IJG

Securities (Pty) Ltd.
Member of the NSX

CAPRICORN INVESTMENT GROUP LIMITED

FY16 Results Review

DECEMBER 2016

Capricorn Investment Group Ltd	Target Price (c)	1820
FY16 Results Review	Current Price (c)	1685

Year End 30 June	2015A	2016A	F2017	F2018	F2019
Net interest income (N$m)	1,267	1,458	1,660	1,873	2,145
Non-interest income (N$m)	813	954	1,042	1,196	1,370
Profit (N$m)	753	905	1,041	1,174	1,334
HEPS (c)	150	181	208	235	267
P/E (x)#	11.3	9.4	8.1	7.2	6.3
DPS (c)	53.0	66.0	75.0	85.0	96.0
DY (%)*	3.1	3.9	4.4	5.0	5.7
P/B (x)*	2.3	2.0	1.7	1.5	1.3

Recommendation	BUY
NSX Code	CGP
Market Cap (N$m)	7933
Shares in Issue (m)	505.3
Free float (%)	20
52 week high (c)	1760
52 week low (c)	1610
Expected Total Return	12.5%

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

CGP, formerly known as Bank Windhoek Holdings (BWH), released its results for financial year ending 30 June 2016. The firm recorded excellent growth, beating our earnings expectations. This performance is particularly impressive given the increasingly challenging macroeconomic climate in the country.

The company recorded growth in profit of 20.2% when compared to FY15, while earnings per share grew 20.4% and headline earnings expanded by 20.3%. The company declared a final dividend of 36cps, which when combined with the interim dividend of 30cps, gives a total for the year of 66cps, up from 53cps in FY15. As such, very attractive dividend growth of 24.5% was seen between the two years. Based on the current share price, this shows a reasonably attractive trailing dividend yield of 3.9%. The results were slightly better than our forecasts, with earnings beating our expectations by 1.2%.

Net interest income expanded by 15.1%, to N$1.46 billion, beating our forecasts by 1.1%. Interest income grew by 22.2%, while the interest expense expanded by 29.9%. Total interest income stood at N$2.96 billion, compared to our forecast of N$2.94 billion, while the interest expense was N$1.51 billion, compared to our forecast of N$1.50 billion.

Impairment losses increased from N$58.3 million to N$60.8 million, compared to our forecast of N$57.3 million. Thus, impairments represent just 0.2% of the loan and advances book. Non-performing loans as a percentage of loans and advances increased from 1.09% to 1.32%.

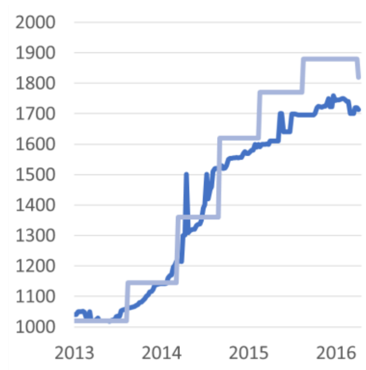
Non-interest income expanded by 17.4%, to N$953 million, beating our forecasts of N$916 million by 4.1%. This was mainly due to growth in transaction-based fee income and trading income which increased by 8.1%.

Operating expenses grew by 13.2%, to N$1.18 million. This resulted in a further improvement in the cost-to-income ratio of the bank, which improved from 51.6% to 50.2% between FY15 and FY16. The increase in costs was largely driven by increased staff costs.

The group remains well capitalized with a total risk-based capital adequacy ratio of 15.8%, unchanged from 2015. The ratio of Tier I capital to risk weighted assets now stands at 14.3%, up from 13.7%, while the ratio of Tier II capital to risk weighted assets fell to 1.5% from 2.1%. Thus, the ratio of core capital to total capital improved over the period. Going forward, the Bank of Namibia has announced its intention for Basel III to be fully implemented by 2021.

To value the company, we establish a required rate of return **of 12.46%.** Based on the required rate of return, the **long-term growth rate for the company of 8.4%,** and a **dividend pay-out ratio of 36%**, broadly in line with historic pay-out ratios, we believe a **PE of 8.76x can be justified** on this share. Given **expected earnings growth of 18.3% in FY17**, taking **total earnings to c208/share**, we derive **a target price of c1820/share**. Coupled with an **expected dividend of 75cps** or **dividend yield of 4.5%**, we expect a **total return of 12.5% in FY16**. We maintain our BUY recommendation.

CGP Share Price



Dividends

A final dividend of 36 cents per ordinary share was declared on 10 August 2016 for the year ended 30 June 2016. Considering the interim dividend of 30 cents per share, this represents a total dividend of 66 cents per ordinary share for the year ended 30 June 2016 (2015: 53 cents per share). The group's dividend policy remains unchanged.

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Macro backdrop

The Global and Namibian Economies

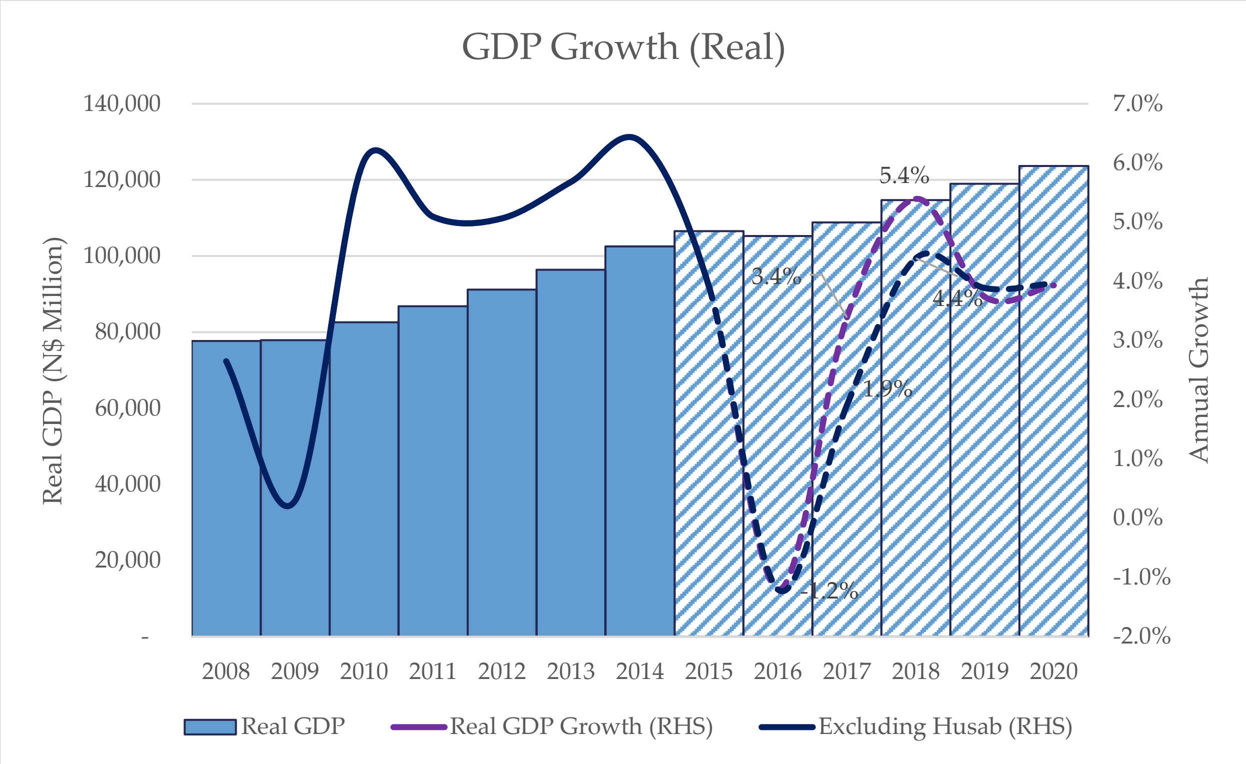
Growth environment:

The Namibian economy performed admirably over the five years from 2010 to 2014. Over this period, growth averaged over 5.6%, compared to average growth since independence of 4.3%. This abnormally strong growth was driven by three key factors. Firstly, Namibia has been through a prolonged period of historically low interest rates which drove unprecedented uptake of credit by the private sector; secondly, 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, with the economy rebasing from a N$83 billion dollar economy to a close to N$160 billion dollar economy in a period of six years.

However, subsequently, the macroeconomic environment in Namibia has started to deteriorate, as a combination of factors have come together to dampen growth and drive imbalances within the local economy. The unwinding of historically low interest rates, less foreign investment into the economy, a weaker external environment – particularly in Angola and South Africa, weakening commodity prices, regional drought and a high base all had a negative impact on the economy directly, as well as reducing government revenues and thus forcing a relatively abrupt slowdown in government expenditure.

Given the high base created over the past half-decade, and the rate of growth experienced over this period, this abrupt deterioration in macroeconomic conditions comes as a shock, which if not carefully handled is likely to drive a host of negative repercussions to the country.



Source: Namibia Statistics Agency

Inflation

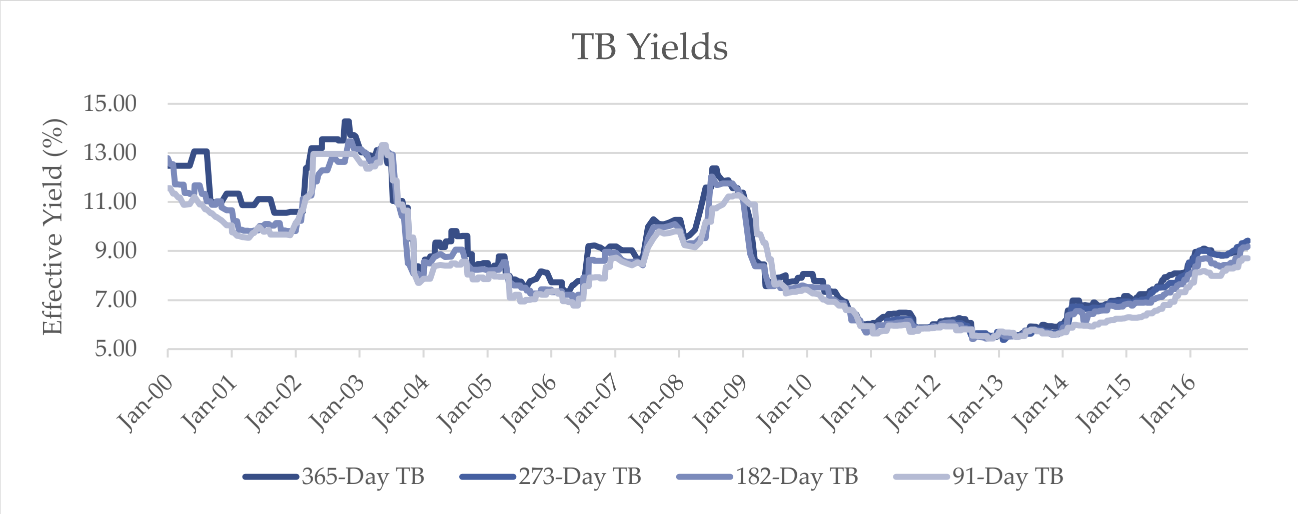
As expected, inflation has seen a sizable upswing in 2016 when compared to 2015. While 2015 saw average inflation of 3.4%, the first 10 months of 2016 saw a more normal 6.6%.

