CAPRICORN INVESTMENT GROUP
FY19 Results Review
October 2019

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Capricorn Investment Group Limited

FY19 Results Review

Target Price (c)	***1710***
Current Price (c)	1594

Year End 30 June	2018	2019	F2020	F2021	F2022
Net Interest Income (N$m)	1,819	2,133	2,355	2,576	2,826
Non-Interest Income (N$m)	1,225	1,359	1,472	1,596	1,732
Profit (N$m)	934	1,015	1,123	1,223	1,341
HEPS (c)	158	182	202	220	241
DPS (c)	60	66	67	73	80
DY (%)	3.5	4.1	4.2	4.6	5.0
P/E (x)	10.9	8.8	7.9	7.3	6.6
P/BV (x)	1.6	1.3	1.2	1.1	0.9

Source: CGP, IJG, Bloomberg

Recommendation	HOLD
NSX Code	CGP
Market Cap (N$m)	8,275
Shares in Issue (m)	519.2
Free float (%)	26.4
52 week high	1613
52 week low	1540
Expected Total Return (%)	11.6%

Capricorn Investment Group released their results for the year ended 30 June 2019. All in all, the results were slightly above our expectations. Profit after tax increased by 8.7% y/y to N$1.015 billion while total comprehensive income increased by 3.8% y/y to N$1.024 billion. The gains were largely top line driven as net interest income increased by 17.3% to N$2.133 billion. This was achieved by increasing interest income by 11.7% to N$4.471 billion while containing the increase in interest expense to 7.5% y/y or N$2.608 billion. Gross loans and advances grew by 6.5% y/y, compared to Namibian private sector credit extension of 7.4% y/y over the same period. Most of the new loans extended were Namibian commercial loans.

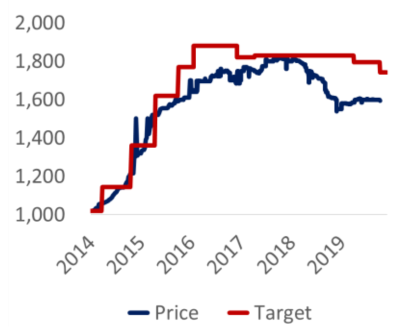
Entrepo was a major contributor to the bottom line making up 15% of total profit after tax. The Namibian microlending book showed good growth in a tough environment growing by 21.5% y/y, while insurance income amounted to N$103.9 million after claims. Botswana was also showed good growth, largely due to the launch of a new unsecured lending product coupled with the roll out of digital services. Botswana contributed 5% of the bottom line. Zambia was a detractor from growth, but following a restructuring has made the probability of a turnaround to profitability more likely in management's opinion. An investment into Paratus Africa subsequent to financial year end has been an exciting development, which should be a catalyst for future growth.

Non-interest income also showed robust growth despite the tough economic environment. Non-interest income increased by 11.0% y/y to N$1.359 billion but by 22.6% when normalised for the effect of once-off items. The growth was driven largely by income from underwriting activities, Entrepo included for the first full year, and profitable forex trading activities across all three banks. Capricorn Asset Management also performed well as its income increased by 11.3% to N$118.2 million. Income from the insurance associate also struggled due to cancelations and downsizing of policies.

Operating expenses grew by 14.3% y/y to N$2.052 billion largely due to an increase in staff costs, up 15.6% y/y. This was expected given the expansion at the Capricorn Private Wealth department, capacity building in the IT department and inclusion of Entrepo. Additionally, operational banking expenses grew by 18.6% y/y. However, the rest of the discretionary operating expenses were very well contained.

We valued the company at **N$c1710 per share**. Coupled with expected dividends of 69 cps over the next 12 months, we expect a total return of 11.6% and have maintained our **HOLD** recommendation on the counter.

CGP Share Price vs Target Price



Dividends

A final dividend of 36 cents per ordinary share was declared on 20 August 2019 for the year ended 30 June 2019, bringing the total dividend to 66 cents.

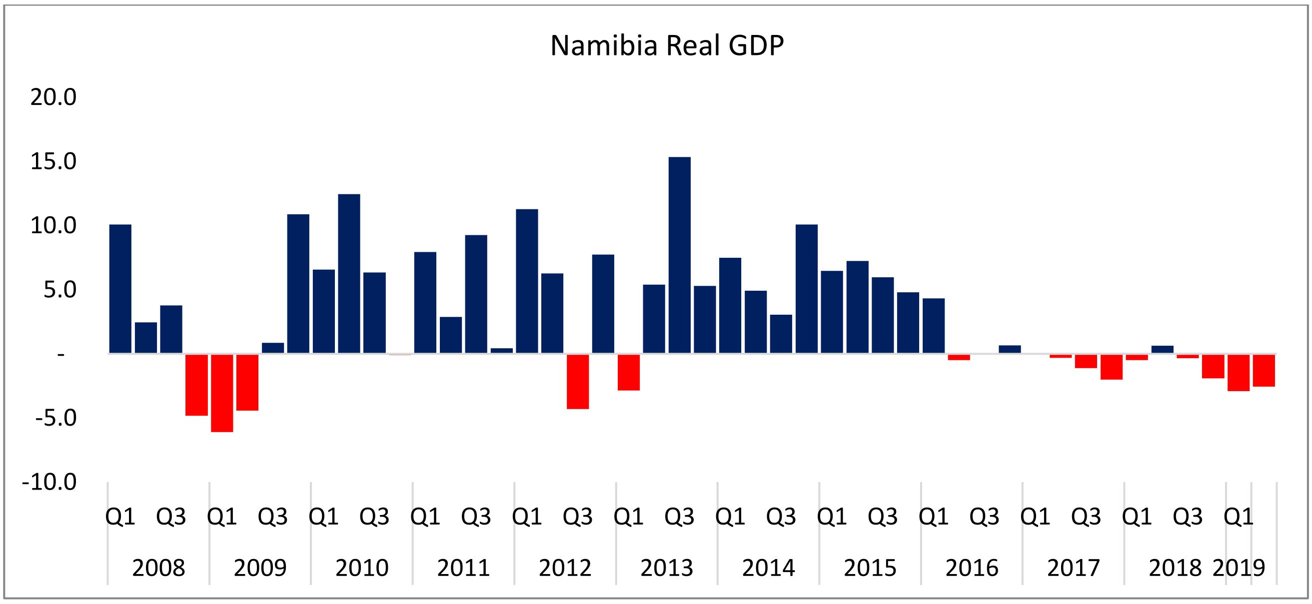
Last day to trade: 6 September 2019
Ex dividend: 9 September 2019
Record date: 13 September 2019
Payment date: 27 September 2019

Macro Environment

Growth environment

Economic growth in Namibia has been stagnant since the start of 2016. Q2 GDP figures released by the Namibia Statistics Agency (NSA) indicates that nine of the last fourteen quarters have posted contractions in real GDP while the positive quarters were marginally positive at best. The Q2 numbers pointed to a contraction of 2.6% y/y making it the fourth consecutive quarter of contraction the country has experienced.

In their July 2019 economic outlook, the Bank of Namibia projected the domestic economy to contract by 1.7% in 2019, revised down from a 0.3% contraction expected for 2019 in their April 2019 outlook. The revision was largely due to the effect of the prolonged drought as well as the effect of lower diamond output following regular maintenance of diamond mining vessels.



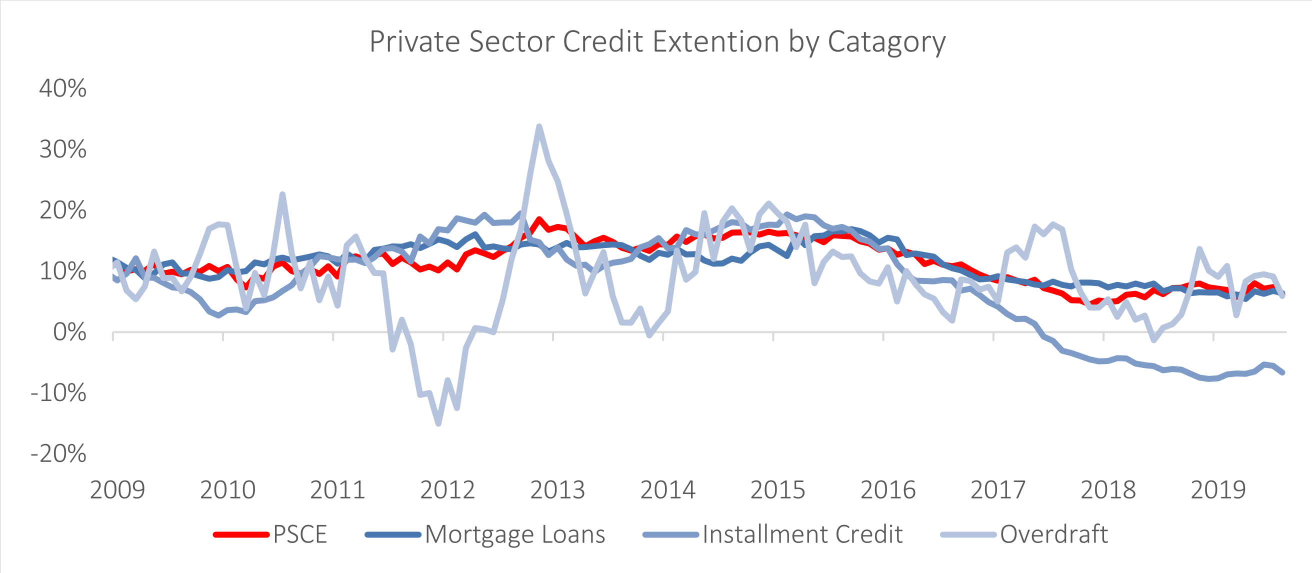
Source: NSA, IJG

Although earlier expectations were for a swifter recovery, reality has set in that the next few years will continue to be trying for the domestic economy. The last three and a half years have posted dismal growth, but of much greater concern is the outlook for the Namibian economy which still shows little signs of turning. In our opinion, the downgrade of Namibia's sovereign credit rating from BB+ to BB by Fitch in October of 2019 was largely due to this deteriorating growth outlook. Fitch indicated that they expect Namibia to stagnate over the 2019 – 2021 period and that Namibia is expected to achieve the third-weakest economic performance among all Fitch-rated sovereigns during that period.

As we have pointed out previously, one of the largest barriers to recovery is low investor confidence. In our opinion, confidence remains low due to problematic legislation such as the NEEEF and NIP bills that have deterred both foreign and local investment which has weighed heavily on gross fixed capital formation. Although there seems to be a more concerted effort to take steps in the right direction and efforts have been made to revive investment, without certainty investors will remain on the side-lines.

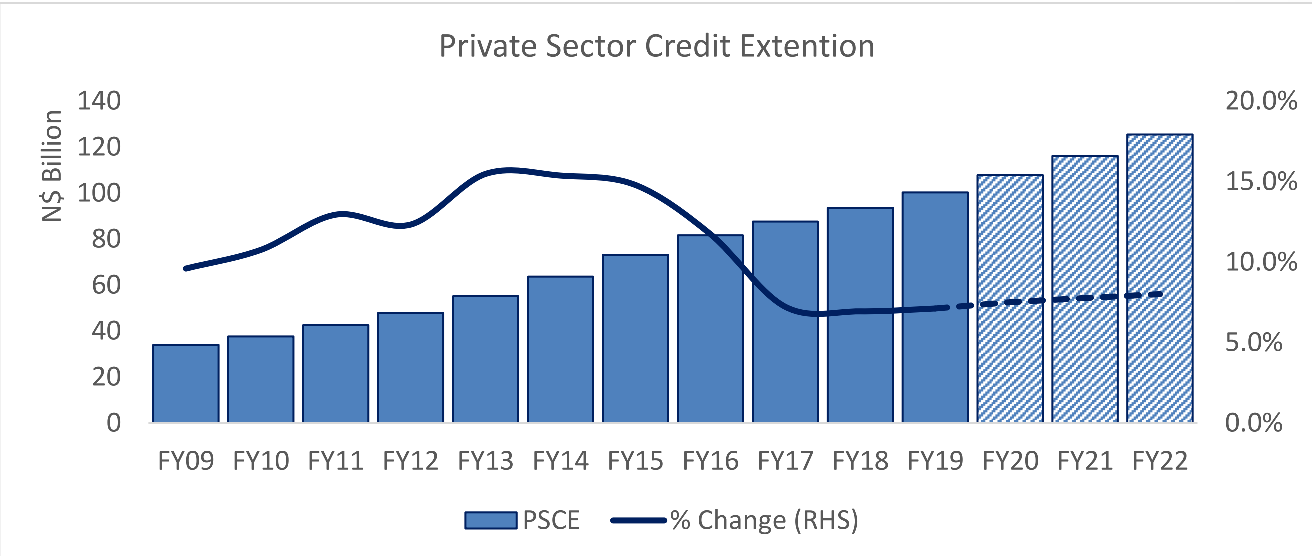
PSCE

Despite economic headwinds, private sector credit has continued to deliver growth, albeit at a slower pace. PSCE growth stood at a 6.1% y/y increase by the end of August. Much of the year-on-year growth has been driven by the 'Other Loans and Advances' category which grew by 19.2% y/y. Mortgage growth has been steady at 6.4% y/y while leasing and instalment credit continues to contract by 21.9% and 6.6% respectively.



