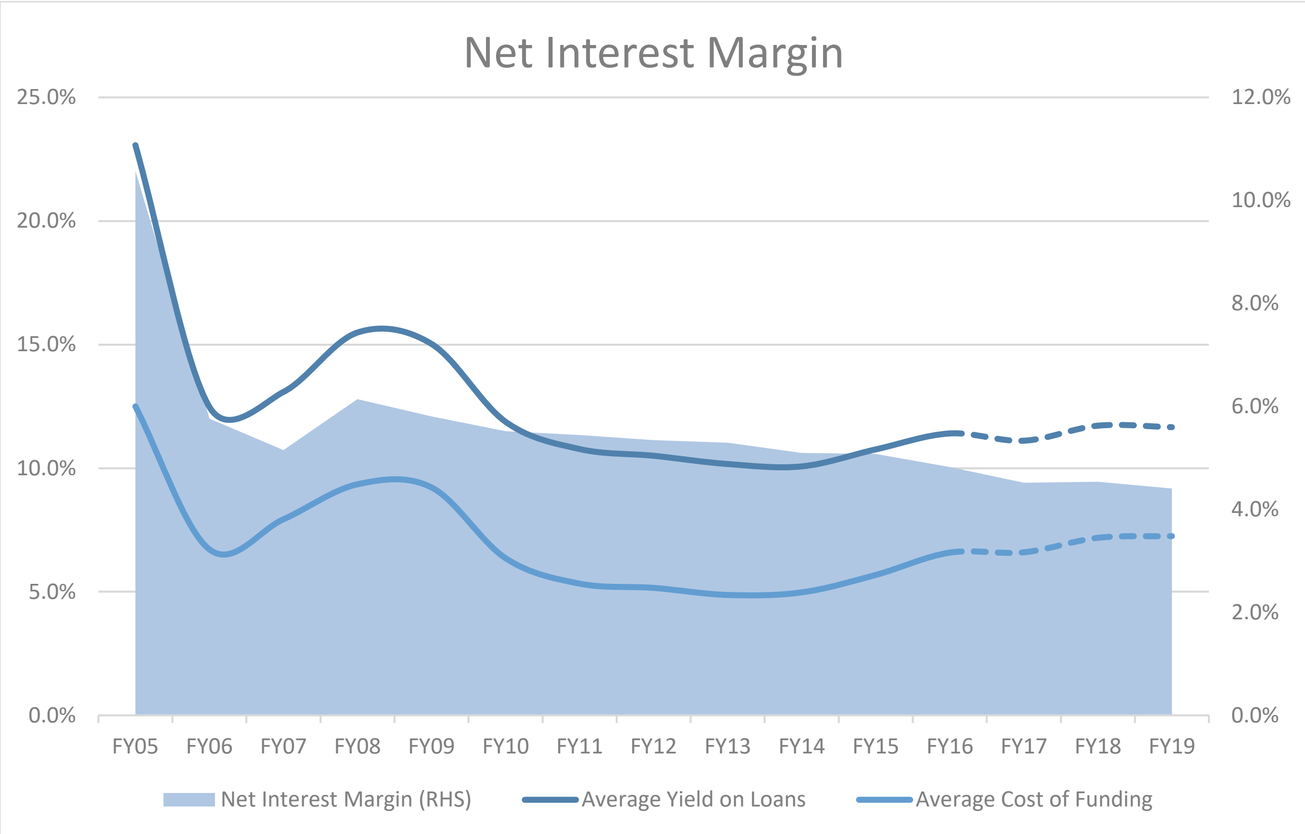


Source: Bank of Namibia, CGP, IJG Securities

Following rapid interest income growth over the last few years, largely on account of interest rate increases on a book that has displayed strong growth, we expect to see some consolidation in growth in interest income going forward.

Although rates are expected to increase at a marginally slower rate, growth in private sector credit extension will likely keep the growth in interest income muted as a result. We expect interest income to grow by 7.1% in FY17, 13.8% in FY18 and 7.5% in FY19.

However, due to the fact that the Namibian prime rate, and resultantly the yield on advances, has remained relatively unchanged, while the cost of funding has been increasing more rapidly, there has been a consistent decline in the net interest margin of Bank Windhoek. 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 pressure. Due to these factors, we see a much slower growth trajectory for net interest income. We expect net interest income to grow by 6.6%, 10.9% and 7.0% for FY17, FY18 and FY19 respectively.