For the year so far, Namibian inflation has outstripped that of South Africa. However, inflation expectations remain high in both countries. South African inflation is expected to average 6.4% in 2016 and 5.8% in 2017, as per figures from the South African Reserve Bank. These expectations are largely driven by currency weakness and the pass through effect of higher Import prices. The effect of higher food inflation due to the drought also has a negative effect. Earlier this year the Bank of Namibia released a study which demonstrated that South African food inflation tends to have significant effects on the inflation in Namibia.

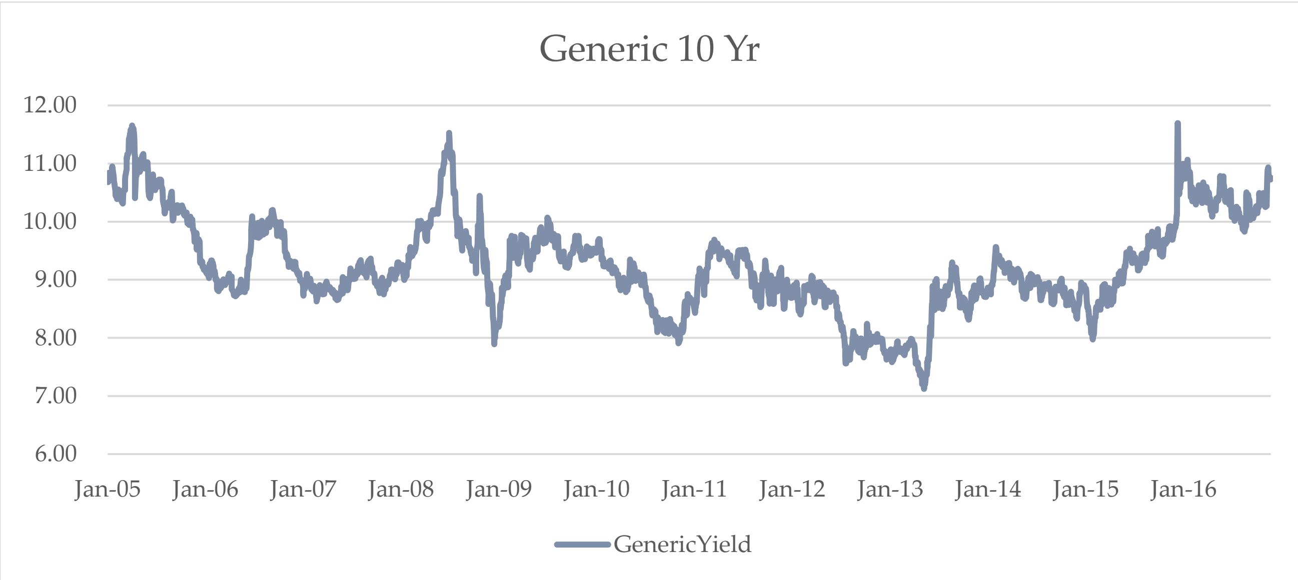
Our expectations of Namibian inflation for 2016 is for an average of 6.6% before slowing slightly to 6.4% in 2017. The main reason for this relatively high level being the continual increases seen in administered prices, sustained increases in rentals and housing, and the continuing pass-through effect of high food import prices.

Funding

Over the past two years, Namibia's public debt stock has doubled, with the domestic debt stock increasing approximately 80%. Over the same period, the assets that conventionally purchase this debt have not increased by the same magnitude, with pension fund and life insurance assets growing by approximately 27% over the two year period. Additionally, the credit worthiness of Government has deteriorated, as illustrated by the recent rating outlook downgrade by Fitch and the increase in the debt-to-GDP ratio from 23% two years ago, to over 40% at present. At the same time, the South African yield curve, off which Namibian government securities are benchmarked, has weakened. These factors have caused a notable repricing in both Government securities, but also all corporate securities. The IJG Generic 10-year yield has seen an increase from 9.73% to 10.76% in the year from 23 November 2015, while the effective yield on the one year treasury bill has increased from 8.13% in November 2015, to 9.43% in November 2016 (up from 7.01% in November 2014).



Source: Bank of Namibia

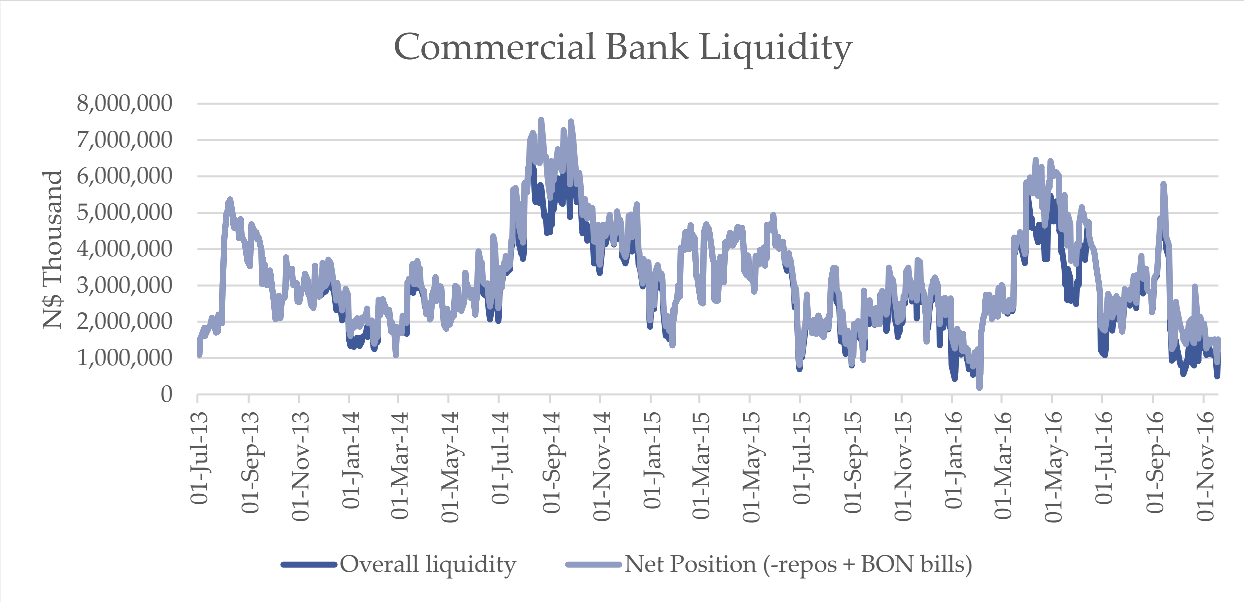


Source: IJG Securities

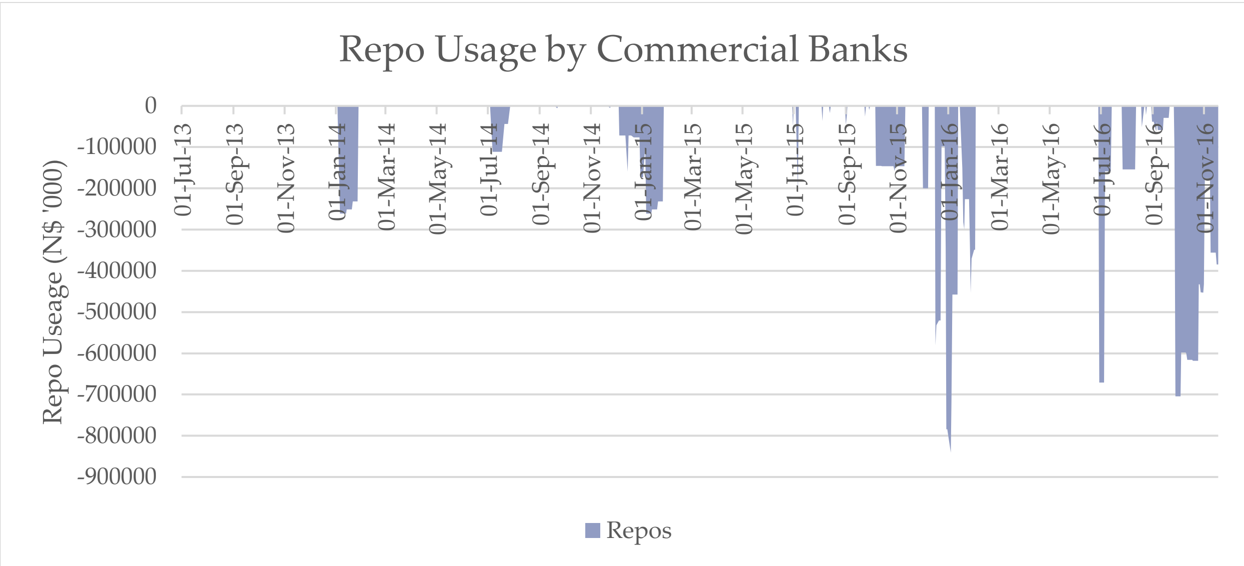
The effect of the major debt issuance, and indirectly, monetary policy tightening, has been to crowd out private sector credit issuance, as most of the private sector entities benchmark off government debt, or compete for the same funding.

Liquidity

Given the major increases in Government debt (mopping up system liquidity), as well as the prolonged period of low interest rates (incentivizing borrowing and disincentivising savings), banking sector liquidity has come under increased pressure of late. Despite notable growth in commercial bank liabilities, the nominal liquidity position has been recording some of its lowest ever levels in recent months, and the central banks reverse repo facility has seen repeated use.