Source: BoN, IJG

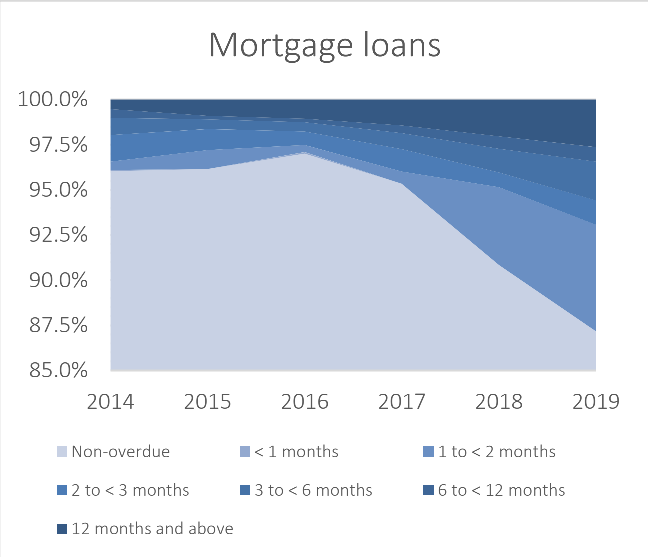
Given the current economic environment we do not expect private sector credit extension to exhibit a strong recovery. We see some growth in the mortgage market seeing as Bank of Namibia have relaxed some of its loan to value directives, which will allow individuals to purchase second and third properties without increasing deposit requirements. We expect that this may bring back some of the buy-to-let investors and this may also be positive for residential property prices at the margin. Nevertheless, we expect PSCE to remain around current levels for the medium-term future and have pencilled in PSCE growth of 7.5% for FY20, 7.8% in FY21 and 8.0% in FY22.

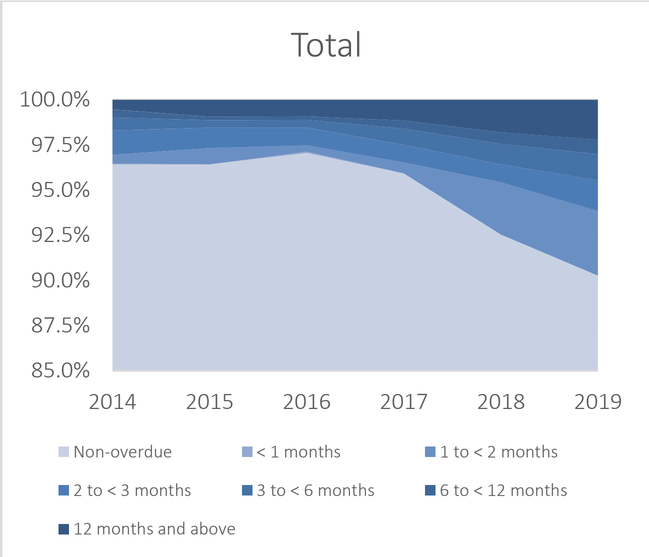


Source: BoN, IJG

Banking Sector Credit Quality

The quality of banking assets has been impacted negatively by the economic slowdown, as is clearly visible in the rising proportion of arrears. This has been observed right across the industry as lower disposable incomes and higher unemployment have resulted in increased non-payments and an ageing advances book.





Source: Bank of Namibia, IJG

Mortgage loans have been one of the worst hit categories with 12.8% of loans in arrears in the country. This is especially worrying as this makes up about half of the total banking credit outstating in the country. Personal loans have also seen some deterioration in arrears as 10% of these loans are now one or more payments behind.

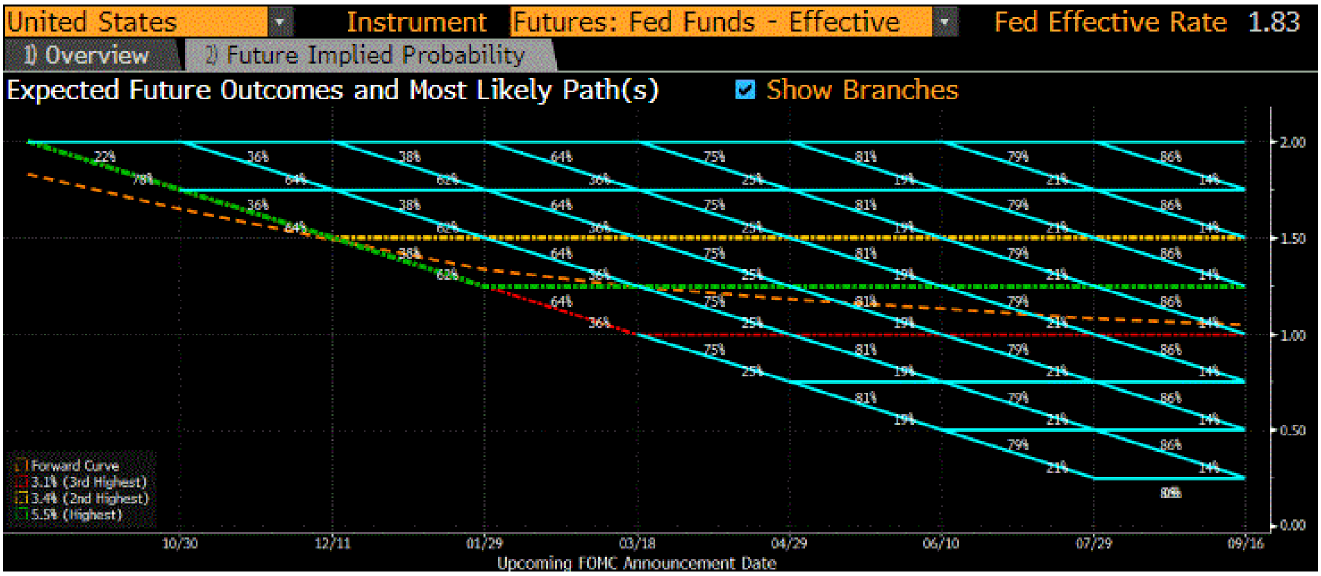
Higher non-performing loans will translate into higher impairments for the sector as banks make provisions for expected credit losses. The transition to IFRS 9 has also come at an unfortunate time from a financial performance perspective, as many of the loans currently classified as stage 2 would previously not have been provided for.

Additionally, the poor economic outlook and sector specific default exposures will further increase portfolio impairment charges. Namibian banks historically had very low credit loss ratios and the implementation of the new standard will likely be a more accurate reflection of reality. It also provides for impairments before they happen which should reduce the chances of large single year write-offs. On the other hand, in the unlikely event that the outlook for the Namibian economy quickly changes for the positive, there is a chance of provisions being released.

Interest Rates

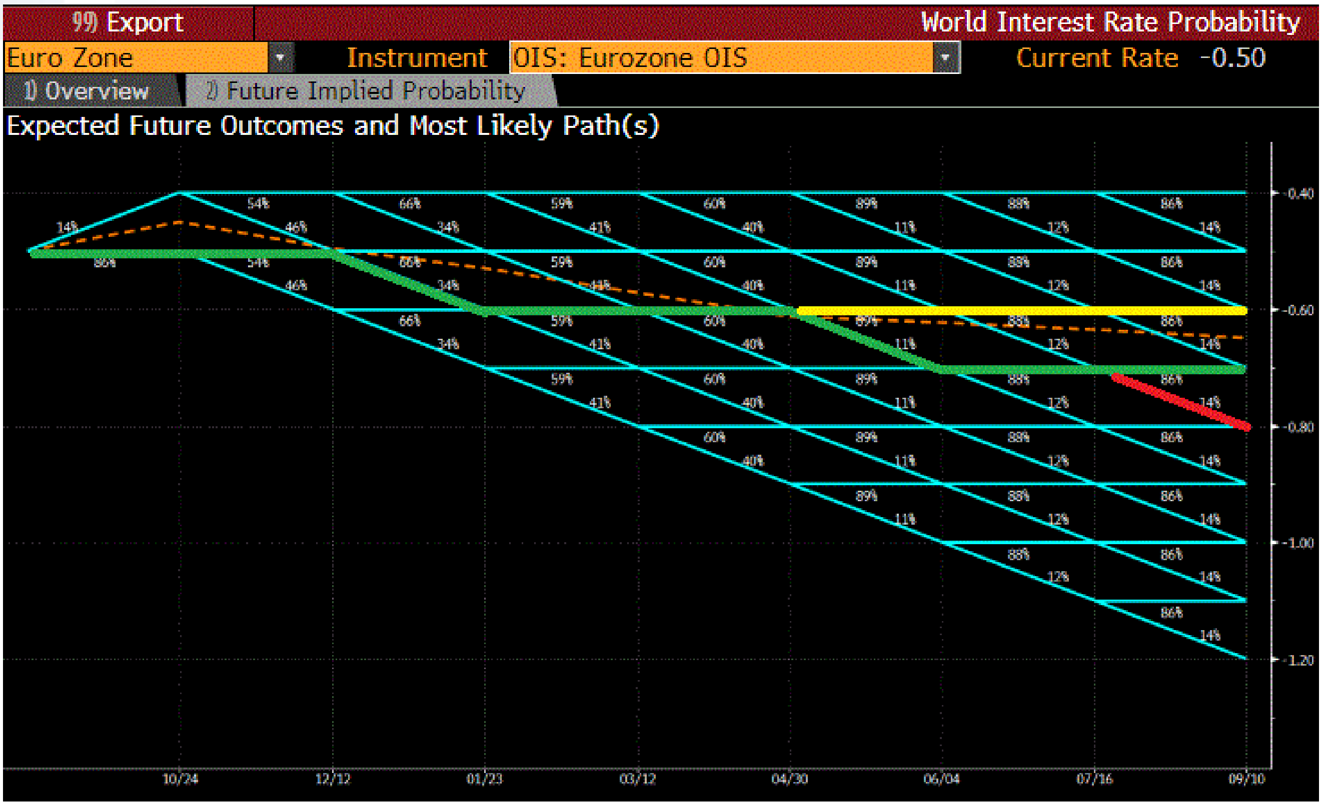
The global economy exposed to increasing uncertainty, mainly as a result of the ongoing trade tensions between the US and China. Combined with deteriorating economic indicators, most notably a contraction in the manufacturing sector and lower expectations for GDP growth, has led to expectations of even more accommodative monetary policy.

The latest manufacturing data indicates American factories are operating at their lowest rate in 10 years, while Chinese plants are also suffering, posting decade low results in July. Much of this directly attributable to the increased tariffs imposed by President Donald Trump, who has publicly called for the Fed to lower rates on multiple occasions. Fed Fund futures now point to three 25bps cuts in the target rate as the most likely scenario, likely taking place at the next three Fed meetings.