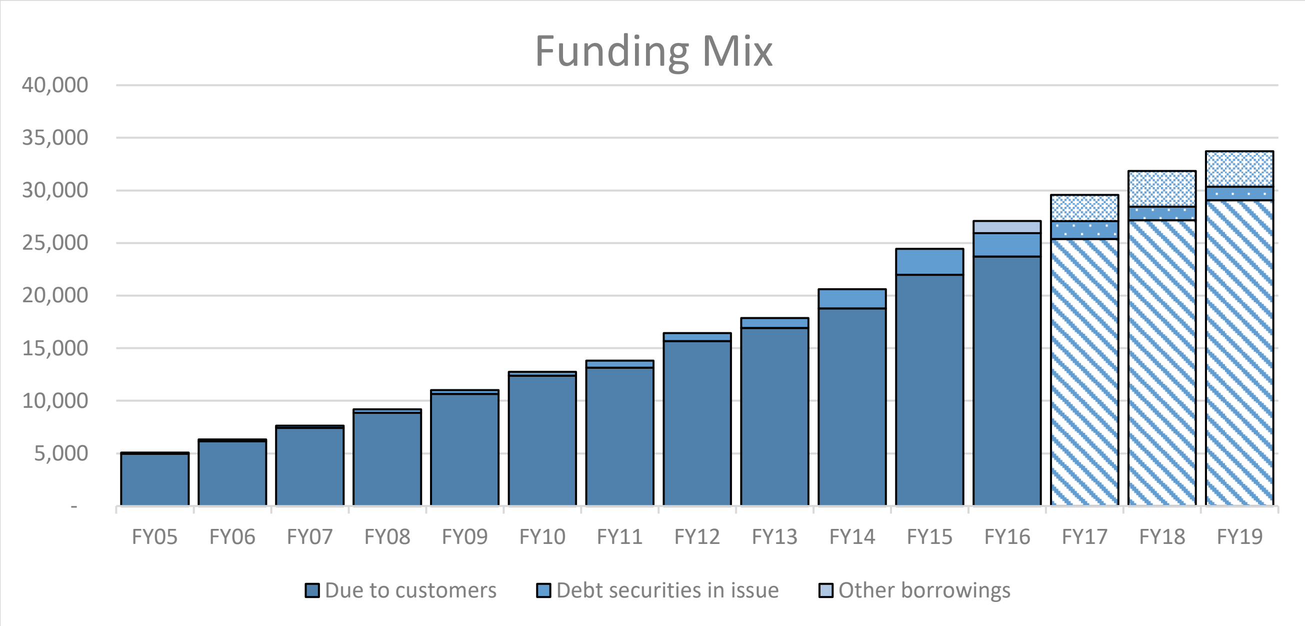


Source: CGP, IJG Securities

Funding the BWH asset base

Funding mix

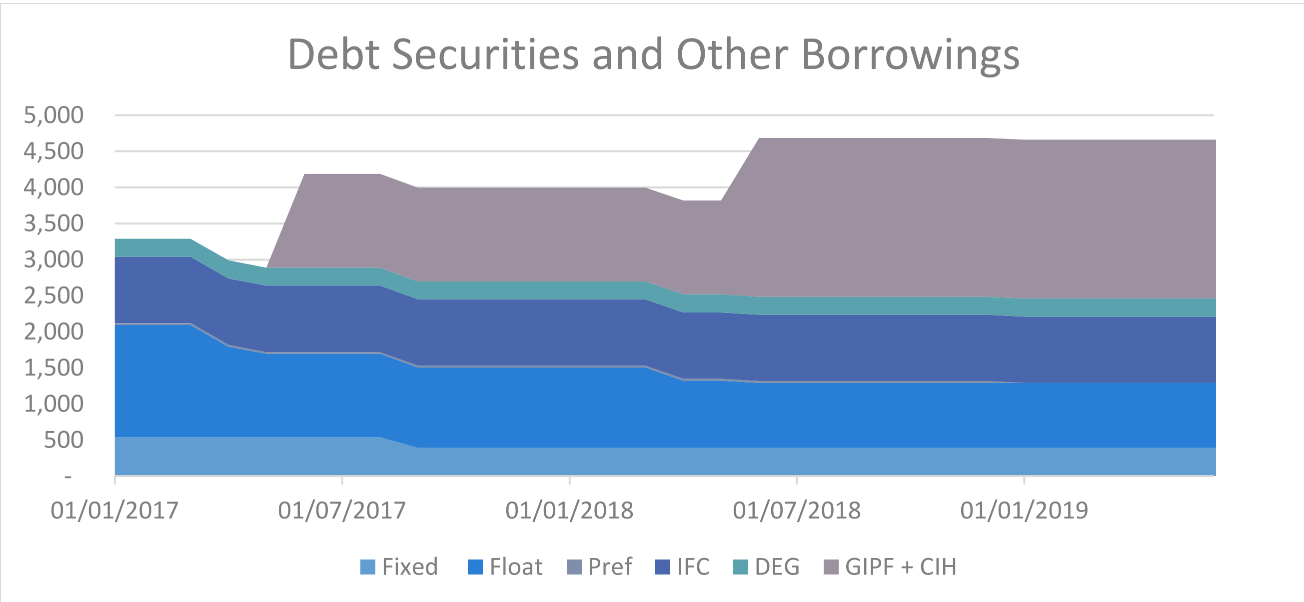
Bank Windhoek grew their funding book by 2.9% y/y in 1H17 to N$27.3bn from N$26.6bn in 1H16. Customer deposits, which make up 86.2% of total funding, grew by only 2.1% y/y. The slow growth can be attributed to the low market liquidity as a result of tighter government finances and tighter economic conditions in general. Although funding growth has been challenging in the current economic environment the group has managed to increase the maturity profile of funding and decrease dependency on short term funding.