Source: Bank of Namibia



Source: Bank of Namibia

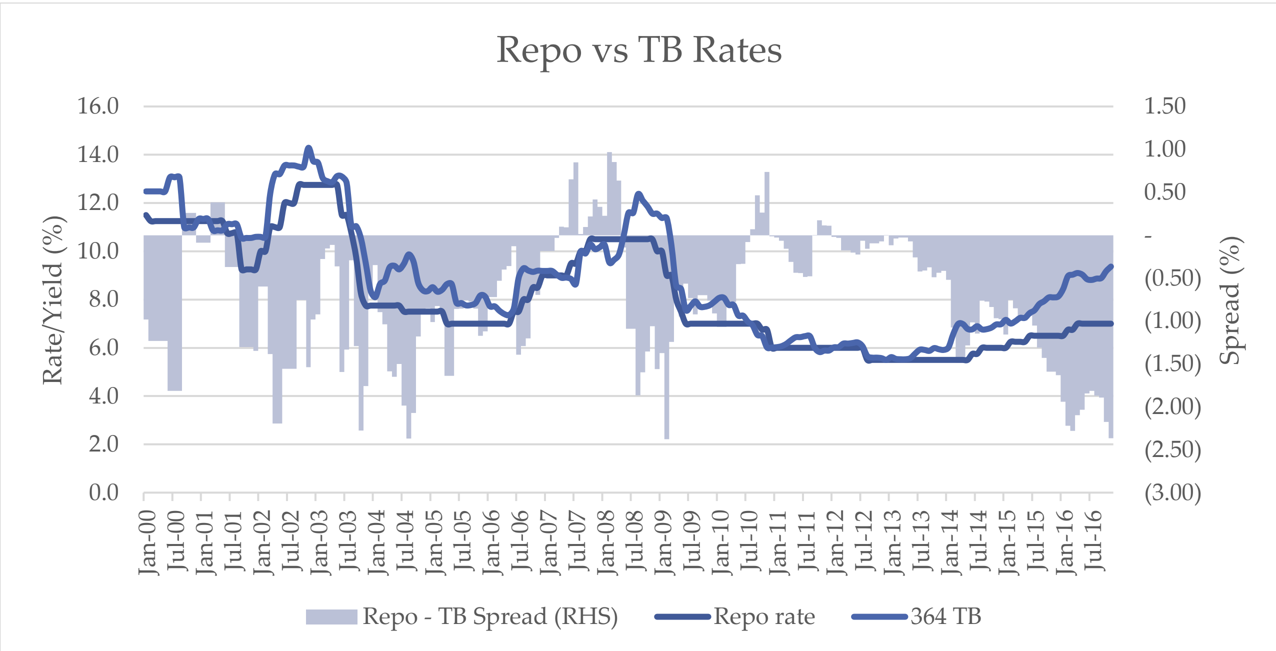
Government finances too have come under strain over the past 18 months, and as a result, a major source of conventional deposits for commercial banks has dried up. While the Bank of Namibia and Ministry of Finance do not use tax and loan accounts as the South African Reserve Bank does, in order to provide funding and liquidity to the commercial banks, payments from the central government to state owned enterprises and regional government have a tendency to find their way into the banking system. Since 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, as well as payments to service providers have become more cautious and slowly made, resulting in less money finding its way into the banking system.

In addition, anecdotal evidence suggests that there have been a number of withdrawals from the banking system as a result of proposed policy changes, with money being taken off-shore as a precautionary measure. Given the nature of a fractional banking system, these withdrawals have a multiplied effect on bank funding, and may be contributing to the current funding and liquidity challenges.

Spread

The spread between the administered interest rate (repo) and the market determined interest rate (one year treasury bills) is now as wide as it's been since 2000, and has been widening consistently, in a manner not before seen, since early 2013. The spread is now approximately 250 basis points, and as the banks tend to borrow at a margin above the government rates, the marginal cost of funding for the commercial banks, particularly through debt securities, is now close to the administered rate at which loans can be made to the public. Thus, the marginal net interest margin is extremely low at present, and in most instances is not sufficient to justify the credit and duration risk on loans, particularly given the current economic climate and the resultant heightened credit risk.

This situation creates a peculiar and counter-intuitive phenomenon whereby higher interest rates are likely to be required to drive an increase in credit extension, as the current constraint to further credit extension is funding more than credit demand. Higher rates would justify commercial banks borrowing to make further loans, as well as attract deposit funding from the public.



Source: Bank of Namibia, IJG Securities

Competitors

Added to the general increase in competition for funding at present is the increased banking sector competition for funding. Not only are a number of large banks now competing for funding more aggressively than they did historically, but there have also been a large number of new entrants into the banking space over the past three years. Given the low liquidity and constrained funding space, the large number of players competing for available funds has driven the cost of funding for the commercial banks up notably.

Licensed Banks

	Full License	Branch License	Fully operational (as a bank)
EBank Limited			
First National Bank Namibia Limited			
Nedbank Namibia Limited			
Standard Bank Namibia Limited			
SME Bank Limited			
Trustco Bank Limited			
Banco Atlantico			
Bank BIC Namibia Limited			
Letshego Bank Namibia Limited			

Source: IJG Securities

Basel III

In 2010, Namibia was the third country in Africa to fully implement a Basel II framework commensurate with the broad principles of the global framework. Now, six years later, the country is once again amongst the continent's forefront of implementation of the new Basel accord, namely Basel III.

The Basel III Framework was developed in response to the deficiencies found in financial regulation during, and resulting from, the world financial crisis. The aim of the new accord is to develop a global regulatory framework for more resilient banks and banking systems.

The latest package of reforms from the Basel Committee on Banking Supervision (BCBS) in December 2010 focuses on strengthening the global quality of capital and liquidity rules, following the peak of the global financial crisis with the aim of promoting a more resilient banking and financial sector. The main objectives of Basel III reforms are:

1. To improve the banking sector's ability to absorb shocks arising from the financial and economic sector.
2. To improve risk management and governance practices within banking institutions.
3. To strengthen transparency and disclosure of capital and liquidity within banking institutions.

In Namibia, the decision to adopt Basel III was taken in 2015, and the new framework will be implemented with five key tenants.

1. Revisions to risk weighted capital adequacy requirements.
2. Revisions to the minimum leverage ratio.
3. Introduction of new liquidity ratios.
4. Revisions to the calculation or risk weighting of assets.
5. Inclusion of off balance sheet items for calculation of capital ratios.

The table below presents the phase-in arrangement for the implementation of the Basel III Capital Framework. This Capital Adequacy Framework is expected to become effect by 2021, two years behind the recommended date envisaged by the Basel Committee, but many years ahead of many of the regional countries. In terms of the Basel Committee timelines banking intuitions are expected to comply with the new capital and liquidity rules by 2019, while they will have to comply with new capital and liquidity requirements for Namibia only by 2021. However, for some of the local banking institutions, parent companies in South Africa have already ensured that local subsidiaries are on the path to becoming Basel III compliant.

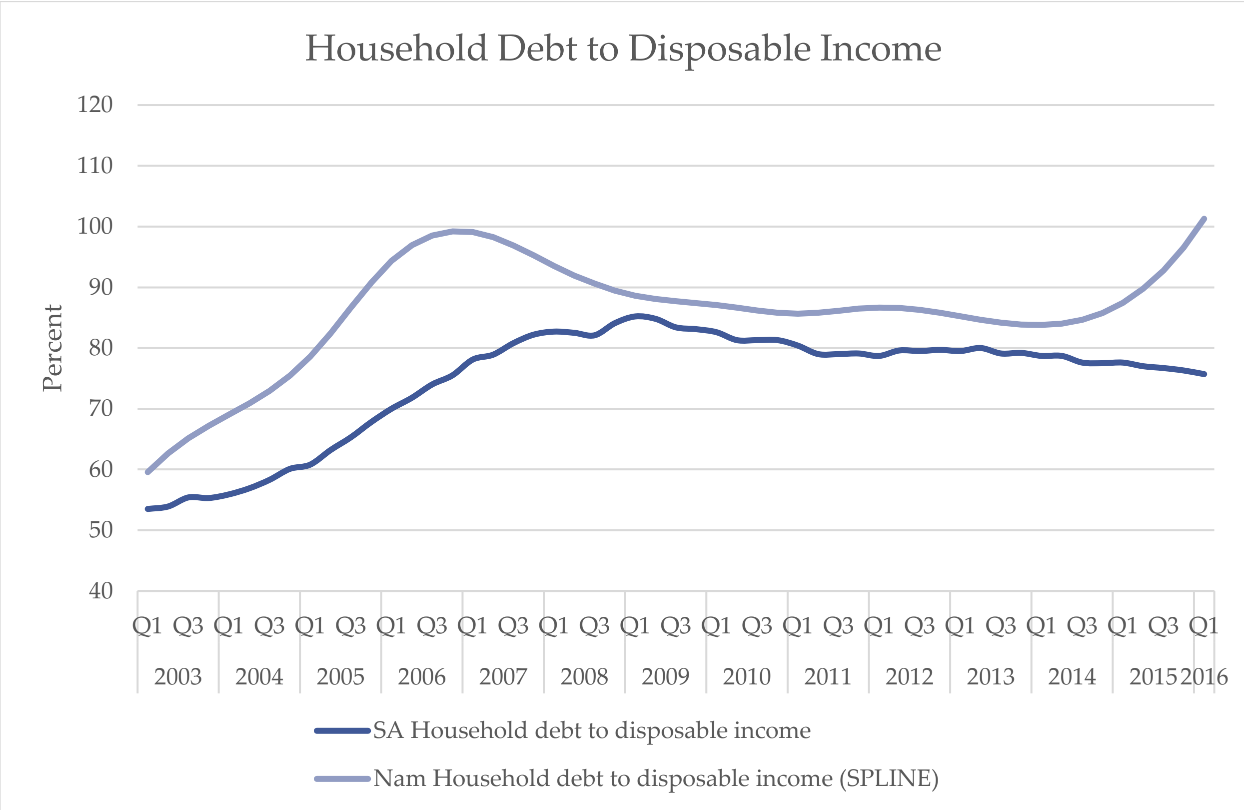
	Current		Phased-in Arrangement				
	2015	2016	2017	2018	2019	2020	2021
Minimum Common Equity Capital Ratio	7.00%	7.00%	5.50%	5.50%	5.50%		
Additional Tier 1 Capital (maximum)			1.50%	1.50%	1.50%		
Common Equity Tier 1 Capital	7.00%	7.00%	7.00%	7.00%	7.00%		
Capital Conservation Buffer			1.00%	2.00%	2.50%		
Total Minimum Tier 1 Capital Ratio	**7.00%**	**7.00%**	**8.00%**	**9.00%**	**9.50%**		
Maximum Tier 2 Capital	3.00%	3.00%	3.00%	3.00%	3.00%		
Total Risk-weighted Capital ratio	**10%**	**10%**	**11%**	**12%**	**12.50%**		
Leverage Ratio	6%	6%	3.00%	4.00%	5.00%		
Liquidity Coverage Ratio				60%	75%	90%	100%
Net Stable Funding Ratio				60%	75%	90%	100%

Regulation 28

On the positive side, as far as the banks are concerned, impending changes to the local asset requirements in Regulation 28 (both reduction in dual listed equity as a percent of total assets and a gradual increase of the local asset requirement to 50% of total assets, over a period of three years) will force a percentage of Namibia's contractual saving pool back into the country from its current home abroad. Given the magnitude of the expected inflow, and the major shortages of available local assets, both the banking system and central government will likely see a recovery in both demand and pricing for their debt instruments. In addition, the banking system will likely see an improvement in the availability of conventional deposits as some of the funds find their way into the system directly or indirectly as a result of government and real sector activity. While this is beneficial to the banking sector, it could be to the detriment of the owners of the capital (primarily pensioners and long term insurance policy holders), as it forces concentration of investments into a handful of entities in a single jurisdiction, likely for an artificially low return.

Credit demand and supply

As we move through an interest rate hiking cycle, private sector credit extension, one of the key drivers of growth in the Namibian economy over recent years, has come under pressure. Strong growth in credit extension through the trough of the cycle has left many consumers highly indebted, and many corporates with heavily leveraged balance sheets. IJG estimates now put household debt to disposable income at over 100% for the first time.