Source: Bloomberg

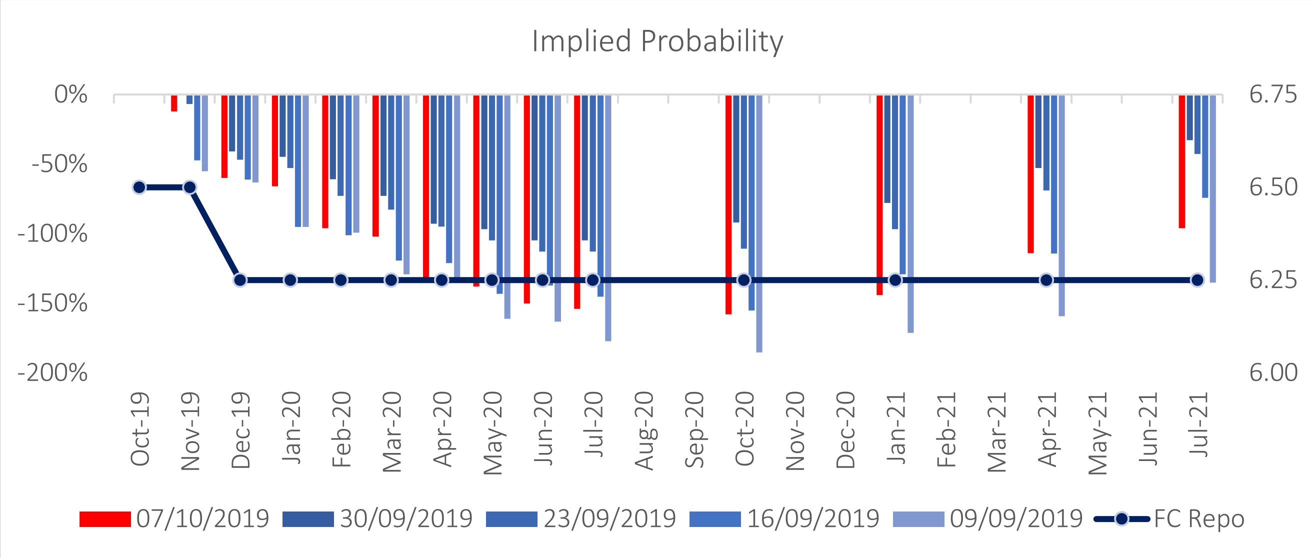
In Europe, Brexit remains the main source of uncertainty as the October 31 deadline draws near. Prime Minister Boris Johnson has claimed that he would "rather be dead in a ditch" than ask for a Brexit extension. However, with no deal in sight, parliament have until 19 October to request a third extension to the Brexit deadline to 31 January 2020 as per legislation passed to prevent a no deal Brexit. Chances remain however, that the UK might leave the EU without a deal at the end of the month, immediately departing from the single market and customs union, which would cause a fall-back onto World Trade Organization terms of trade requiring border checks for goods. This is expected to result in extreme traffic bottlenecks at ports and an inevitable rise in ‘dogging’ at the border.



Source: Bloomberg

The increased trade barriers and general anti-trade rhetoric continue to weigh on European sentiment. Expectations are for the ECB to follow the global trend of easing. However, given the fact that rates are already in negative territory and that the ECB has restarted their quantitative easing programme, it remains to be seen if even more accommodative monetary policy will have any effect.

Being in a very similar boat to the rest of the world, South Africa also faces low growth and low inflation. Minutes of the September 2019 Monetary Policy Committee meeting indicates that the South African Reserve Bank expects real GDP growth for 2019 to be around 0.6% and inflation is expected to average 4.2%. The combination of low growth and low inflation makes a good case for a rate cut, but higher inflation remains a risk. Forward rate agreement rates have declined recently, but still indicate that only one cut is likely after the midterm budget speech in October.



Source: Bloomberg, IJG

As has usually been the case, we expect Bank of Namibia to follow the South African Reserve Bank's monetary policy stance. Given the low level of growth in Namibia, the central bank will likely jump on the opportunity to provide some monetary stimulus to the domestic economy, albeit only through a 25 basis point rate cut.

Developments

Over the last couple of years, the Capricorn Group has been making a concerted effort to diversify their income streams and have made a number of investments. With organic growth in the Namibian market becoming all the more scarce, investments into geographic diversification as well as strategic acquisitions have played out reasonably well for the group.

These investments include the take on of Bank Gaborone and Cavmont Bank, which expanded the group's reach into Botswana and Zambia, the acquisition of a 55% interest in Entrepo, and an investment into both Paratus Namibia and Paratus Africa, internet and telecommunication providers operating in 24 African countries. Additionally, Capricorn Capital started operations in the first quarter of 2018, offering investment banking, advisory services and other solutions in southern Africa. Management seem acutely aware that Bank Windhoek is a maturing business and have demonstrated a commitment to growth and expansion to become a regional competitor in Southern Africa, not only in the banking space, but in a range of financial services.

The investment into Botswana has yielded good results and contributed 5% of the profit after tax. Growth in this territory in the amount of loans extended and number of clients has been promising. This has largely been due to the successful rollout of services. Management have indicated that Namibia and Botswana are quite similar in certain aspects, and thus that the Namibian business model and products are easily transferable to Bank Gaborone. The roll out of point of sales devices, the banking app, credit cards and wealth services have all contributed to the growth in clients and revenue. Management also pointed out that a strong management team and good relationships with clients have been instrumental in Botswana's performance.

On the other hand, Zambia was a detractor to the bottom line of the group, posting a loss of N$19.8 million, half the loss it posted in FY18. The Zambian environment continues to be a challenging one as GDP growth continues to slow and liquidity remains a challenge. The Zambian credit rating was also downgraded by all three the major ratings agencies this year to CCC+, CCC- and Caa2 by S&P, Fitch and Moody's respectively, indicating substantial risk of default. As a result, provisions have been raised on Cavmont's holdings of government securities.

Management have on several occasions pointed out that Zambia is a very different market to Namibia and Botswana and it has been a continuing challenge to get to grips with the dynamics of the territory. Although the group has undeniably made some mistakes in its initial implementation, Management have indicated that they now have a much better understanding of the market. As a result, there have been significant changes to the business model in Zambia with interventions made to ensure a successful turnaround.

Due to the small size of Cavmont, the bank has struggled to gain the economies of scale required to operate profitably. The focus has been turned away from the rural retail market and emphasis has been placed on the small and medium enterprise market. A number of branches have been closed or downsized, while the number of employees has also reduced to 308 from 324 in 2018. Despite the setback management still see immense opportunity in this market as a large amount of the informal cash economy remains unbanked and are pursuing an alliance model which would give them a foothold in the mobile money space.

Last year, Capricorn purchased a 55% stake in Entrepo, a financial services group providing lending and credit protection products to government employees in Namibia. The investment was done at a very attractive price and has contributed to 15% of the FY19 financial year profits. Entrepo's profits were split 56:44 between lending and insurance income.

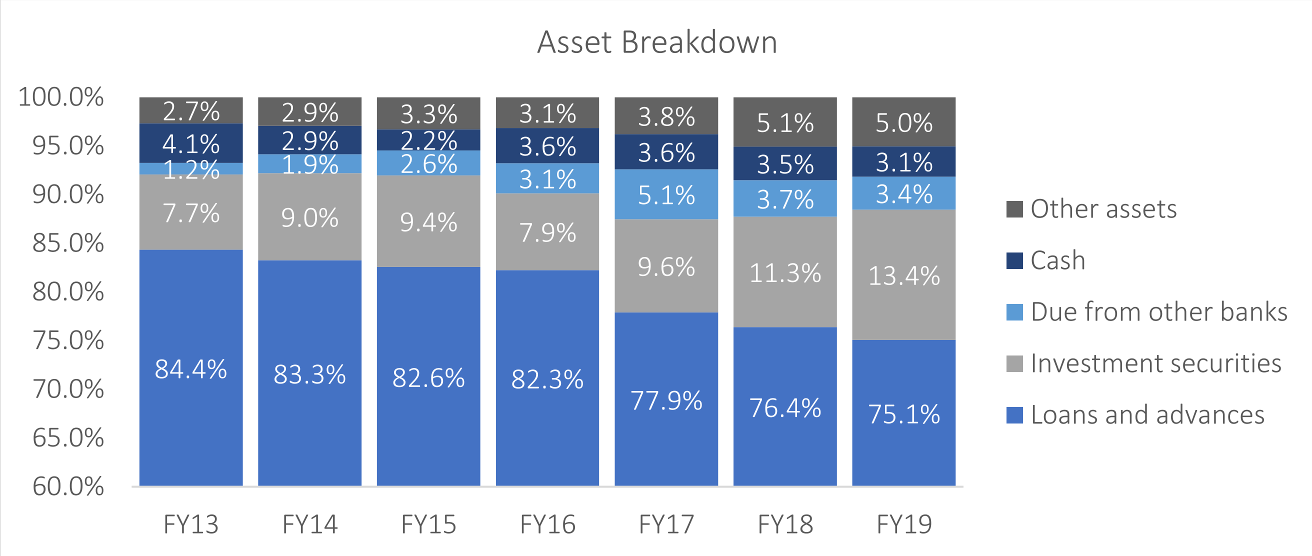
In its most recent, and possibly most interesting move, Capricorn group has made investments into Paratus Namibia and Paratus Africa. The Namibian investment was facilitated through investments into Nimbus infrastructure, while the investment into Paratus Africa was made directly after the 2019 financial year end. Capricorn purchased 30% of Paratus Namibia for a cost price of N$88.7 million and acquired 30% of Paratus Africa for a cost price of N$251.0 million.

This gives the group exposure to the fast-growing ICT industry with a large amount of synergies between the two companies. The most obvious benefit is the connectivity Paratus can provide between the three Banks operating in the three different countries. However, of far more value to the Capricorn team will be the wealth of experience that Paratus has amassed with regards to doing business and aggressively growing footprint on the African continent. Although Capricorn group remains concentrated in the banking space, all the recent moves point to the fact that the group is hungry for growth and generally not opposed to taking risk where they see opportunity. If these investments gain traction it is likely that the contributors to the CGP bottom line will look very different in ten years' time. The management team at CGP are very confident in their capital allocation ability.

Net Interest Income

Asset Base

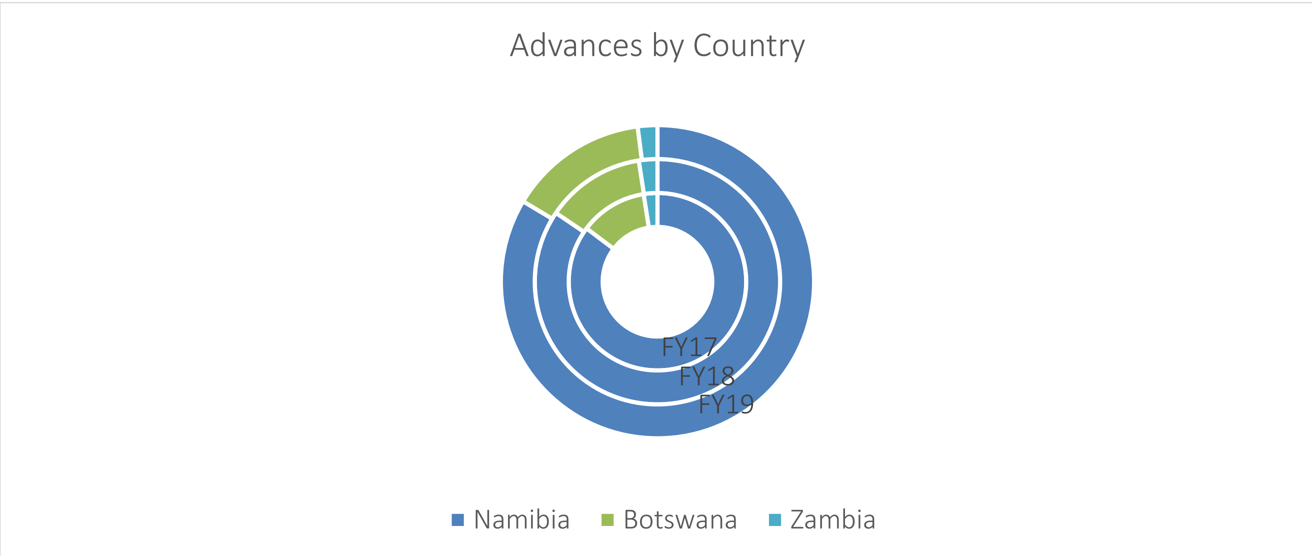
Total group assets grew by 6.8% y/y or N$3.244 to N$50.678 billion, which was primarily funded through an increase in deposits. Loans and advances grew by N$1.815 billion (56% of the increase) while investment securities increased by N$1.400 billion (43% of the increase in assets). Investment securities as a proportion of total assets continued to grow in FY19, making up 13.4% of the balance sheet, compared to 11.3% one year ago. The shift being primarily due to the slow growth in credit uptake in the Namibian market.