Source: CGP, IJG Securities

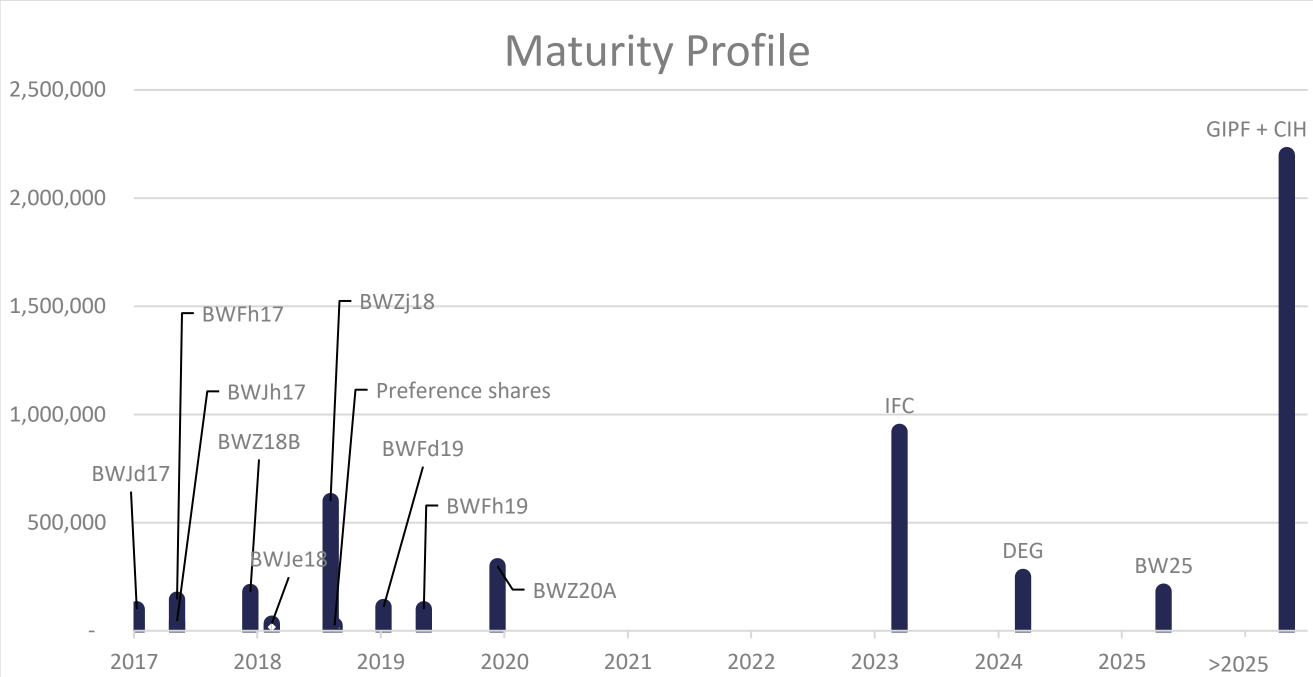
The announcement of funding from the GIFP and CIH comes at a perfect time. The commitments by GIPF to supply N$1.3 billion of funding and CIH which is willing to supply another N$900 million will change the funding profile of the group markedly. Currently the other borrowing category is made up primarily of loans from the International Finance Corporation (IFC) and German Investment Corporation (DEG), which made up a very small portion of the total funding mix.