Source: Bank of Namibia, IJG Securities

As a result of increasing interest rates, falling or stagnating household incomes and highly indebted households, credit demand has declined somewhat over the second half of 2016. However, more importantly, credit supply has become increasingly constrained by the funding position of most of the banks and the constrained liquidity environment. In this regard, the loan to funding ratios in the sector have increased from the low 80%'s five years ago, to the high 90%'s at present. This is to say that in order to extend further loans, the majority of the local banks would need to acquire back-to-back funding, which is increasingly difficult and expensive to come by.

In addition to this, Government, previously a key provider of funding to the banking sector has been under financial pressure since the back end of 2015, and thus does not have the funds that they used to have to deposit with the commercial banks (often via local authorities or state owned enterprises). As well as this, government has become relatively slow when it comes to paying contractors, particularly for civil works, which meant fewer deposits from such individuals and entities into commercial banks. Private sector credit extension growth has thus slowed notably through 2016, and is expected to register 10.00% growth for the year. This is expected to increase marginally in 2017, but only to 10.10%, before increasing to 13.95% in 2018, when funding starts to recover.

Interest Rates

The rate of interest rate increases slowed through the second half of 2016, following increases in the first half of the year after the rand weakness caused by the Minister of Finance rotation in South Africa at the back end of 2015. The repo rate now stands at 7.00% in both Namibia and South Africa. Going forward, the repo rate in South Africa is highly exposed to binary events, most notably the question of whether the country will maintain its investment grade rating, and whether there is a leadership change in the ANC.

In the event that South Africa is downgraded to junk status, our expectation is that rates will be increased in South Africa and that Namibia will be forced to follow. However, should this be averted, it appears likely that rates will be kept on hold to support growth in the South African economy, provided inflation remains within the SARB target band over the medium term. Despite the dovish leaning of the SARB in recent meetings, it appears unlikely that rates will be cut in South Africa any time soon, particularly given the expectation of higher interest rates in the US towards the end of 2016 and into 2017.

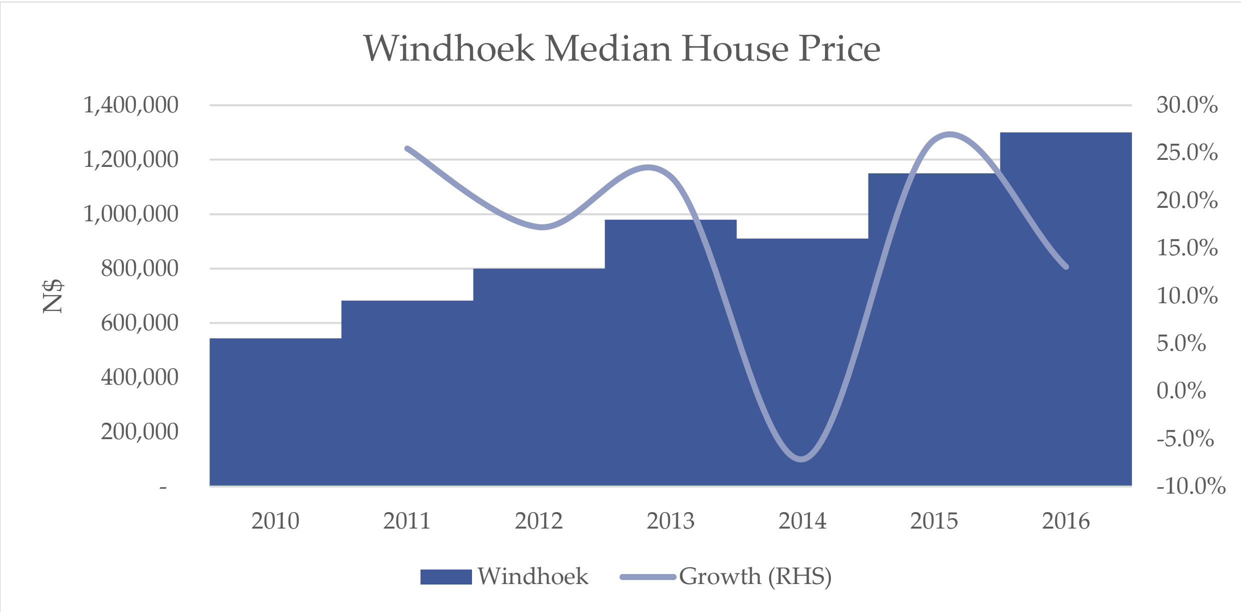
In Namibia, interest rates are expected to broadly follow South Africa going forward, as despite the clear need for higher rates in Namibia, the low and slow growth environment means the central bank is likely to try and keep rates as supportive as possible for as long as possible.

Windhoek Property Market

The Windhoek property market has come under deep scrutiny for the past half-decade, as prices have risen dramatically, away from fair value, according to some. This market represents the single jurisdiction and loan type to which the commercial banks are most exposed. Mortgage loans make up approximately 51% of total loans extended to the private sector, of which 75.8% are loans to households. It is estimated that approximately 65% of the outstanding mortgage loans are against properties in Windhoek.

The only recognized measure of property prices in the country is the FNB Housing Index, based on the median price of bonds registered for natural persons at the Deeds Office. This measure is not without fault for many reasons, including the fact that the median house price in the index is likely to be incomparable to the median house on the banks' balance sheet and the low volume of transactions through the deeds office. As such, the index should be taken with a pinch of salt, but remains a reasonable indicator of general trends in the market.

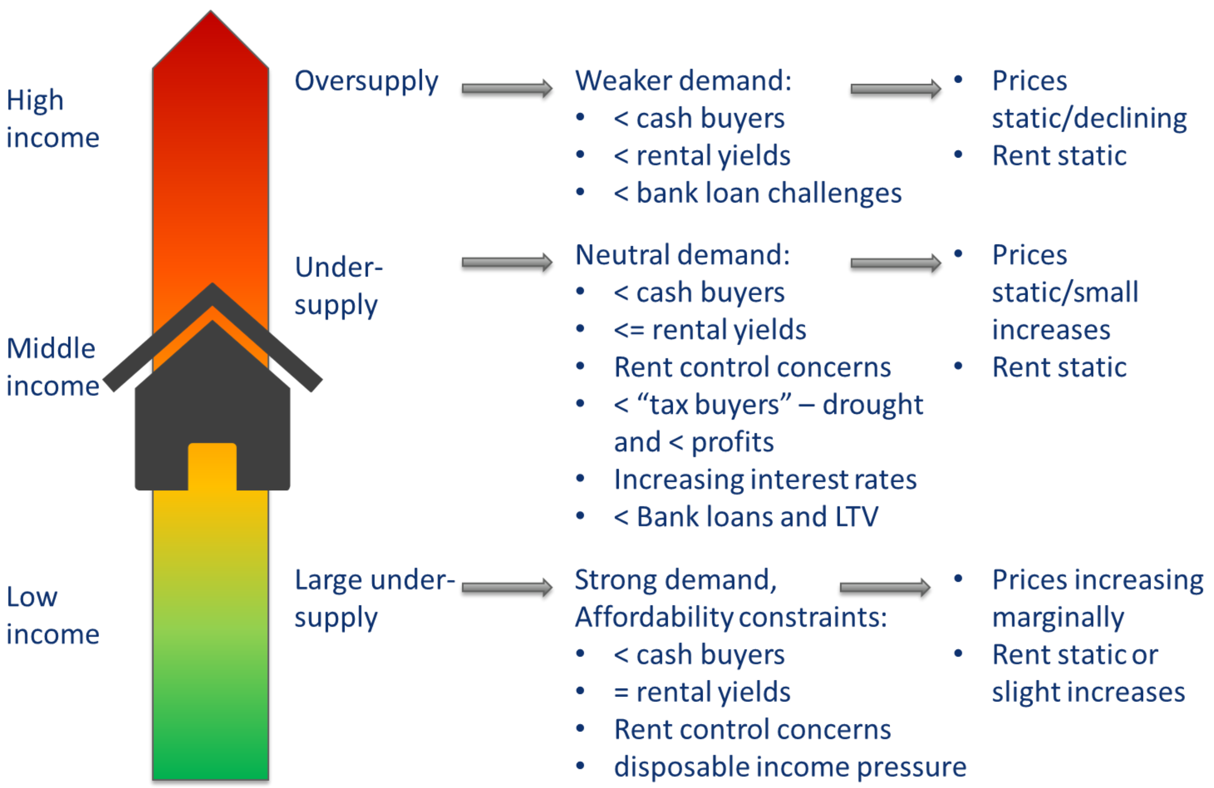
The FNB index for Windhoek illustrates a CAGR in the median house price of 15.6% per year over the past six years, implying that house prices have been doubling every five years on average. The underlying cause of this property price growth is the growing shortfall between demand for housing and the supply thereof. The national shortfall of housing is now estimated at approximately 135,000 units, growing at a rate of approximately 5,000 units per year. The shortfall has meant that property prices have been bid to a point where only the most wealthy own or inhabit the available stock. However, fuel has been added to this fire of late as household incomes across the board have risen, driven by accommodative fiscal and monetary policy and the construction boom, particularly. As such, more money has been chasing a largely unchanged stock of assets, and thus prices have risen.



Source: FNB Namibia

While not yet visible in the FNB Index data, extensive anecdotal evidence from various different market players suggests that property prices have started to correct as growth in income and thus the money chasing the stock of assets, has slowed and even started to reverse. At the same time, supply and the expectations of supply have increased, largely due to mass housing initiatives. It is at present unclear as to the extent to which prices will correct, however it is apparent that house price increases have stalled, particularly in the higher income end of the market. Nevertheless, it is estimated that there is significant equity (around 30% to 35%) in the average property, thus limiting the commercial banks exposures to relatively minor market corrections. Moreover, because of the basic supply/demand imbalance, it appears unlikely that any price corrections will be dramatic, however this will also be determined by the extent of the current economic slowdown and its impact on incomes, particularly for highly indebted consumers.

Housing market: Windhoek



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While more detail on the implementation timelines and targets are believed to have been communicated to the commercial banks, these details have not yet been made public.

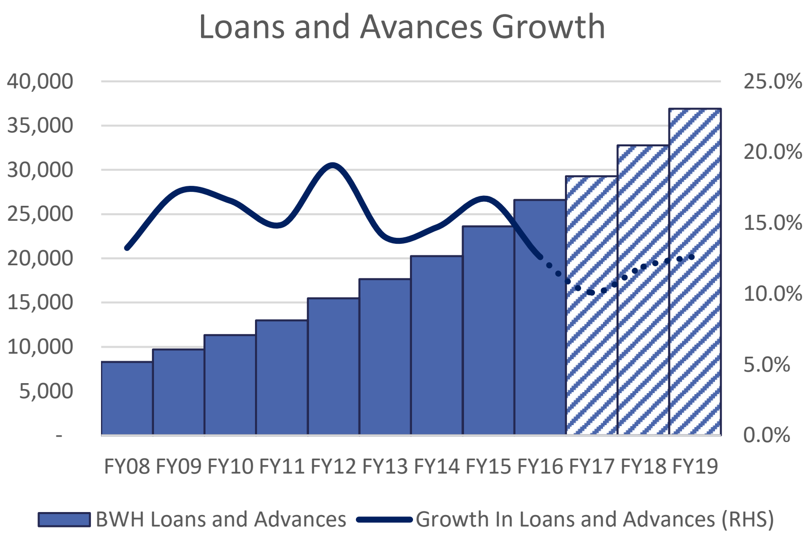
Outlook

The second half of 2015 and 2016 have proved challenging for Namibia, due to the aforementioned "perfect storm" of factors converging on the country simultaneously. The coming year is likely to remain challenging, however should a handful of the 2015/2016 negative factors start to improve, some growth can be expected. This could come about as a result of improved rainfall, commodity price recovery and/or improvement in the Angolan balance of payments. However, the slowdown in Government expenditure seen between 2015 and 2017 will likely keep the economy under immense pressure in 2016/17, and 2017/18, before some respite is seen in 2018/19.