Source: CGP, IJG

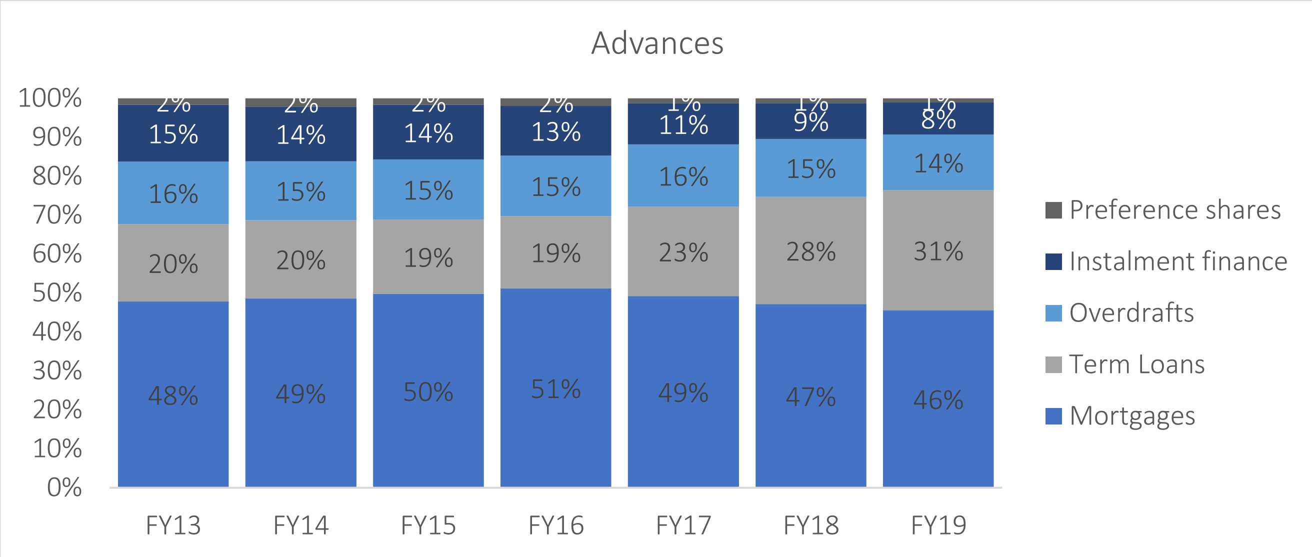
Loans and advances

Loans and advances grew by 5.0% y/y to N$38.050 billion. The Namibian book grew by 3.9% y/y, Botswana posted growth of 15.5% and Zambian loans and advances declined by 12.8%. As a result, Namibia now accounts for 83.6% of total advances, while Botswana has grown to 14.4% of the total book, and Zambia has declined to 2.0%.



Source: CGP, IJG

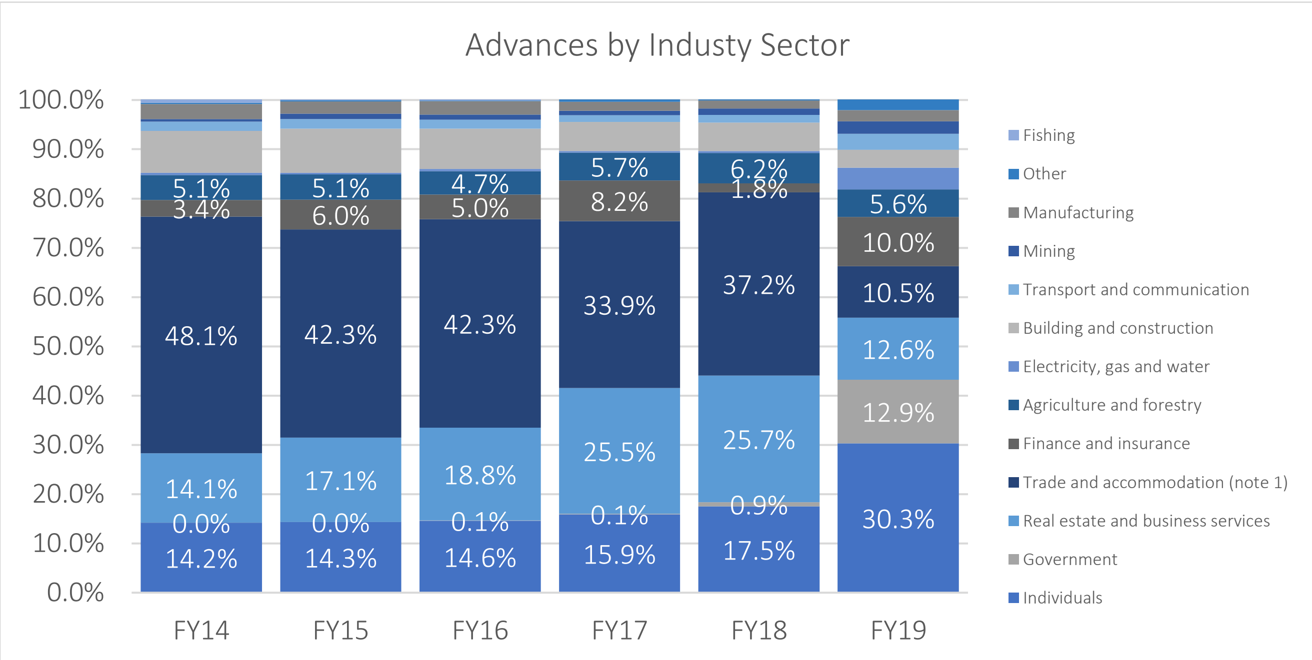
Loans and advances growth in Namibia remain lacklustre as the recession continues. However, strong growth was witnessed from Bank Windhoek's commercial loans book, which grew by 31.2% y/y. Additionally, Namibian microlending and related activities, mainly conducted under the Entrepo banner, showed robust growth, increasing by 21.5% y/y, and growth in the Botswana market was driven primary through unsecured products. As a result, there has been some shift in the asset mix of the bank due to the strong growth in term lending compared to other products. Term loans now make up 31% of the total book, while mortgages and instalment finance continue to decline as a proportion of the total book. It must be noted that due to the increase of unsecured products as a proportion of total advances, the loan book has become inherently riskier.



Source: CGP, IJG

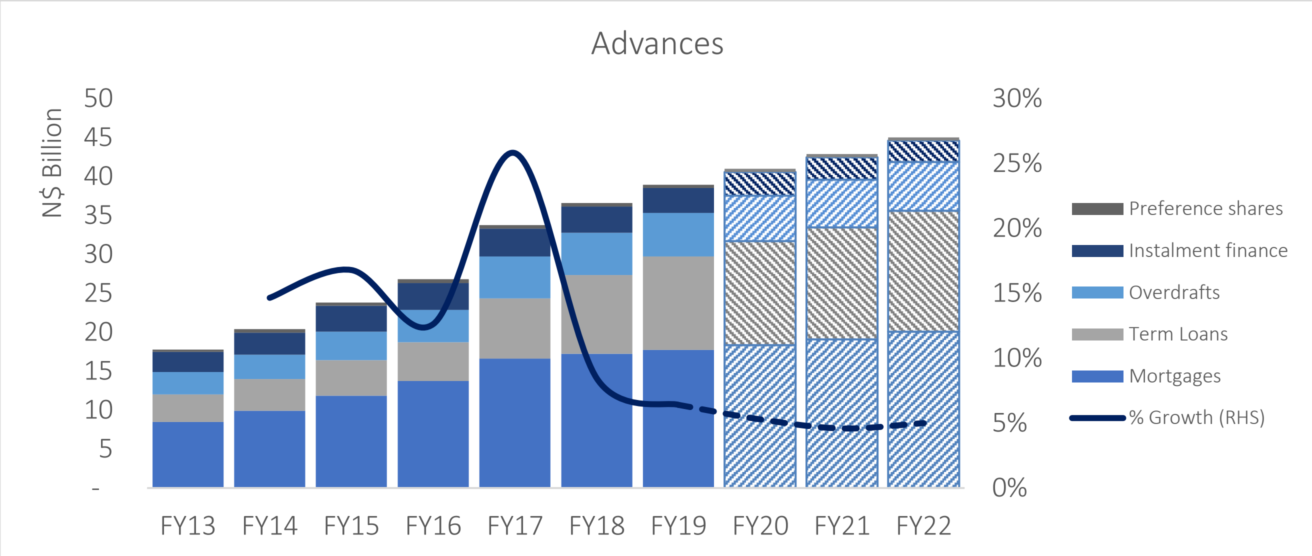
Bank Gaborone's strong growth in loans and advances was as a result of a significant increase in new clients, which was largely due to the launch of a new unsecured lending product, which requires customers to deposit their salaries into a Bank Gaborone account. Additionally, non-interest revenue was driven by continued uptake of the digital offering. Botswana contributed 5% of the profit after tax and performed quite well overall.

Net interest margins in Botswana remain under pressure, as the benchmark rate was lowered to 5.0% in March, while the cost of funding continued to increase. The business climate in Botswana is generally expected to improve and Botswana is expected to remain a contributor to the growth in the loans and advances book going forward. However, the elections in October of 2019 may bring with it some political instability as commentators have indicated that there is a real chance of the opposition coalition gaining power and displacing the ruling Botswana Democratic Party (BDP) that has been in power since the nation's independence in 1966.



Source: CGP, IJG

There have been some distinct changes in the sectoral makeup of the loan book, however most of these changes are due to reclassifications. The trade and accommodation sector (which used to include property for residential purposes purchased through close corporations) is now included as a part of individuals. There has been a marked increase in the amount of loans extended to government, up from N$314 million to N$4.920 billion, while Real estate and business services have declined by a similar amount of N$4.526 billion. Finally, exposures to Electricity, gas and water have increased by N$1.546 billion and Finance and insurance has seen a N$3.141 billion increase.

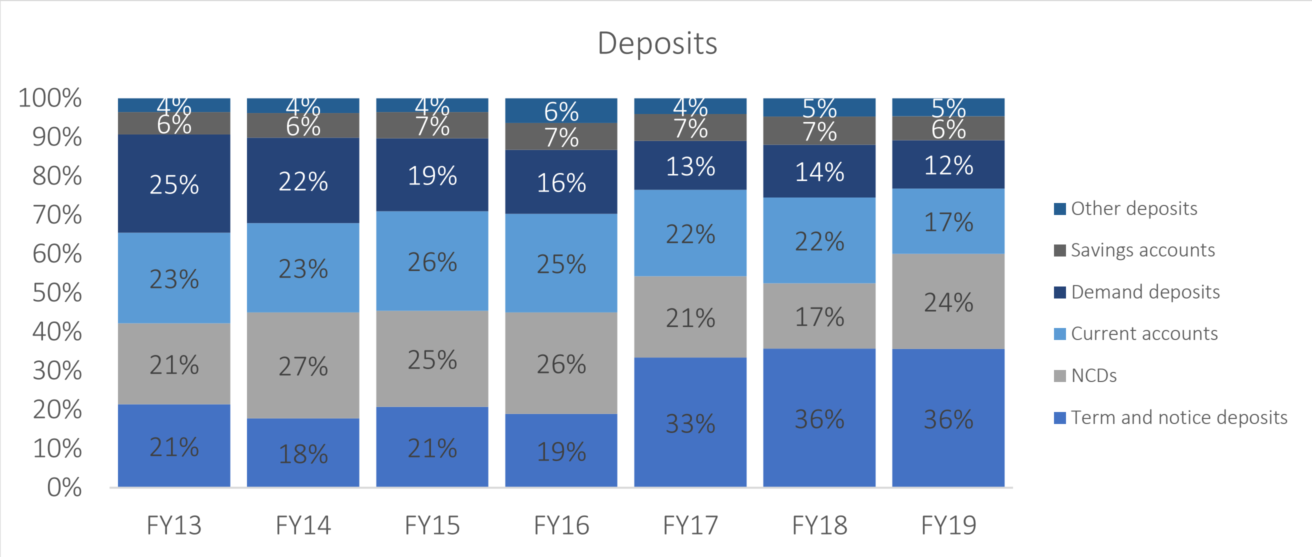


Source: CGP, IJG

We expect advances growth to remain low over the forecast horizon and most growth to continue to come from term loans in the microlending and corporate space. As a result, we see the overall book growing by roughly 5% over the next three years.