Should the funding be taken up immediately, it would increase total funding by 8.0% and debt and other financing by an astounding 58.4%. This financing will alter the debt profile of the group considerably. This should allow the group to be less dependent on short term financing in the form of retail deposits, and increasingly expensive NCD financing.



Source: CGP, IJG Securities

We do not expect an immediate uptake of the entire loan facility and have rather assumed that the uptake of this credit will be phased in over a two-year period, simply because it is difficult to see where the funds will be applied. We suspect that some of the groups short term debt might be allowed to mature, or be called, to be substituted by this issuance



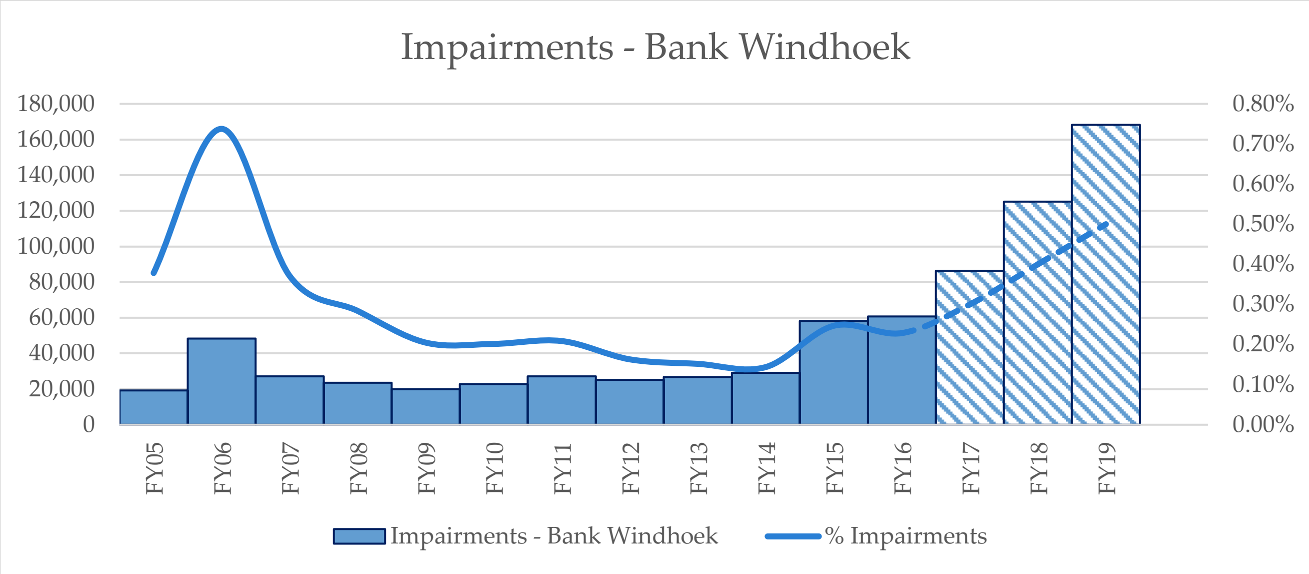
Source: CGP, IJG Securities

The details surrounding the rate and duration of the GIPF and CIH funding will only be disclosed at the end of this financial year. However, according to management, this financing will be the longest duration funding they currently have and was issued at a favourable rate.

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, after interest rates stated to increase, impairments started to tick up, returning to 2009/2010 levels when compared to the loan book. As of the end of FY16, impairments stood at 0.24% of the total loan book, totalling N$60.8 million. Surprisingly, the first half of 2017 saw a decline in impairment charges, with impairments of N$26.5 million in the first half of the financial year, a 15.8% decrease versus the previous year.