Interest income and the asset base

Asset growth

Growth in private sector credit extension has been slowing recently due to increasing interest rates and a low liquidity environment. Over the review period the year on year growth in private sector credit extension stood at 11.7%. This follows a period of prolonged low interests in which the banks could aggressively grow their loan books. From 2012 to 2015 the compound annual growth rate in credit extension was 15.3%.



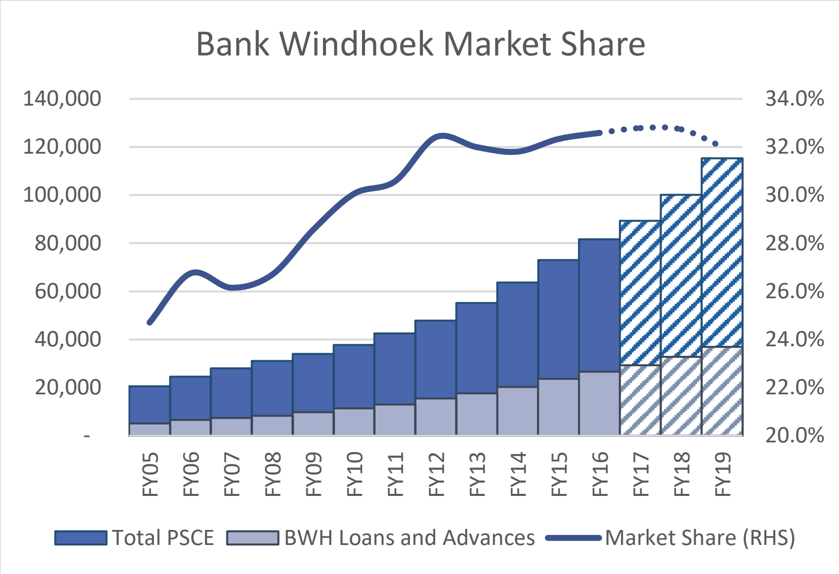
Since the start of the rate hiking cycle in 2014, the Bank of Namibia has increased the repo rate six times in 25 basis point increments, from 5.5% to 7.0%. Although increases have been gradual, and have not shocked the market, the cumulative effect of the small increases has undoubtedly dampened credit demand.

Due to the lag between the implementation of monetary policy and its effect on the real economy, which may take between nine months and two years have an effect, we expect the slowdown to continue well into FY17 and start to gradually recover thereafter.

However, credit supply will probably remain a larger constraint on extensions in the future. Liquidity in the market remains low and any free cash is mopped up by short term government securities, which are currently yielding close to or higher than bank term and negotiable deposits.

In this low liquidity environment banks become more reliant on debt financing, or must raise their deposit rates to become more attractive to depositors, both of which adversely affect their cost of funding. We believe that the banks with South African parent companies, namely FNB, Nedbank and Standard Bank, are likely to have a natural upper-hand over local banks, due to the availability of liquidity and funding via their parent companies. This fact illustrates the uneven playing field in Namibia between local and foreign banks.

As at the end of FY16 Bank Windhoek had a market share of private sector credit extension of 32.6%. This represents a 0.3% improvement from FY15. Bank Windhoek has made leaps and bounds in terms of market share, the bank has increased its share from 24.7% in FY05 to 32.4% in FY12, a level around which it has stabilized.

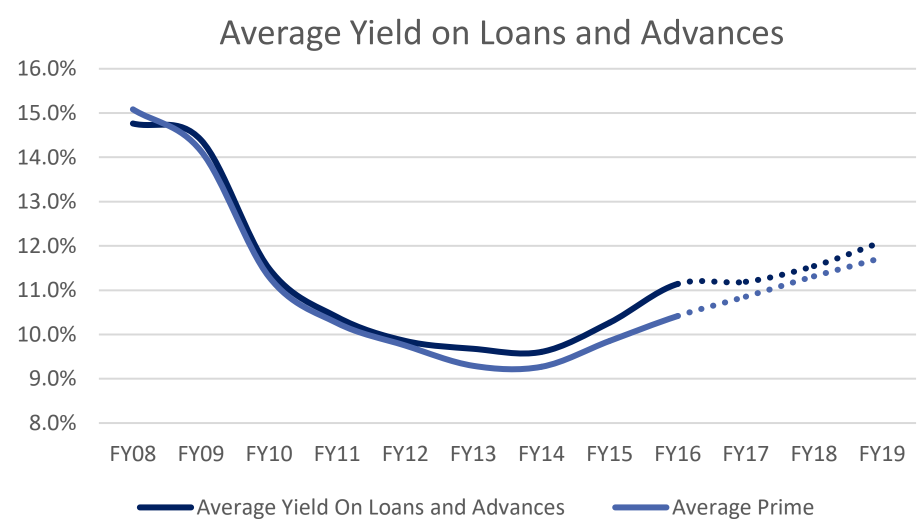


Going forward, we expect to see market share decline slightly to around 32%. The reason for the slight decline in market share being the influx of new market entrants. Currently there are ten commercial banks operating in Namibia, many of them small and new, which have the potential of poaching clientele away from the large banks, in terms of both funding and advances. Nevertheless, we do not see this as a substantial threat to Bank Windhoek's market share of nearly a third of Namibia's credit extension.

Considering the factors above Bank Windhoek's loan book is expected to continue to grow, albeit at a slower pace. Future growth should be relatively in line with the trend in private sector credit extension. Given the headwinds faced on both the demand and supply side of credit extension we forecast growth in advances to slow to 9.3% in FY17 then gradually recover to 10.8% in FY18 and 13.8% in FY19.

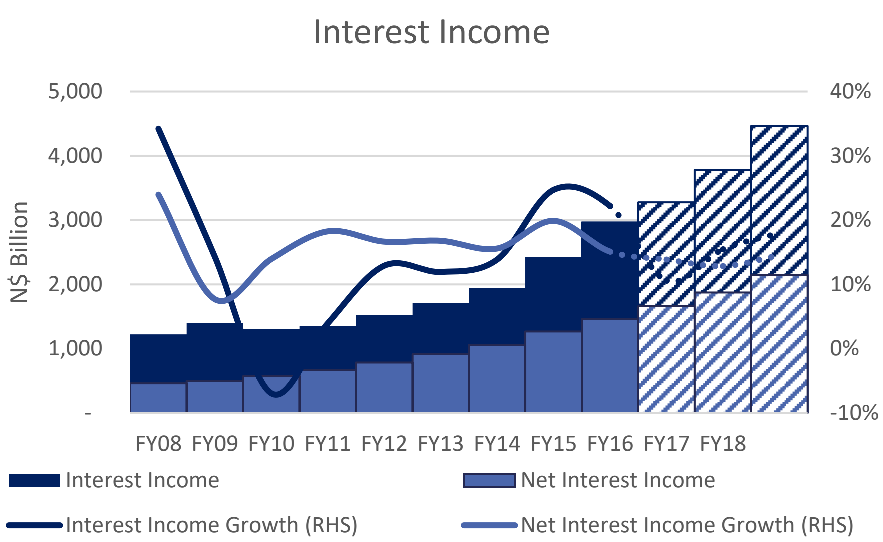
Net interest income

Net interest income increased by 15.1% from FY15 to reach the N$ 1.46 billion mark. Interest income grew by 22.2% while interest expense was up 29.9% on a year on year basis, causing a contraction in the net interest margin. The average interest rate charged on advances increased from 10.3% to 11.1%, slightly above our expectations of 10.8%, and well above the average prime rate of 10.4% in FY16.



The high spread between the average yield on loans and the average prime rate has been an interesting development. It seems to imply that Bank Windhoek has increased its weighting to higher yielding loans such as mortgage and subprime loans during the last financial year. We expect to see a slight, but narrower, spread over the next few years

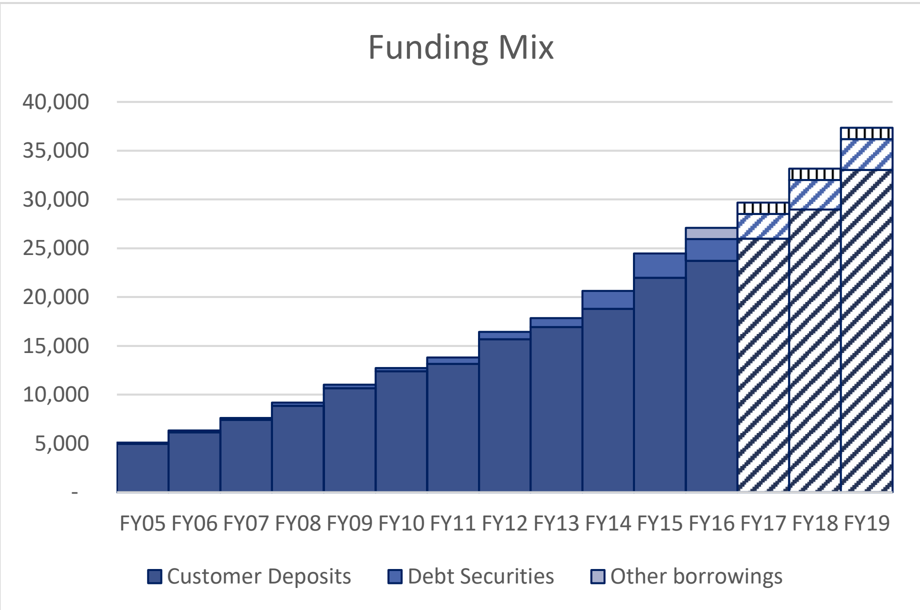
Following strong interest income growth in FY16, largely due to the combination of interest rate increases and a book that has grown quickly over the last few years, we expect to see some consolidation in interest income growth going forward.