Funding

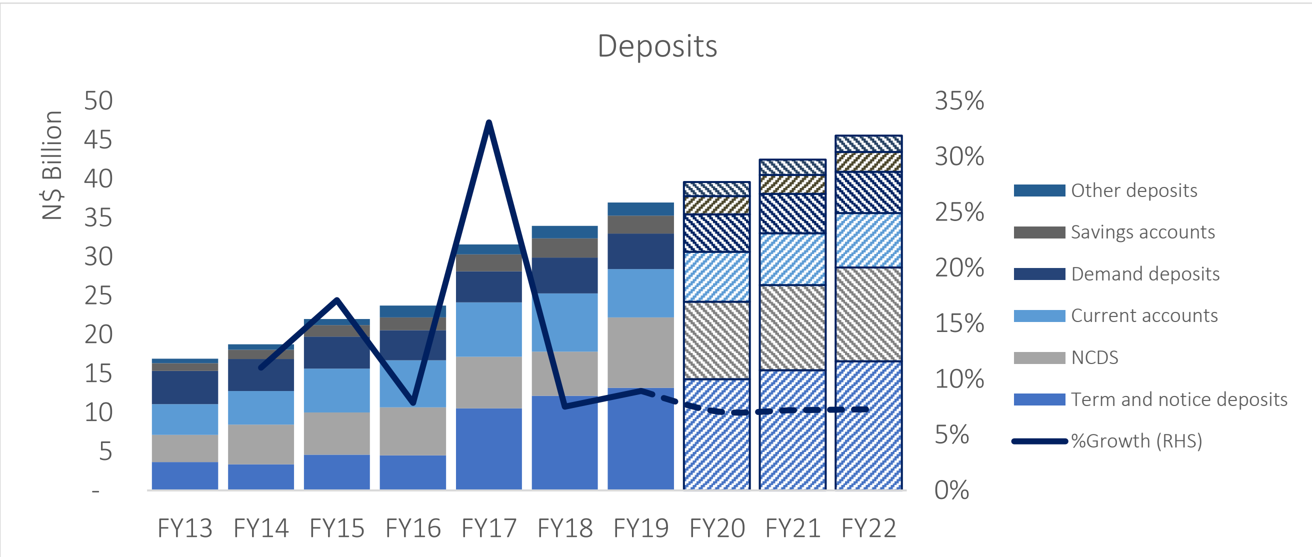
Total deposits increased by 8.9% y/y or N$3.037 billion. This was driven largely by 9.7% y/y growth in the Namibian market and supported by very good growth in Bank Gaborone's deposit book of 20.8% y/y. Zambia, however, saw deposits decline by 68.5% y/y following the restructuring.



Source: CGP, IJG

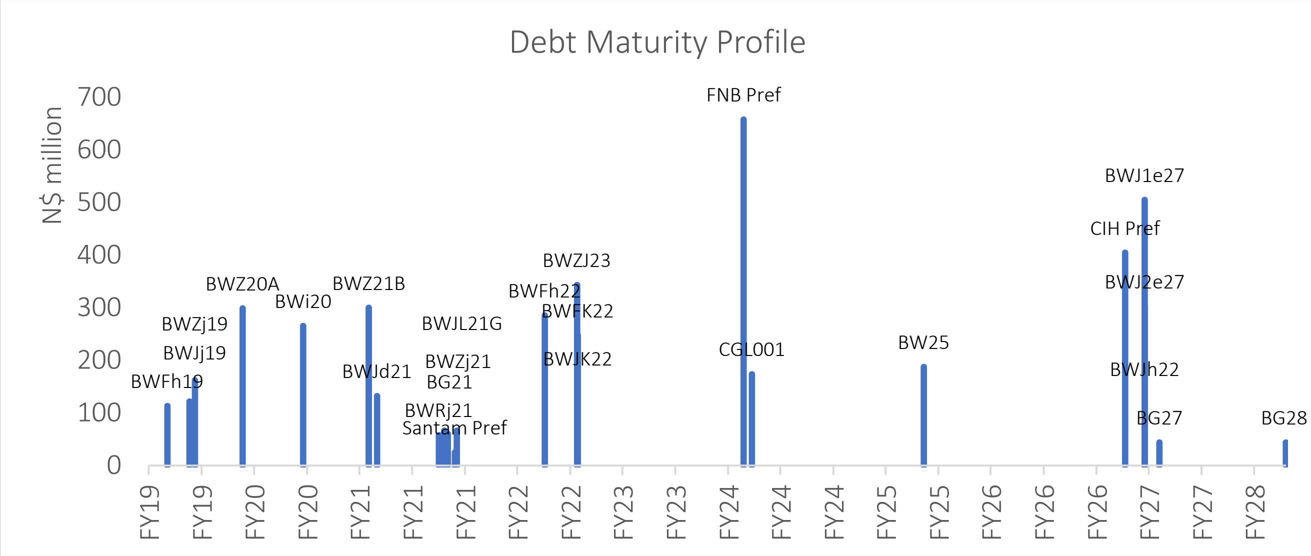
The increase in deposits was largely due to issuance of NCDs, which increased by 58.7% y/y or N$3.343 billion, while term and notice deposits increased by 8.6% or N$1.043 billion. This has largely made up for the drop in current accounts, which declined by 16.9% y/y or N$1.265 billion.

NCDs have now grown to 24% from 17% of total deposits, while current accounts have contracted to 17% from 22% of total deposits. The overall retail to wholesale funding split has tilted from 48:52 to 40:60 in favour of the more expensive wholesale funding. We believe this is largely attributable to increased banking sector liquidity following the changes in the domestic asset requirements for local pension funds.



Source: CGP, IJG

We expect deposit growth to remain relatively low, as retail deposit growth has been declining in the market and wholesale funding, which remains relatively abundant, will be raised as required to fund advances. We have pencilled in a 7.0% - 7.2% annual growth in deposit funding going forward.

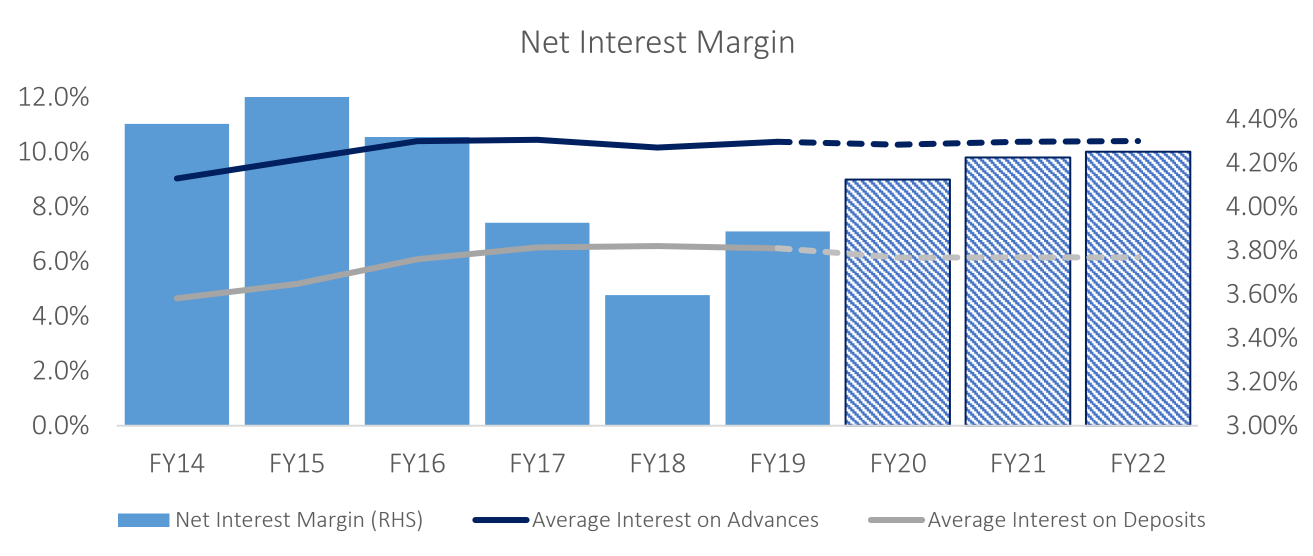


Debt securities and other borrowings grew by 9.5% y/y or N$576.8 million to N$6.667 billion. Most of the increase could be attributed to the issuance of 65,000 preference shares of N$650 million issued to First National Bank of Namibia carrying interest of 71.8% of prime. The BW18 range of bonds were rolled into various longer dated maturities ranging from 2021 to 2023.

The CGL001 bond was the first issue under the Capricorn Group Medium Term Note Programme, registered with the Johannesburg, Botswana and Namibian Stock Exchanges, raising BWP128,510,000 at an interest rate of Botswana bank rate + 160bps. Oddly, there is also a N$55 million loan from Caliber Capital Trust, Capricorn Asset Management's unlisted solution, included under other borrowings which carries interest at prime plus 3.5%. Overall, Floating rate borrowings now represent 85% of total borrowing and fixed rate borrowing represents 15%, indicating that the bank does not carry much interest rate risk.

Interest Income and Expenses

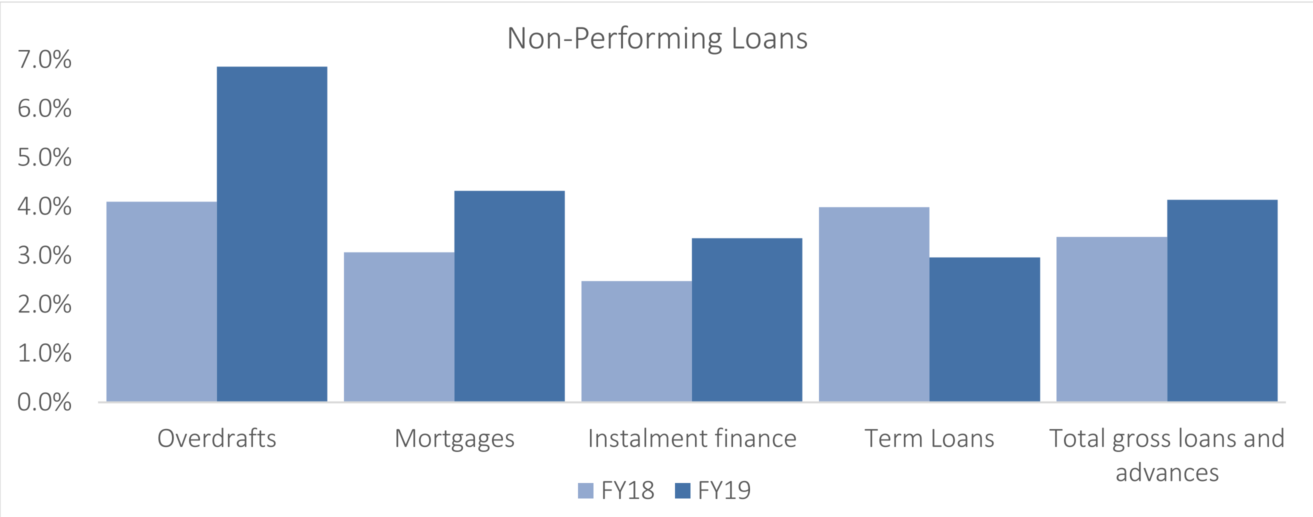
Although there has been a shift to more expensive types of funding, overall improved liquidity conditions and high demand for local assets have driven the overall cost of funding down in Namibia. From the advances side there is also a shift to shorter term and higher interest rate products, such as term lending and unsecured products, which are growing at a faster pace than the lower interest long term collateralised products such as mortgages. As a result, we see a slight opening in the net interest margin over the next two years as has been the case in FY19.