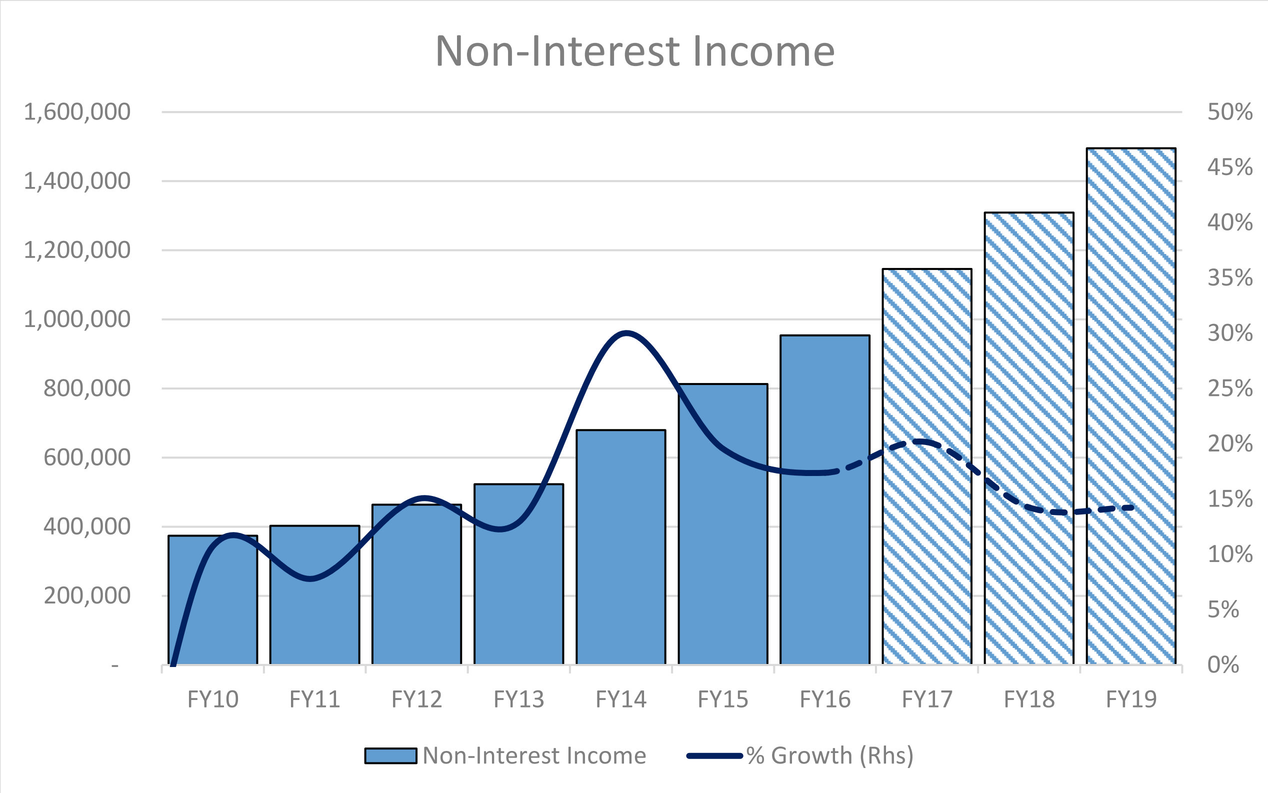
Management has acknowledged that their loan book has started showing signs of stress. This was already evident in the FY16 figures, as the average age of loans and advances was on the increase. However, management have added that they have taken a very proactive approach and are dealing with clients on a case by case basis to appropriately manage their risks. In an increasing interest rate and slowing growth environment, coupled with slower government spending and a particularly vulnerable construction sector, it is unlikely that the bank will manage to maintain these losses at the extremely low level seen over the past five years.



We expect a meaningful uptick in impairments over the next three years. Impairment losses are expected to nearly triple over the next three years to N$166 million by FY19. However, as a percent of credit extended, we expect impairment losses to remain at reasonable levels, increasing to 0.30% in FY17, 0.40% in FY18 and 0.50% by the end of FY19. The high demand for credit and the relatively low supply has allowed the banks to cherry pick their loans. Bank Windhoek's loan book consist of quality credit and the low levels of impairments reflect the prudent approach followed when advancing loans to customers.