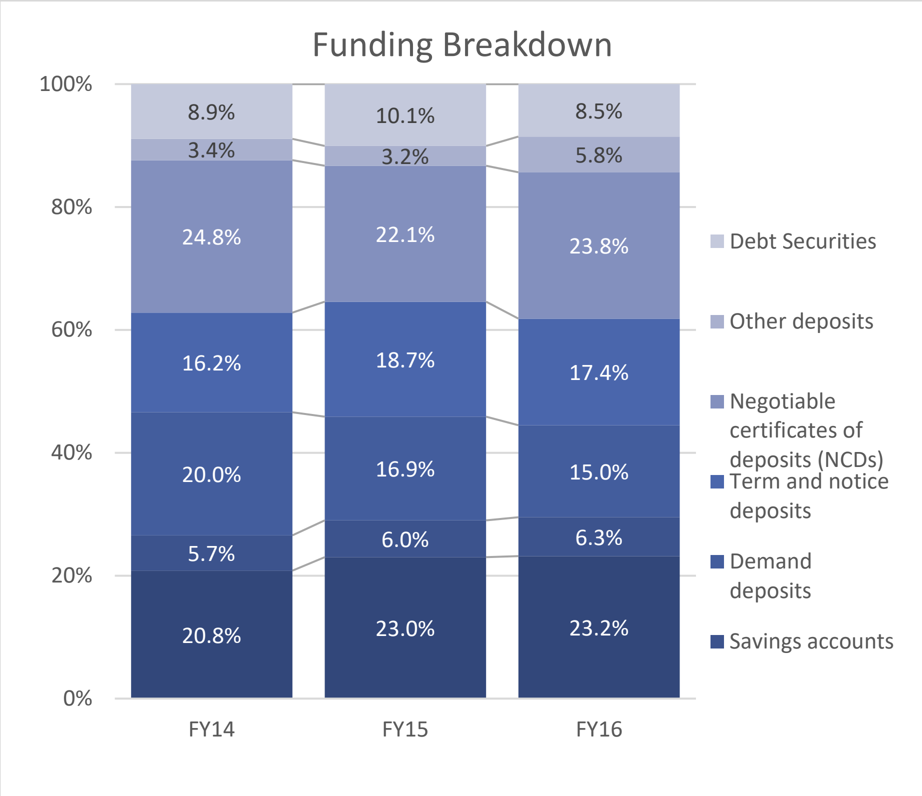
Following expansion of 22.2% in FY16, we expect to see a slowdown in growth, to 10.6% in FY17, as PSCE continues to cool. We expect a slight recovery in growth after next year's slowdown seeing increases in interest income of 15.5% and then 18.0% in FYs 18 and 19 respectively.

Funding

Bank Windhoek grew their funding book by 10.8% from N$ 24.46 billion to N$27.10 billion. The N$2.65 billion increase was financed by a N$ 1.73 billion increase in customer deposits and a N$ 1.16 billion increase in other borrowings, which was mainly borrowings from the International Finance Corporation and DEG (German Investment Corporation). Furthermore, N$ 240 million of traditional debt financing was retired during the year.

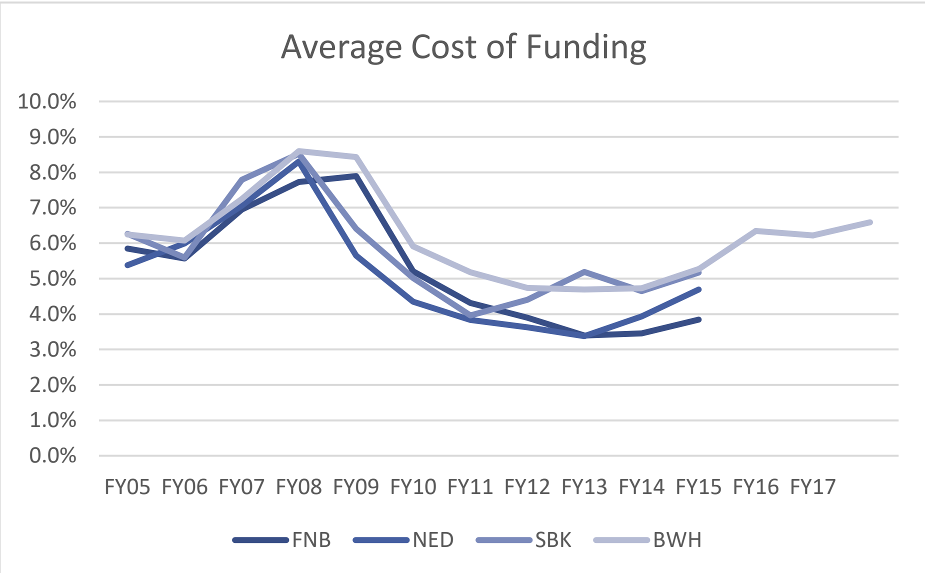


Bank Windhoek grew their customer deposits by only 7.9% in the FY16 financial year, well below the ten-year average of 16.2%. Debt and other financing, on the other hand grew by 37.3%. Over the last two years the debt and other financing has grown from 12.3% to 14.3% of total funding. Going forward, we expect to see a continuation of debt securities growing more quickly than deposits.



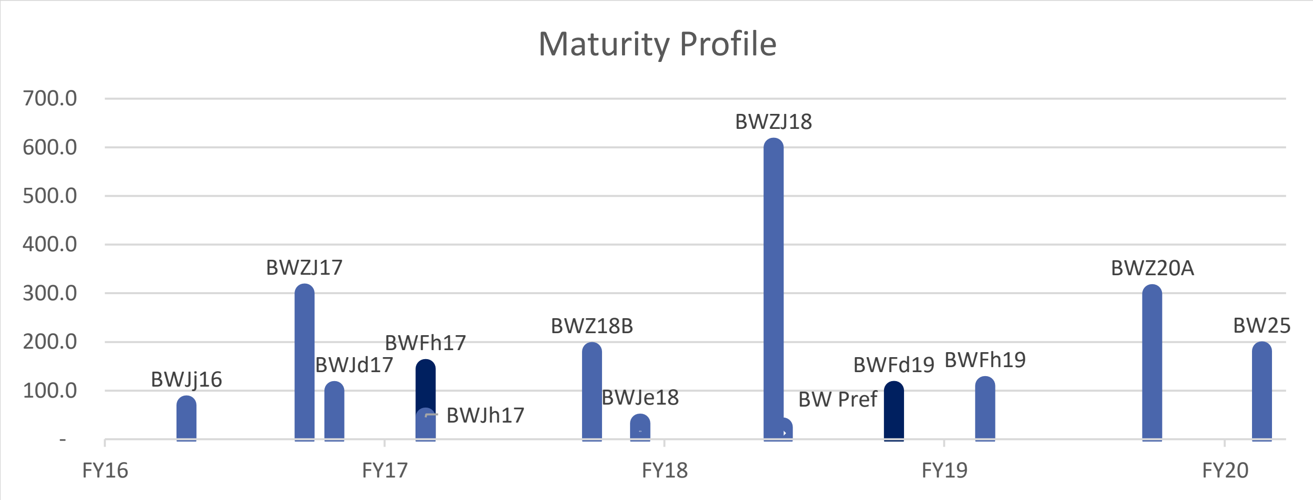
Historically, Bank Windhoek has had a higher cost of funding than many of its competitors, largely due to the lack of big-brother backing, and the higher percentage of funding sourced through negotiable certificates of deposit (NCD) and debt securities than the other major players.

Average Interest Cost	
Savings accounts	2.50%
Current accounts	3.30%
Demand deposits	5.60%
Term and notice deposits	6.90%
NCD's	7.10%
Debt Securities	8.10%
Other deposits	11.30%

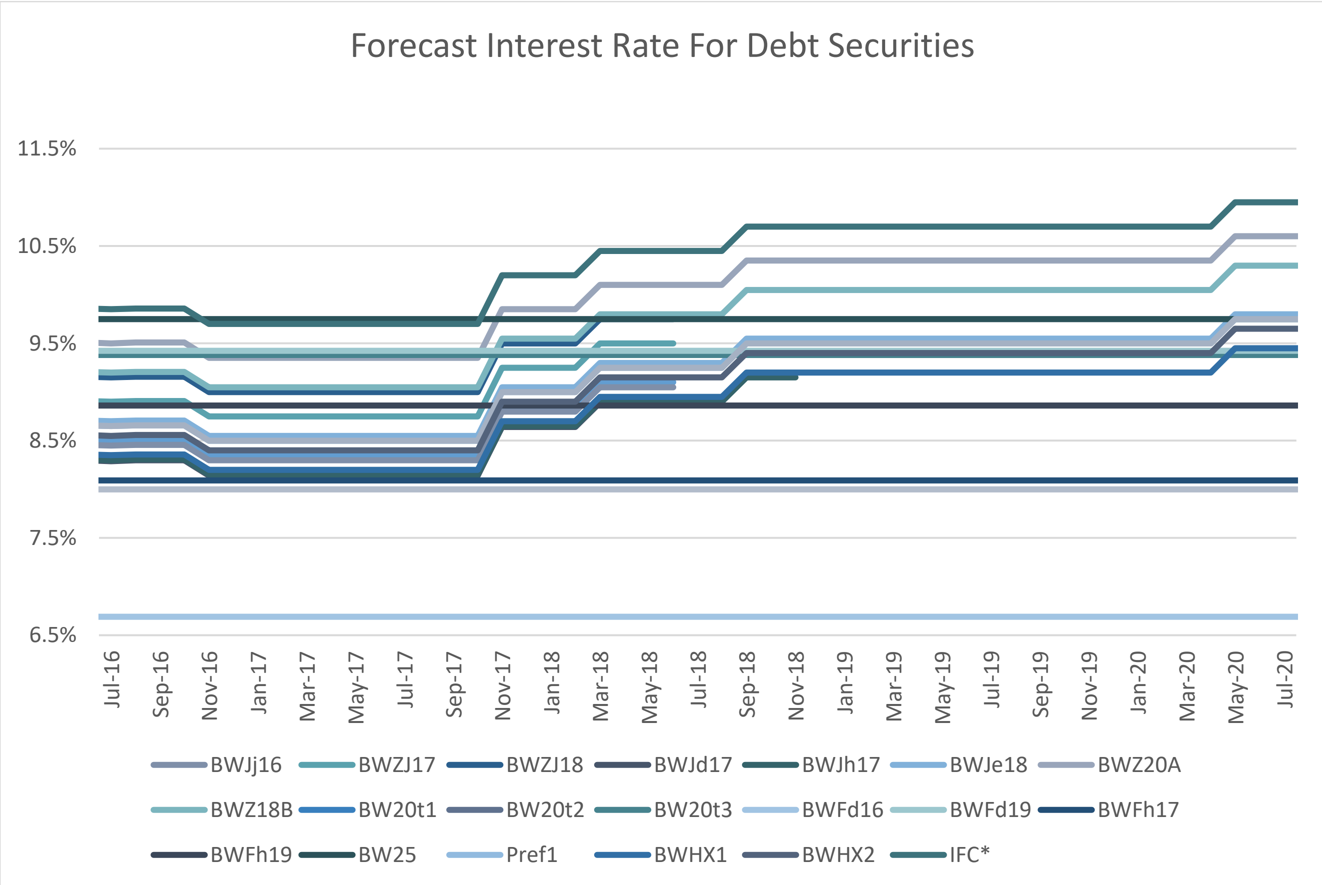


We expect to see more long term funding being added to the mix over the medium term. The bank will be reliant on debt securities to fund loan growth in the absence of adequate deposit growth. Additionally, the introduction of Basel III in 2018/19 will require the banks to include more long duration funding to comply with minimum net stable funding ratios.