Source: CGP, IJG

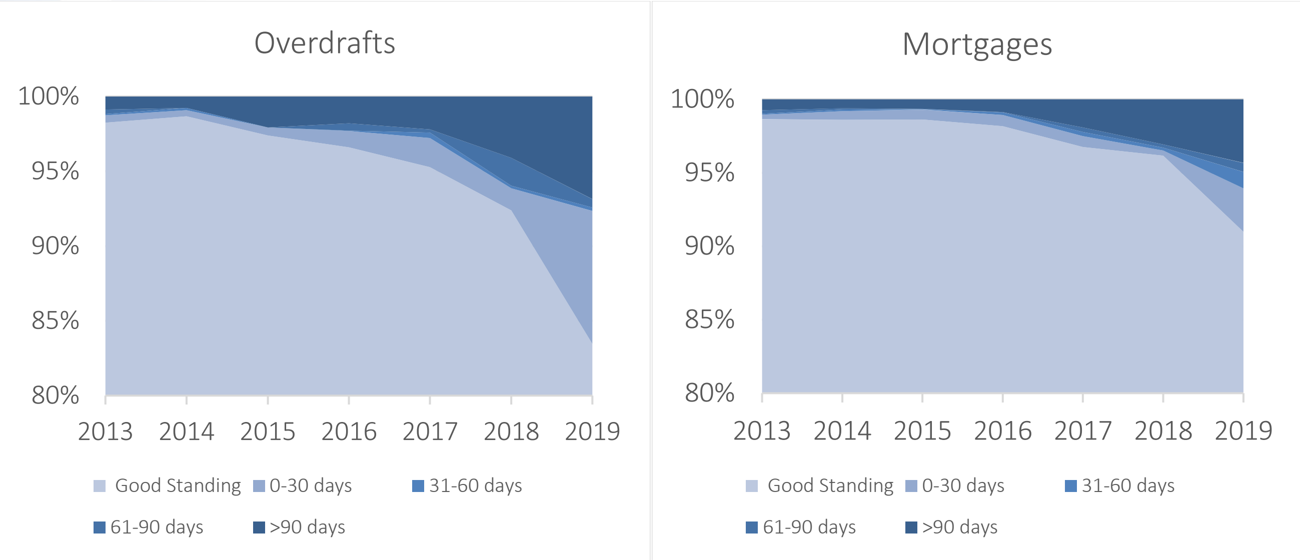
Impairments

As alluded to in the macroeconomic overview, arrears have been on the increase across the Namibian banking industry. Capricorn group has been no exception to this and non-performing loans (more than 90 days overdue) have ticked up from N$1.238 billion to N$1.613 billion or 4.1% of gross loans and advances. According to the statements, when accounts become non-performing the group focuses on rehabilitation of the accounts and ultimately on effective and efficient recovery processes.



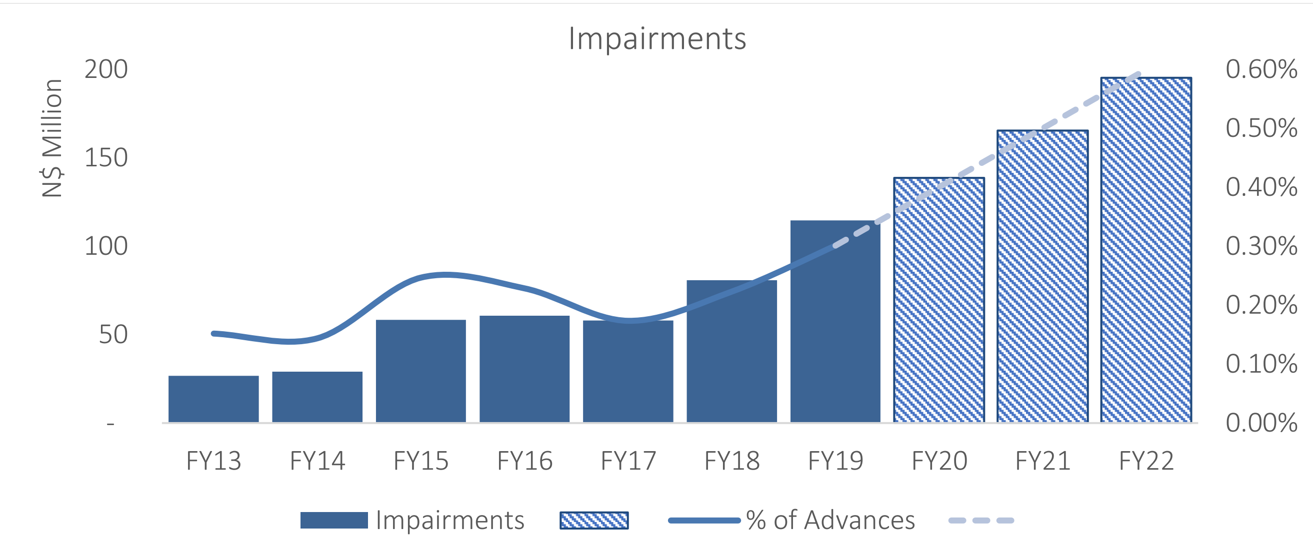
Source: CGP, IJG

Overdrafts represent the largest uptick in non-performing loans increasing to 6.9% from 4.1%. However, total overdraft arrears stand at 16.5% and these will be categorised as stage 2. Mortgages have also seen a steady uptick in non-performing loans, up from 3.1% to 4.3% of total, while total arrears amount to 9.0% of the total book. Term loans was the only category to see an improvement in NPLs, declining from 4.0 to 3.0%.



Source: CGP, IJG

The impairment charge for the group increased by 41.7% to N$114.5 million. However, as a percentage of advances, this amounted to only 0.30% of gross advances, by far the lowest in the Namibian market. According to management, the reason for the lower-than-industry impairment charge is twofold, firstly with the implementation of IFRS 9 Capricorn group made an effective day one adjustment of N$235.9 million to retained earnings, which is akin to taking the medicine upfront. Secondly, a large proportion of the non-performing loans were large well-secured loans in Bank Windhoek. Due to the high amount of recoverable collateral on these loans, the expected credit losses on these loans are relatively low, and thus resulted in lower impairment charges.

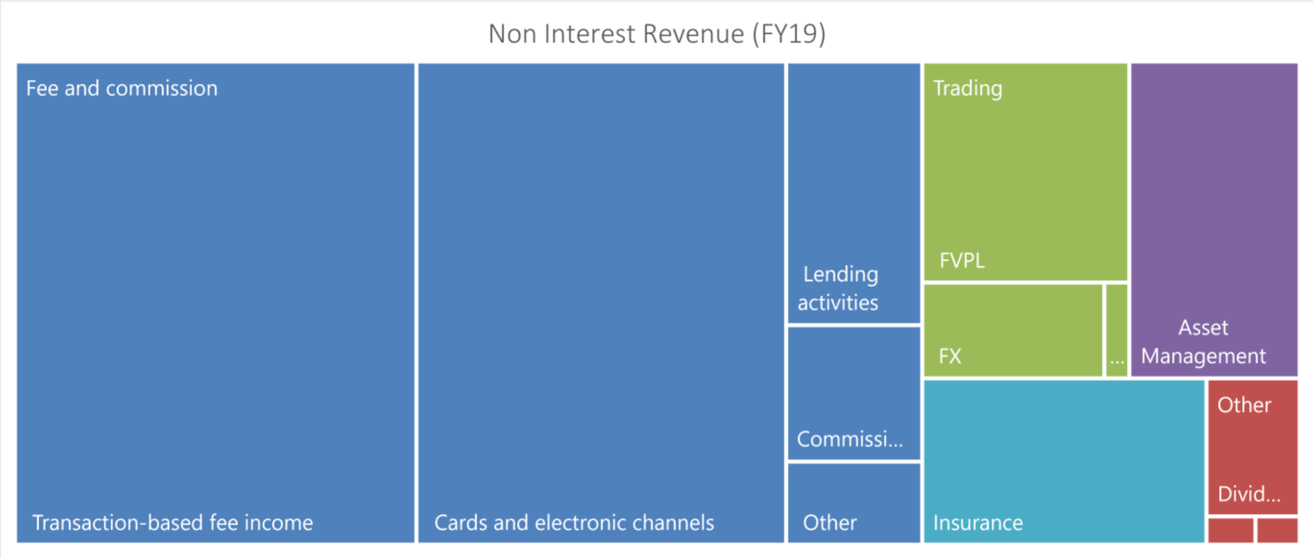


Source: CGP, IJG

Nonetheless, given our macroeconomic outlook we expect a steady uptick in impairments as more of the arrears slip into the non-performing category. The bank will likely aim to maintain its level of impairment coverage ratios which stood at 42.8%, 47.6% and 110.5% for Bank Windhoek, Bank Gaborone and Cavmont Bank at the end of FY19 respectively.

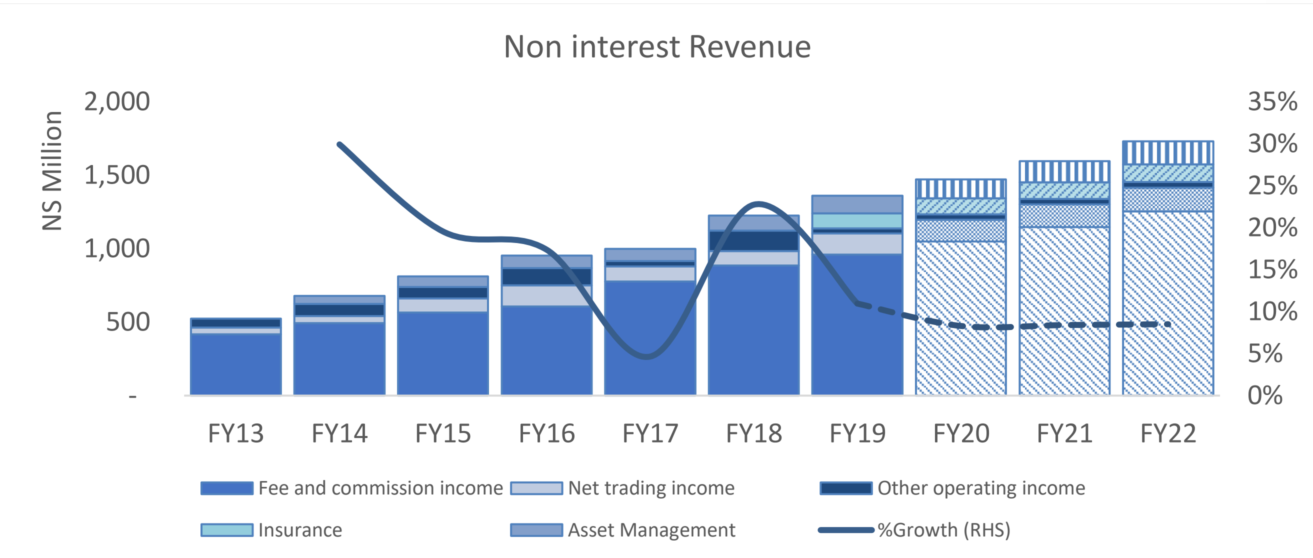
Non-Interest Revenue

Non-interest income grew by 21.0% y/y or N$235.5 million to N$1.359 billion. As usual fee and commission income made up the majority of non-interest income contributing 66.7% of the total. Transaction based fee income grew by 4.3% y/y and now makes up 31.3% of total non-interest revenue. Card and digital channels continue to post strong growth and the uptake of online and mobile solutions remains strong. Bank Windhoek income from electronic channels increased by 25.4% y/y.



Source: CGP, IJG

A large amount of the growth in non-interest income was driven by the inclusion of Entrepo, which underwrites all of its loans through its subsidiary, Entrepo Life. N$103.5 million worth of insurance income was recognised in FY19 making up 7.6% of the total non-interest revenue. Asset Management income also posted strong growth, driven largely by good growth in assets under management. According to management this was driven largely by growth in money market portfolios.