Non-interest income

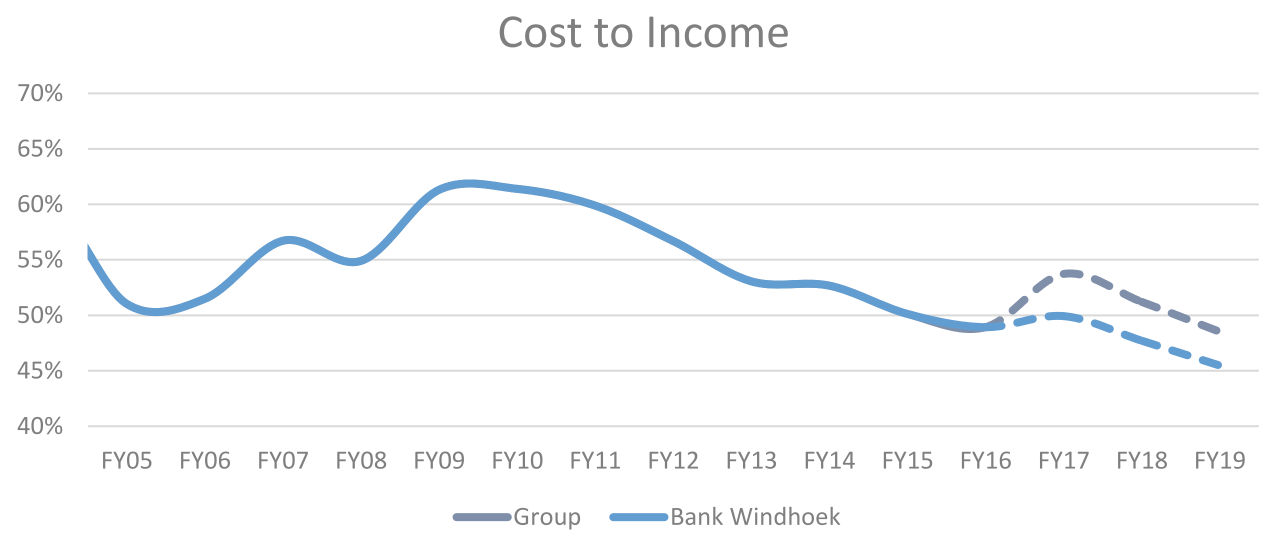
Non-interest income has been a significant contributor to Bank Windhoek's overall revenue over recent years, and is likely to remain so as net-interest income growth slows due to margin compression. At the end of 1H16, Bank Windhoek's non-interest income stood at N$481.4 million, representing 40.9% of total income. In 1H17, this income declined by 3.1% to N$466.5 million for the first six months of the financial year. However, after normalising for the Sale of Welwitschia Insurance Brokers and once-off Kwanza trading income, this represents an 11.6% increase. The normalised increase is mainly due to strong growth in transaction income of 29% and robust growth in revenue from cards and electronic channels.



As net interest income growth slows, and in order to compensate for such, we expect to see the bank explore and develop avenues to increase non-interest revenue. 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. 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. Given the comparative ratio of interest to non-interest income in competitors, we believe there to be ample scope for this for Bank Windhoek. Going forward, we are expecting to see continued growth in non-interest income, as the bank pushes expansion of its electronic channels, the company has been investing heavily in IT systems, allowing for improved digital service provision.

Operating expenses

While the financial industry has been hit with increased costs relating to more stringent compliance regulations, Capricorn have managed to contain costs comparatively well. Year on year, operating expenses grew by 0.7%, to N$582.7 million for 1H17. On a normalized basis, accounting for the disposal of Welwitchia Insurance Brokers, operating expenses grew by 4.5% y/y. This resulted in a stable cost-to-income ratio, which improved from 49.1% to 49.0%. Management indicated that the streamlined nature of their business was a result of focus on cost control coupled with continued investment and continual improvement of information technology systems and electronic delivery channels.



Going forward, we expect to see a concerted effort in cost containment as revenue and profits come under pressure due to the weakening economic climate and increasing interest rates. This strategy, when coupled with efforts to improve non-interest revenue, is likely to assist the bank in maintaining sound growth for the future. It should be noted, however, that due to the consolidation of the two new banks, we expect the cost to income ratio to deteriorate slightly, to around the 54% level before improving to current levels again.