Unfortunately, longer term borrowings are more expensive and should increase the average cost of funding. The combined effect of increasing interest rates and a change in funding mix has pushed up the cost of funding from 5.3% in FY15 to 6.3% in FY16. Going forward, we expect moderate increases in the interest rate and a gradual shift to a longer duration funding mix in FY19.

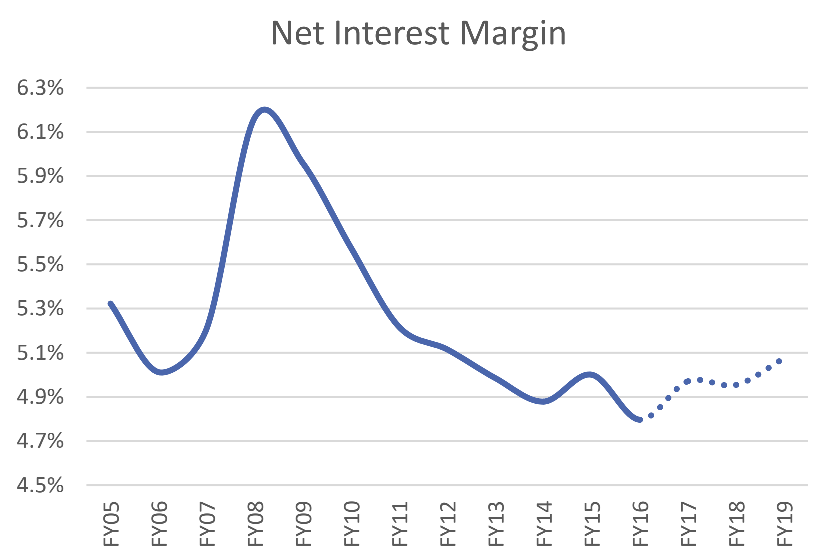


The BW20 callable bond series was redeemed in August 2015 and N$ 181 million of the five-year callable bond BW25 was issued in its place. This bond was issued under Bank Windhoek's Medium term note program and qualifies as tier 2 capital. Of the fixed rate notes the BWFd16 matured in April 2016 and no new fixed rates bonds were issued.



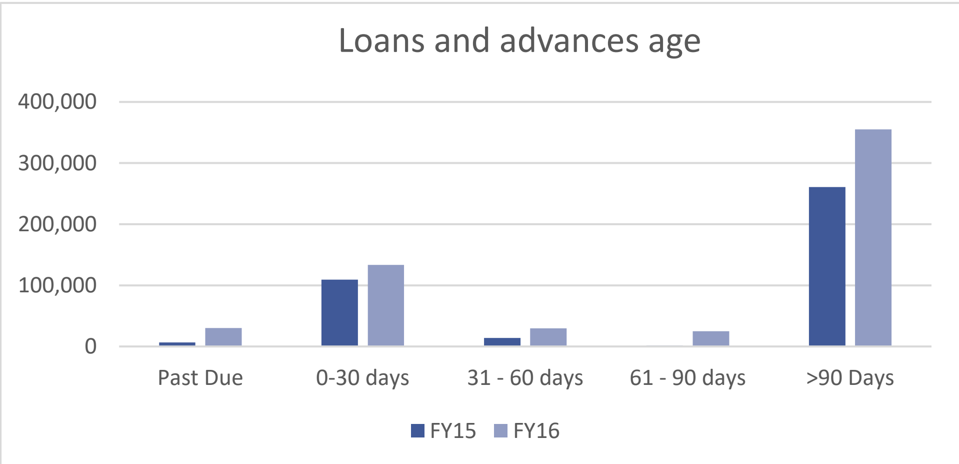
At the FY16 year-end bank Windhoek listed debt was split 75.1% floating and 24.9% fixed. All the floating rate debt is JIBAR linked, meaning that it re-prices in the build up to interest rate moves, and more regularly, than the company's loans to customers. N$470 million worth of debt is maturing in FY17 and it highly likely that the bank will roll these maturities into longer dated paper. Thus, we expect average funding cost at 6.2% in FY17, increasing thereafter to 6.6% in FY18 and 7.0%

Net interest margin



The net interest margin contracted by 0.2% from 5.0% to 4.8%. The contraction was largely due to an increase in the average cost of funding which rose from 5.3% to 6.3%. The disproportional increase in cost of debt relative to income was a result of a change in funding mix, which was more heavily weighted towards NCD and debt funding. Going forward we can expect the margin to remain relatively stable, increasing to 5.0% in FY17 and FY18 and 5.1% in FY19.

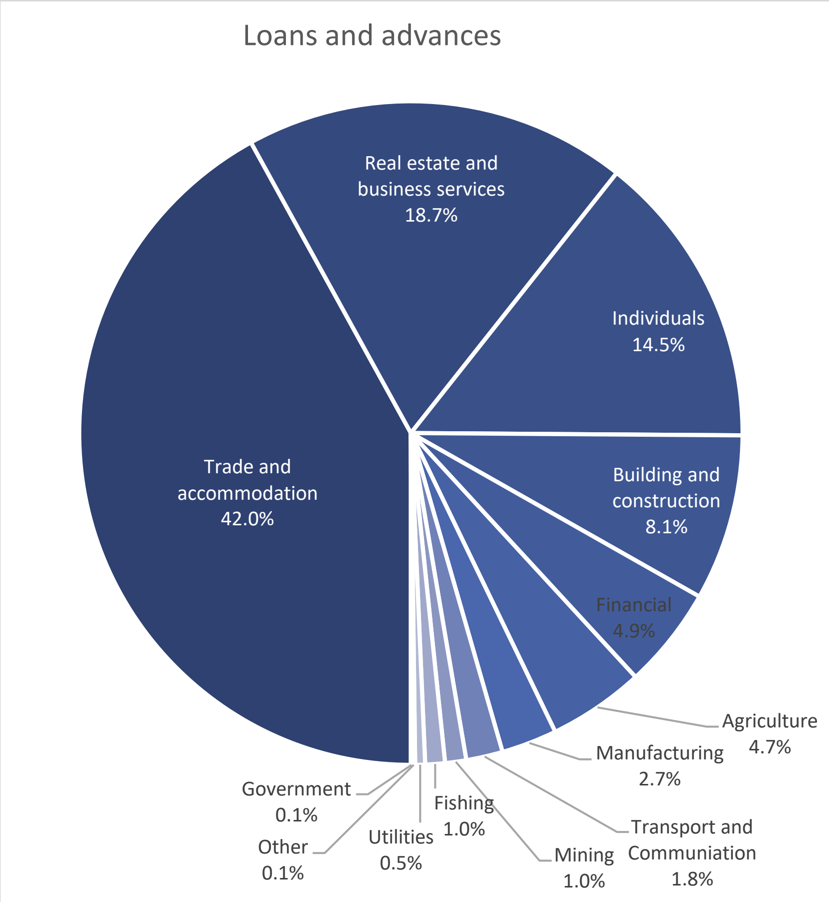
Non-Performing Loans and Impairments



The economic outlook for Namibia has deteriorated. The major government spending cuts combined with a rising interest rate cycle have already resulted in a slow increase in arrears and non-performing loans.

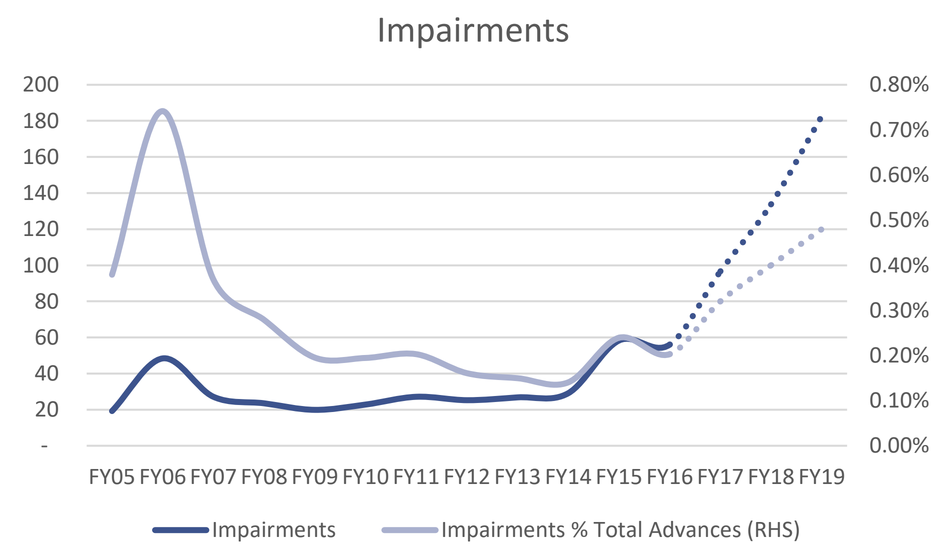
Advances more than 90 days in arrears are considered non-performing and increased from N$260.7 million to N$355.2 million. As a percentage of total advances NPLs increased from 1.09% to 1.32% of total advances, which is still well within banking norms.

Impairments losses have been stable, increasing only 4.2% in FY16, to N$60.8 million. This represented an improvement from 0.24% of total advances to only 0.20%. Up until FY14, impairments had been at very low levels, dipping to as low as 0.14% of total advances.



The makeup of the bank's loan book is worrying. Trade and accommodation, which includes all loans and advances granted to individuals that acquire property for residential purposes (residential mortgage loans and advances granted to hotels, lodges, restaurants and the related) makes up 42% of advances. Combined with the "building & construction" and "real estate & business services segments", 69% of the bank's book is skewed towards property.

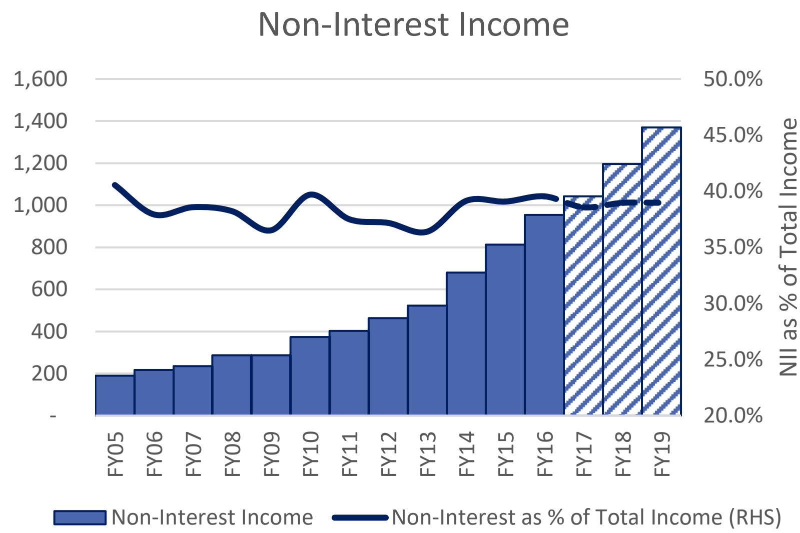
The high property allocation is worrying because of the high proportion of residential mortgage loans on the book. The Namibian residential property market seems to be cooling as more and more properties are being advertised as selling below valuation. Rental escalations will become harder to negotiate as economic activity continues to slow and vacancies are expected to increase. Mortgages taken up by the buy-to-let and speculative buyers will likely come under pressure. The increase in interest rates has already put pressure on borrowers and the current climate may make it difficult to cover their monthly repayments.