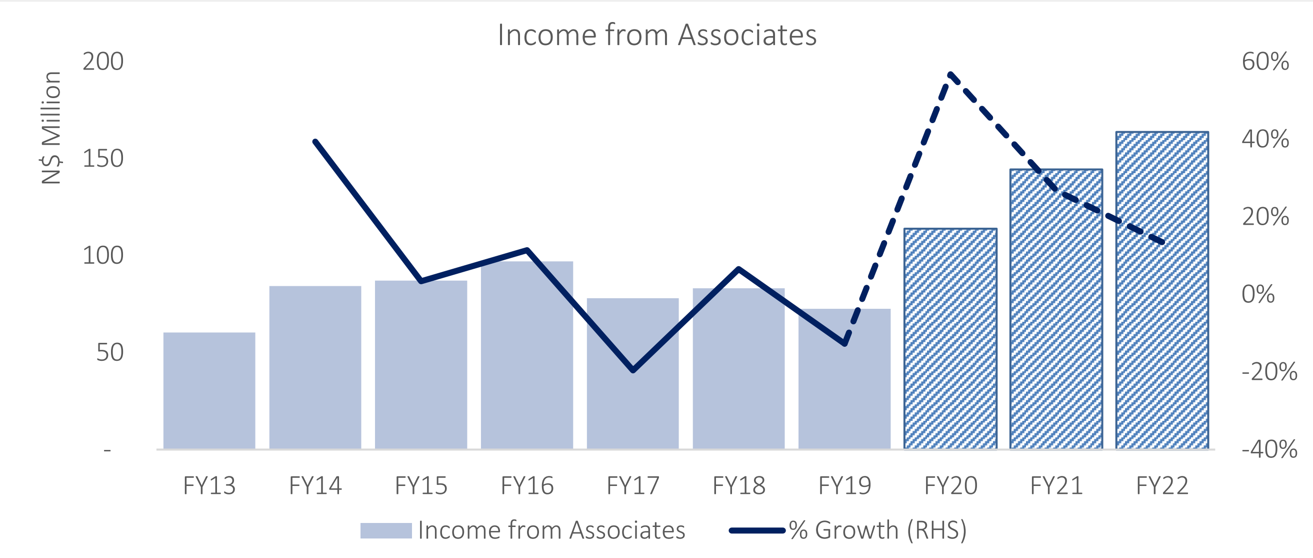


Source: CGP, IJG

We expect non-interest revenue to continue to grow by a modest 8.3 - 8.5% over the next three years. Driven mostly by continued, but slowing growth in digital channels and card transactions.

Income from Associates

The insurance segment did not perform particularly well as income from Santam and Sanlam decreased by 18.9% y/y. It seems as though insurance is one of the first expenses people cull when cash becomes tight and there have been many cancelations and adjustments to decrease premiums. Claims were also higher due to the drought and commercial property fires. Additionally, Santam received a N$15 million fine in July 2019 from the Namibian Competition Commission due to anti-competitive behaviour, which will put a dampener on the FY20 results.



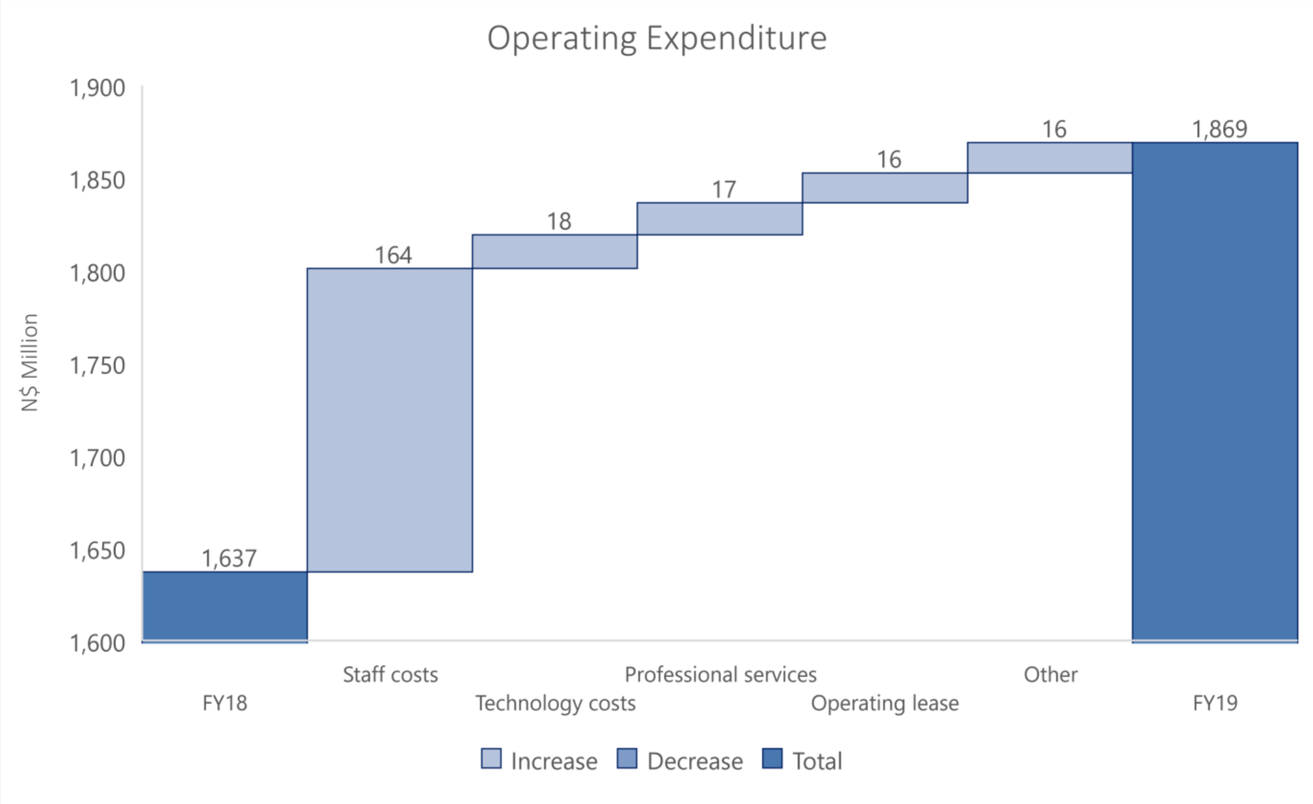
Source: CGP, IJG

The investments into Paratus should add some much-needed growth and diversification to the bottom line of Capricorn Group. We expect to see a good contribution from Paratus Africa and expect Paratus Namibia's performance to improve over time. We expect investments into associates and new subsidiaries to drive growth in the bottom line over the medium to long term. Management have indicated that they are pursuing an inorganic growth strategy and target investments where Capricorn can play an enabling role. It is too soon to say what type of role these investments will play in the long-term future of the group; however, the initiative taken to diversify and expand is highly commendable.

Operating Costs

Capricorn group saw their operating expenditure increase by 14.3% y/y from N$1.795 billion to N$2.052 billion, which was further subdivided into normal operating expenditure and fee and commission expenditure which increased by 14.2% y/y and 15.8% y/y respectively.

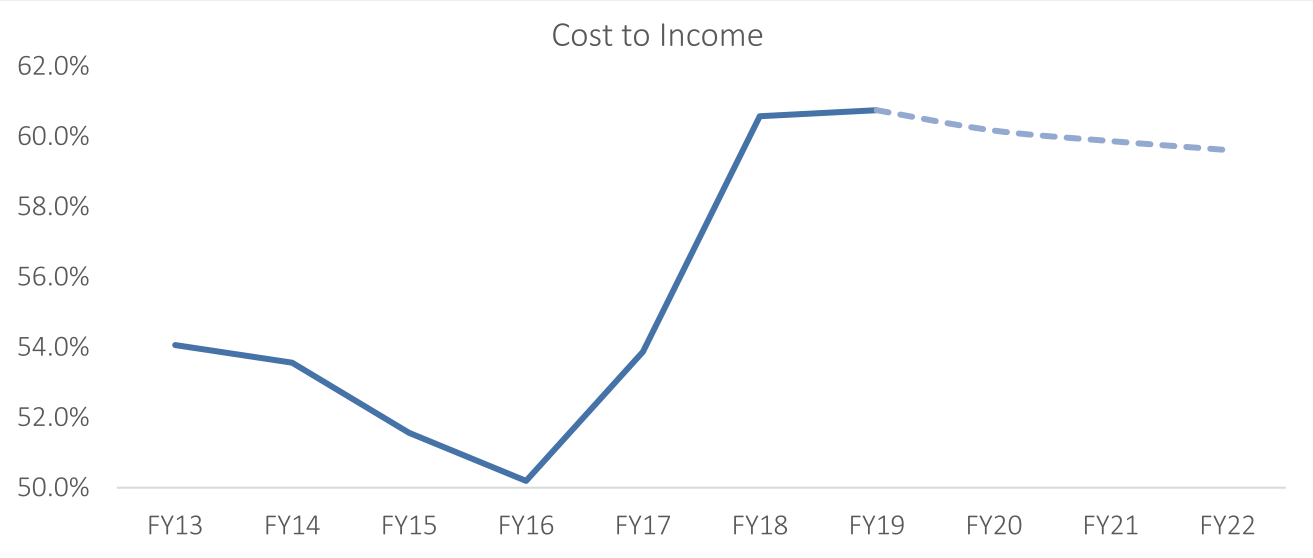
The increase was largely driven by an increase in staff costs, up 15.6% y/y as a result of the inclusion of Entrepo and capacity building in the Capricorn Private Wealth and the group's IT department. According to the statements, the increase in IT staff should be seen as a drive to replace external consultants with internal positions. Entrepo has a staff compliment of 33 while the headcount at Bank Windhoek increased by 126 people to total 1,575 at the end of FY19. The increase in staff costs added N$163.9 million to total operating expenses. The second largest contributor to normal operating expenditure was technology costs, increasing by 19.8% to N$109.9 million. This is largely due to continuing investment into digital channels, which the group invested heavily in.



Source: CGP, IJG

Fee and commission expenditure also saw a large increase, climbing up 15.8% y/y to N$183.0 million. Most of this was made up of the "Association transaction fees" line item, which would indicate that transaction volumes have been on the increase and this should be offset by a greater increase in non-interest revenue. The group further pointed to a once-off loan settlement fee within Bank Windhoek which drove up operational banking expenses.

Save for the increases above, the rest of operating expenditure was reasonably well contained. Increasing by only 8.5% y/y. Indicating a strong focus on expenditure management. Some examples of savings include security expenses which declined by 31.9% y/y, stationary and printing, which was down 11.8% y/y and other expenses which declined by 41.7%, shaving a combined of N$35 million off total operating expenditure.

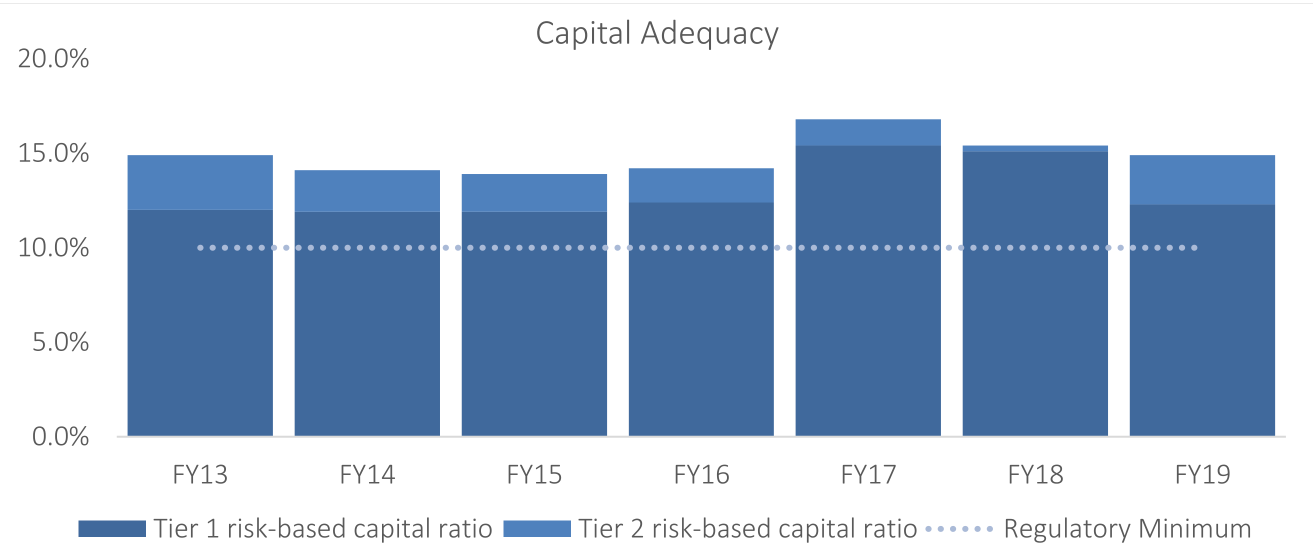


Source: CGP, IJG

The cost to income ratio increased marginally, from 60.6% to 60.8%. Largely due to the increases in staff costs which have yet to translate into higher non-interest revenue. We expect the cost to income ratio to improve slowly over time as these revenue streams become more prominent.