Financial Statement Summary

Income Statement

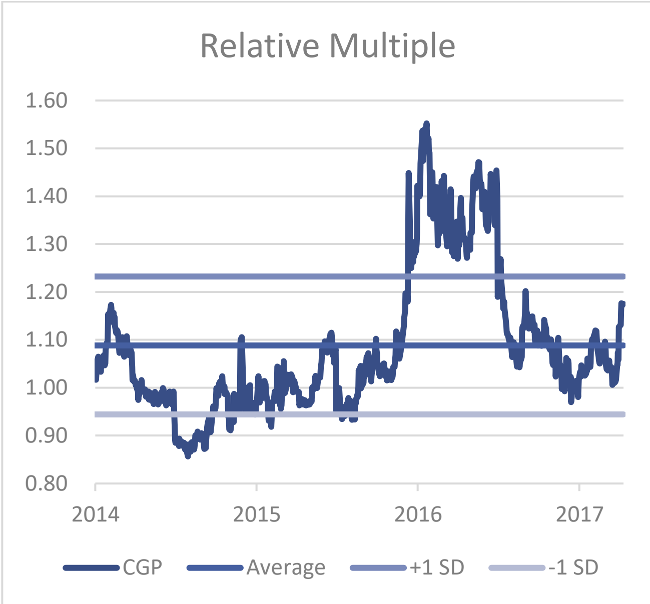
in N$ 000s	*Actual* 2015	*Actual* 2016	*Forecast* 2017	*Forecast* 2018	*Forecast* 2019
Interest and similar income	2,425,239	2,963,244	3,788,620	4,302,997	4,670,560
Interest and similar expense	(1,158,278)	(1,505,102)	(1,906,381)	(2,204,846)	(2,380,154)
Net interest income	**1,266,961**	**1,458,142**	**1,882,239**	**2,098,151**	**2,290,406**
%Growth	19.9%	15.1%	29.1%	11.5%	9.2%
Impairment losses	(58,305)	(60,779)	(128,898)	(172,603)	(221,325)
Non-Interest Income	**812,598**	**953,804**	**1,105,443**	**1,262,547**	**1,441,680**
Operating expenses	(1,042,231)	(1,180,153)	(1,605,102)	(1,720,936)	(1,810,308)
Operating profit	**979,023**	**1,171,014**	**1,253,681**	**1,467,158**	**1,700,453**
%Growth	23.5%	19.6%	7.1%	17.0%	15.9%
Share of profit from joint ventures	960	1,405	1,616	1,858	2,137
Share of profit from associates	87,159	97,123	111,691	128,445	147,712
Profit before tax	**1,067,142**	**1,269,542**	**1,366,989**	**1,597,462**	**1,850,302**
Income tax expense	(314,140)	(364,494)	(395,062)	(461,276)	(533,515)
Profit for the year	**753,002**	**905,048**	**971,927**	**1,136,185**	**1,316,787**
%Growth	20.5%	20.2%	7.4%	16.9%	15.9%
Net gains on available -for - sale financial assets	**28,486**	**33,465**	**25,398**	**29,116**	**29,327**
Total comprehensive income	**781,488**	**938,513**	**997,325**	**1,165,302**	**1,346,113**
Headline Earnings	781,488	938,513	997,325	1,165,302	1,346,113
%Growth	22.3%	20.1%	6.3%	16.8%	15.5%
EPS (c)	**150.4**	**181.2**	**192.9**	**225.4**	**260.4**
HEPS (c)	**150.5**	**181.2**	**192.9**	**225.4**	**260.4**
Dividends declared per share (c)	**54.0**	**66.0**	**69.0**	**81.0**	**94.0**