Due to the general economic slowdown and property specific concerns, we foresee a meaningful uptick in impairments over the next three years. Impairment losses are expected to triple over the next three years to N$180 million by FY19. However, as a percent of credit extended, we expect the level to remain at reasonable levels, increasing to 0.32% in FY17, 0.40% in FY18 and 0.48% 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 expanded to N$953.8 million, up 17.5% from the previous financial year. The increase was mostly due to larger than expected trading income, which increased from N$96.0 million to N$142.7 million, which was due to profits in the foreign exchange market. These profits originated largely from Kwanza trading activities, however the bank of Namibia withdrew the dispensation for Namibian banks to trade in the currency in December 2015.

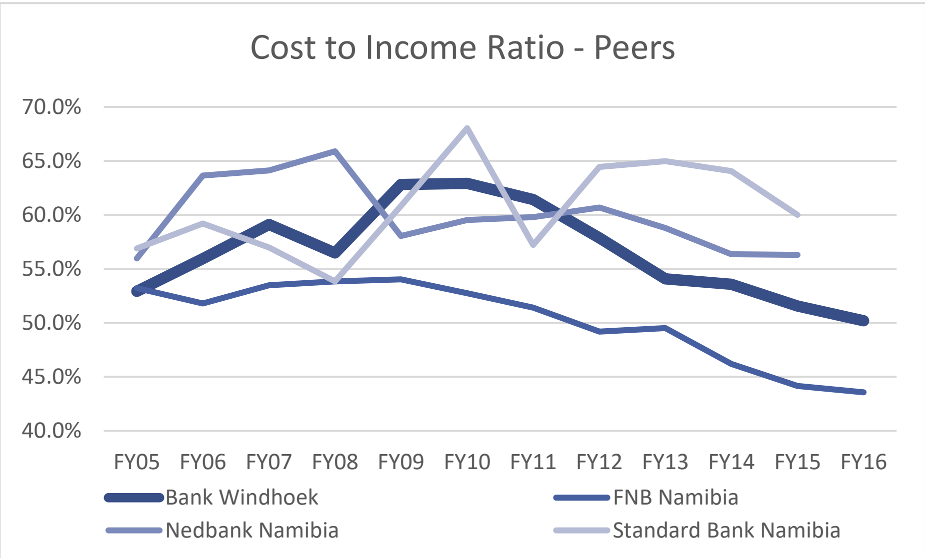


The accelerating non-interest income is in line with the group's strategy of diversifying the sources of revenue. Currently non-interest income makes up 39.5% of revenue and net interest income the remaining 60.5%.

The regulator is in the process of attempting to reduce fee and commission income earned by commercial banks. The waiver of cash deposit fees on individual and SME transactions which came into effect in April 2015 was the first step in this direction. Nevertheless, Bank Windhoek managed to grow fee and commission income by 7.6% to N$607.2 million. Fees and commissions still make up 63.7% of all non-interest income.

Other operating income increased from N$151.6 million to N$203.9 million due to increases in asset management fees, insurance commissions and profits on sale of residential units.

Operating performance



Total operating income increased by 16.3% to N$2.41 billion, while total operating expenses increased by only 13.2% to 1.18 billion. The increase in operating expenses is mainly due to the increase in staff costs, which increased from N$569.7 million to N$645.1 million, or 13.2%. Staff costs make up 54.7% of total operating expenses. Bank Windhoek's cost to income ratio improved from 51.6% to 50.2%, which is attractive in comparison to its Namibian peers. On this measure however, FNB remain the most efficient, at 43.6%.

Financial Statement Summary

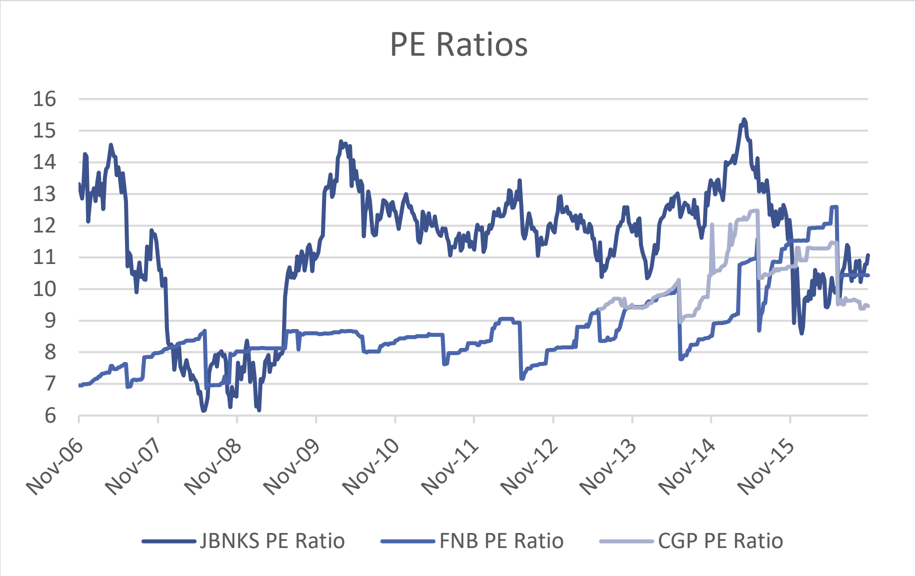
Income Statement

in N$ 000s	*Actual* 2015	2016	*Forecast* 2017	2018	2019
Interest and similar income	2,425,239	2,963,244	3,276,249	3,782,460	4,462,964
Interest and similar expense	(1,158,278)	(1,505,102)	(1,615,928)	(1,909,017)	(2,317,550)
Net interest income	**1,266,961**	**1,458,142**	**1,660,321**	**1,873,443**	**2,145,413**
Impairment losses	(58,305)	(60,779)	(96,590)	(133,744)	(182,641)
Non-Interest Income	**812,598**	**953,804**	**1,042,352**	**1,195,855**	**1,369,913**
Operating expenses	(1,042,231)	(1,180,153)	(1,290,011)	(1,453,099)	(1,649,679)
Operating profit	**979,023**	**1,171,014**	**1,316,072**	**1,482,455**	**1,683,006**
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**	**1,429,379**	**1,612,758**	**1,832,855**
Income tax expense	(314,140)	(364,494)	(388,791)	(438,670)	(498,537)
Profit for the year	**753,002**	**905,048**	**1,040,588**	**1,174,088**	**1,334,318**
Other Comprehensive Income	**28,486**	**33,465**	**22,518**	**24,214**	**24,585**
Total comprehensive income	**781,488**	**938,513**	**1,063,106**	**1,198,302**	**1,358,904**
Headline Earnings	753,218	905,048	1,040,588	1,174,088	1,334,318
EPS (c)	**150.4**	**181.2**	**208.3**	**235.0**	**267.1**
HEPS (c)	**150.5**	**181.2**	**208.3**	**235.0**	**267.1**
Dividends declared per share (c)	**54.0**	**66.0**	**75.0**	**85.0**	**96.0**

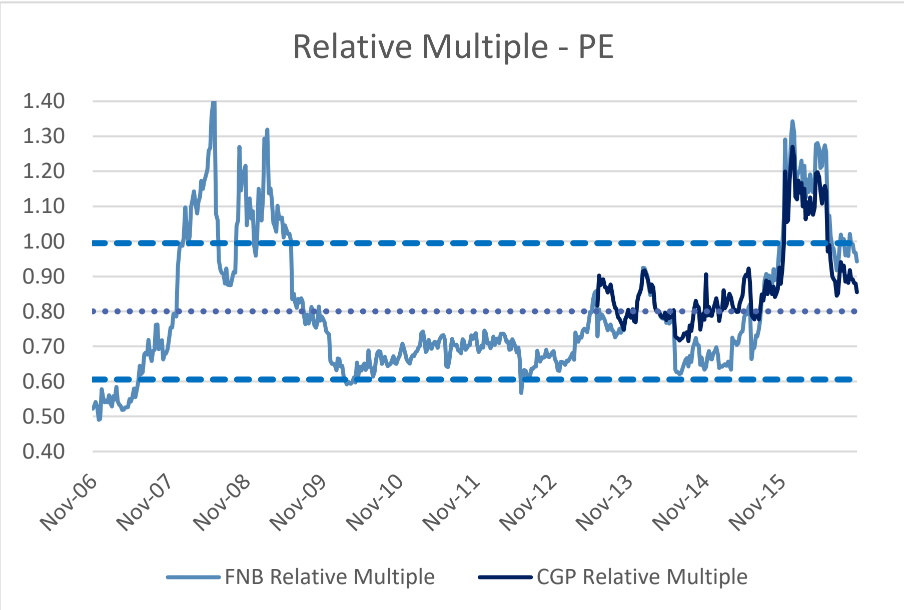
Balance Sheet

	Actual			*Forecast*	
in N$ 000s	**2015**	**2016**	**2017**	**2018**	**2019**
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



On a PE multiple basis both FNB and CGP shares have become much less expensive. Over the last year FNB Namibia and Capricorn Group have seen increases in their share price of 11.5% and 6.5%, respectively. However, FNB's earnings grew by 15.7% and its PE ratio dropped from 11.4x to 10.4x, while CGP's earnings grew by 20.5% and its PE ratio dropped from 10.7x to 9.5x. The JBNKS Index, which consist of all the South African listed peers, saw its PE increase to 11.1x over the same period.



On a relative PE basis both FNB and CGP saw their relative multiples decrease to within one standard deviation of the ten-year average versus their South African peers. CGP now only trades at a 15% PE discount. Using the ten-year average relative multiple of 0.8x versus the 11.1x PE on the JBNKS Index implies a fair PE of 8.9x.

However, to value the company, we establish a justified PE using the following assumptions: a required rate of return, or **cost of equity, of 12.46%,** a **long-term growth rate for the company of 8.4%,** and a **dividend pay-out ratio of 36%**, broadly in line with historic pay-out ratios. This yield **a justified PE of 8.76x**. Given **expected earnings growth of 18.3% in FY17**, taking **total earnings to c208/share**, we derive **a target price of c1820 per share**. Coupled with an **expected dividend of 75cps** or **dividend yield of 4.5%**, we expect a **total return of 12.5% over the next twelve months.**

Due to the deterioration in the current economic environment, we have revised our long-term growth expectations down to 8.4% from 9.5%. As a result, our target price has decreased from 1880 cps to 1820 cps. However, this security still promises a return in line with our required return on equity. Furthermore, changes to regulation 28, requiring 50% of pension assets to be held locally, will likely provide support for the security's price going forward. Despite the challenging conditions ahead, we maintain our **BUY** recommendation.

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