Balance Sheet

in N$ 000s	*Actual*		*Forecast*		
	2015	**2016**	**2017**	**2018**	**2019**
ASSETS					
Cash and balances with central bank	619,907	1,169,170	1,973,587	3,213,118	3,311,798
Financial assets designated at fair value	2,587,461	2,408,196	4,209,209	3,326,104	3,449,890
Investment securities	100,533	133,998	130,215	136,726	143,562
Derivative financial instruments	977	229	-	-	-
Due from other banks	740,321	1,006,602	1,469,284	1,518,547	1,571,284
Loans and advances to customers	23,621,871	26,598,023	33,499,059	36,530,531	39,490,661
Investment in associates	233,157	248,297	270,000	297,000	326,700
Other assets	704,615	769,138	784,370	843,794	896,466
Total assets	**28,608,842**	**32,333,653**	**42,335,725**	**45,865,819**	**49,190,360**
LIABILITIES					
Derivative financial instruments	1,731	6,068	2,646	3,482	4,065
Due to other banks	130,151	447,129	286,648	287,976	340,584
Other borrowings	-	1,164,051	2,495,123	3,395,123	3,370,000
Debt securities in issue	2,461,212	2,215,345	1,946,114	1,554,779	1,565,524
Deposits	21,993,998	23,724,128	31,807,595	34,082,335	36,508,801
Other liabilities	378,377	502,893	670,183	669,187	668,665
Total liabilities	**24,965,469**	**28,059,614**	**37,208,309**	**39,992,881**	**42,457,639**
EQUITY					
Share capital and premium	530,050	512,045	726,445	726,445	726,445
Distributable reserve	2,916,837	3,548,960	4,187,937	4,933,459	5,793,243
Non-controlling interest	0	0	142,368	147,919	158,523
Total shareholders' equity	**3,643,373**	**4,274,039**	**5,127,416**	**5,872,938**	**6,732,722**

Valuation and recommendation

For the purpose of valuing the company, we establish a **cost of equity, of 14.9%,** which consist of a risk free rate of 10.9%, an equity risk premium of 3.0% and a liquidity premium of 1.0%. Based on this cost of equity, a highly conservative **long-term growth rate for the company of 9.3%,** and a **long term sustainable Return on Equity of 19.8%** we believe a **Price to Book multiple of 1.84x can be justified** on this share. Given **expected book value per share of 992 cps in FY17**, we derive **a target price of N$c1829 per share**. Coupled with an **expected final dividend of 40cps**, we expect a **total return of 7.2% in 2H17**.



Based on the historical multiple versus the South African banking index, Capricorn Group is overvalued. This is mostly due to the correction witnessed in the South African financials following the cabinet reshuffle, while CGP was unmoved following the news. Historically, CGP has traded on a 10% Price to book premium, which would justify a 1.90x price to book multiple, however it is difficult to attest to why this premium should exist.

Overall, our expectations regarding private sector credit growth and interest rates in Namibia are relatively conservative, and the risks are weighed in favour of even higher interest rates and a sharper slowdown in credit extension. Due to the low expected return and tough economic environment, which may continue for an extended period of time, we **revise our recommendation to a HOLD for the Capricorn Investment Group**.

TEAM NAMIBIA MEMBER

IJG Holdings

Group Chairman
Mathews Hamutenya
Tel: +264 (61) 256 699
mathews@millennium-invest.com

Group Managing Director
Mark Späth
Tel: +264 (61) 383 510
mark@ijg.net

Group Financial Manager
Helena Shikongo
Tel: +264 (61) 383 528
helena@ijg.net

IJG Securities

Managing Director
Lyndon Sauls
Tel: +264 (61) 383 514
lyndon@ijg.net

Sales and Research
Eric van Zyl
Tel: +264 (61) 383 530
eric@ijg.net

Equity & Fixed Income Dealing
Leon Maloney
Tel: +264 (61) 383 512
leon@ijg.net

Settlements & Administration
Annetjie Diergaardt
Tel: +264 (61) 383 515
anne@ijg.net

Dylan van Wyk
Tel: +264 (61) 383 521
dylan@ijg.net

IJG Wealth Management

Managing Director
René Olivier
Tel: +264 (61) 383 522
rene@ijg.net

Portfolio Manager
Jan-Hendrik Conradie
Tel: +264 (61) 383 523
janhendrik@ijg.net

Money Market & Administration
Tashiya Shekutamba
Tel: +264 (61) 383 511
tashiya@ijg.net

IJG Capital

Managing Director
Herbert Maier
Tel: +264 (61) 383 522
herbert@ijg.net

Portfolio Manager
Jakob de Klerk
Tel: +264 (61) 383 517
jakob@ijg.net

Business Analyst
Mirko Maier
Tel: +264 (61) 383 500
mirko@ijg.net

IJG Advisory

Director
Jolyon Irwin
Tel: +264 (61) 383 500
jolyon@ijg.net

Business Analyst
Jason Hailonga
Tel: +264 (61) 383 529
jason@ijg.net