Capital Adequacy

The group remains well capitalised although the capital adequacy ratio declined from 15.4% to 14.9%, which is well above the minimum regulatory capital requirement of 10.0%. Additionally, Global Credit Ratings Company affirmed the group's and Bank Windhoek Limited's credit ratings of AA(NA) with a stable outlook during November 2018.



Source: CGP, IJG

Namibian banks are subject to the Basel III framework, as implemented on 1 September 2018 in Namibia. However, Namibia is following a five-year phase in to be completed by 2022. The tier 1 capital ratio is set to incrementally increase to 9.5%, while the total capital ratio will increase to 12.5%. Two additional aspects of Basel III, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) will also be phased in over this period. But should not materially affect any of the operations of the bank.

Outlook

The outlook for the Namibian banking sector is not very optimistic as the outlook for the general economy is for stagnation over the next couple of years. The turnaround will likely be a slow and arduous process and much still needs to be done in terms of policy and fiscal consolidation to ensure that the fiscal situation and growth prospects of Namibia improve over the medium term. Unfortunately, the fact of the matter is that the group is currently still concentrated in the banking sector in a stagnating economy and the medium-term outlook remains negative.

Nevertheless, the Capricorn Group has been able to find avenues for diversification well and find alternative markets for growth. It has done quite well in its endeavours in Botswana, which has a much better medium-term outlook although political risks should be kept in mind. The long-term trajectory of the company is promising, as management have their targets set on accretive acquisitions and growth beyond the borders of Namibia. These investments will likely not pay off immediately, but we are keeping a close eye on their development.

Valuation

To value the shares of Capricorn Investment Group, several valuation methods have been incorporated to reduce the overreliance on a single methodology. These methods include three discounted cash flow methodologies and two justified multiple approaches. The outputs of the different methodologies were equally weighed.

Two of the main valuation input assumptions are the cost of equity and long-term sustainable growth rate. The cost of equity was calculated using the capital asset pricing model (CAPM). The resultant cost of equity amounted to 15.11% based on a 9.46% yield on the IJG generic 10-year bond, an equity risk premium of 4.05%, a beta of 1.15 plus a company specific risk premium of 1.0%. The sustainable growth rate was estimated to be 10.89% based on a long tern sustainable return on equity of 16.80% and an estimated pay-out ratio of 35.0%. Seeing as the valuation is very sensitive to these inputs, a sensitivity analysis can be found in the annexures to illustrate the effect of changes in these assumptions.

The output of our valuation model is presented below.

	Value (NS'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	8,697,152	16.98	9.4	8.6	1.41	1.33	3.89%	3.83%	20%
Residual Income	9,309,424	18.18	10.0	9.2	1.51	1.43	3.63%	3.58%	20%
Dividend Discount	8,572,855	16.74	9.2	8.5	1.39	1.31	3.94%	3.88%	20%
Justified Price to Earnings	8,569,719	16.73	9.2	8.5	1.39	1.31	3.94%	3.88%	20%
Justified Price to Book	8,646,005	16.88	9.3	8.6	1.40	1.32	3.91%	3.85%	20%
Weighted Average	**8,759,031**	**17.10**	**9.4**	**8.7**	**1.42**	**1.34**	**3.86%**	**3.80%**	**100%**

Source: IJG

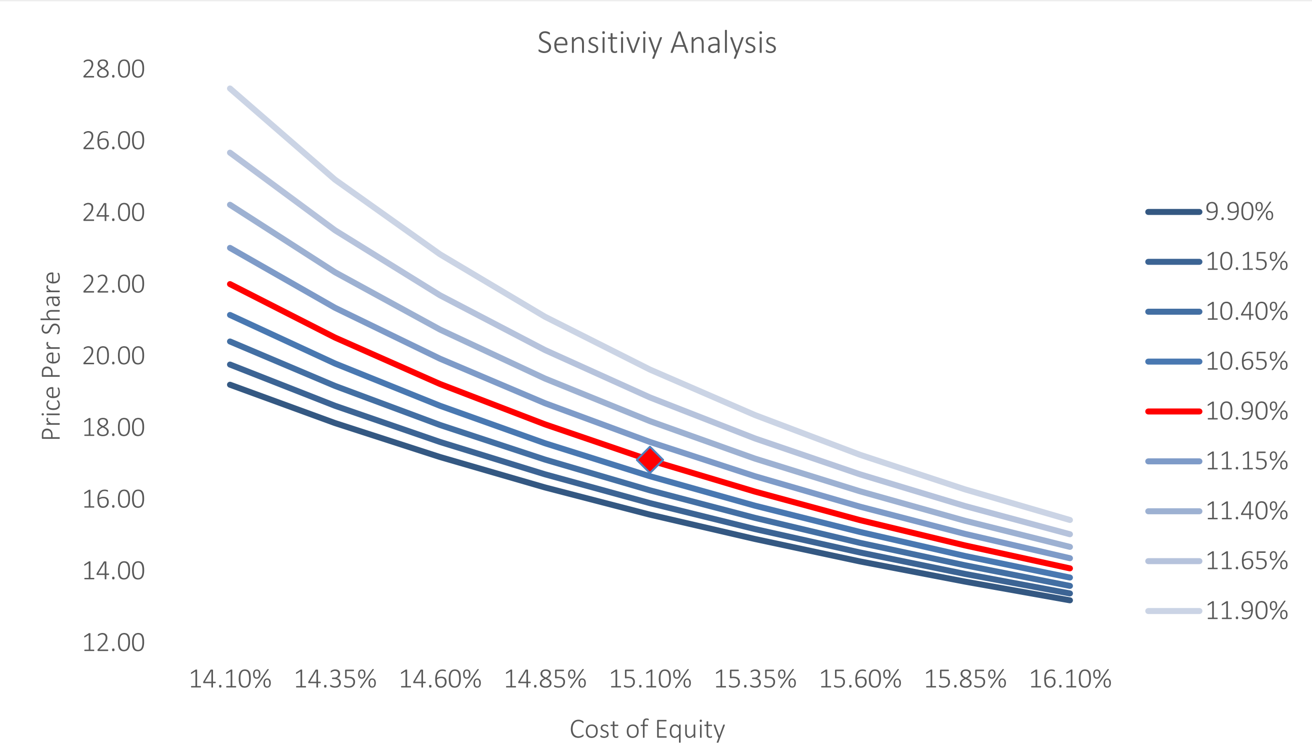
Based on the table above, we derive a **target price of N$c1710** per share. Coupled with expected dividends of 69 cps over the next 12 months, we expect a **total return of 11.6%.** Seeing as this is below our cost of equity and economic risks remain skewed to the upside, we maintain our **HOLD** recommendation on the counter.

Summary of Financial Statements

	Actual		Forecast		
in N$ 000s	2018	2019	2020	2021	2022
Interest and similar income	4,244,215	4,740,554	5,001,095	5,384,875	5,811,228
Interest and similar expense	(2,425,318)	(2,607,681)	(2,645,726)	(2,808,808)	(2,983,754)
Net interest income	**1,818,897**	**2,132,873**	**2,355,368**	**2,576,067**	**2,827,474**
%Growth	10.3%	17.3%	10.4%	9.4%	9.8%
Impairment losses	(80,840)	(114,547)	(160,969)	(210,623)	(265,613)
Non-Interest Income	**1,225,168**	**1,359,484**	**1,472,232**	**1,595,952**	**1,731,696**
Operating expenses	(1,795,108)	(2,052,038)	(2,213,742)	(2,389,445)	(2,580,474)
Operating profit	**1,168,117**	**1,325,772**	**1,452,889**	**1,571,951**	**1,713,083**
%Growth	-2.2%	13.5%	9.6%	8.2%	9.0%
Share of profit from joint ventures	1,148	3,675	1,972	2,265	2,637
Share of profit from associates	83,236	72,657	113,910	144,397	163,863
Profit before tax	**1,252,501**	**1,402,104**	**1,568,771**	**1,718,614**	**1,879,584**
Income tax expense	(318,066)	(386,805)	(470,631)	(515,584)	(563,875)
Profit for the year	**934,435**	**1,015,299**	**1,098,140**	**1,203,029**	**1,315,709**
%Growth	1.8%	8.7%	8.2%	9.6%	9.4%
Net gains on available -for - sale financial assets	**44,026**	**7,263**	-	-	-
Total comprehensive income	**986,240**	**1,015,299**	**1,098,140**	**1,203,029**	**1,315,709**
Headline Earnings	922,556	929,323	1,010,289	1,106,787	1,210,452
%Growth	1.8%	8.7%	8.2%	9.6%	9.4%
EPS (c)	**180.6**	**181.6**	**197.3**	**216.1**	**236.4**
HEPS (c)	**157.9**	**181.6**	**197.3**	**216.1**	**236.4**
Dividends declared per share (c)	**60.0**	**66.0**	**69.0**	**76.0**	**83.0**

in N$ 000s	*Actual*		*Forecast*		
	2018	**2019**	**2020**	**2021**	**2022**
ASSETS					
Cash and balances with central bank	1,642,557	1,572,616	1,707,587	1,740,101	1,823,844
Financial assets designated at fair value	5,245,981	2,037,188	2,200,000	2,200,000	2,200,000
Investment securities	134,028	4,742,725	4,982,864	6,605,867	8,721,771
Due from other banks	1,773,529	1,724,043	1,724,043	1,724,043	1,724,043
Loans and advances to customers	36,234,418	38,049,583	40,242,360	42,124,691	44,268,818
Investment in associates	282,511	348,716	670,948	759,294	865,207
Other assets	1,246,410	1,342,770	1,289,524	1,296,183	1,258,786
Total assets	**47,433,686**	**50,677,955**	**53,677,639**	**57,310,493**	**61,722,783**
LIABILITIES					
Due to other banks	252,683	245,703	249,193	247,448	248,321
Other borrowings	1,313,433	996,372	996,372	996,372	996,372
Debt securities in issue	4,777,074	5,670,974	5,670,974	5,670,974	5,670,974
Deposits	33,948,091	36,984,725	39,611,064	42,466,426	45,561,442
Other liabilities	1,244,010	619,403	620,274	621,940	621,732
Total liabilities	**41,542,496**	**44,517,177**	**47,151,479**	**50,004,962**	**53,101,542**
EQUITY					
Share capital and premium	724,507	720,302	720,302	720,302	720,302
Non-distributable reserve	269,653	85,954	85,954	85,954	85,954
Distributable reserve	4,620,531	5,009,140	5,719,904	6,499,276	7,814,984
Total shareholders' equity	**5,891,190**	**6,160,778**	**6,526,160**	**7,305,532**	**8,621,240**

Sensitivity Analysis



Source: IJG

Sustainable Growth Rate / Cost of Equity	14.00%	14.25%	14.50%	14.75%	15.00%	15.25%	15.50%	15.75%	16.00%
9.90%	19.21	18.14	17.19	16.34	15.58	14.90	14.28	13.71	13.19
10.15%	19.77	18.62	17.61	16.71	15.90	15.18	14.52	13.93	13.38
10.40%	20.41	19.17	18.08	17.12	16.26	15.49	14.79	14.16	13.59
10.65%	21.15	19.80	18.61	17.58	16.65	15.83	15.10	14.43	13.82
10.90%	22.01	20.52	19.23	18.10	**17.10**	16.22	15.43	14.72	14.08
11.15%	23.02	21.36	19.93	18.69	17.61	16.65	15.81	15.05	14.36
11.40%	24.23	22.34	20.75	19.38	18.19	17.15	16.23	15.41	14.68
11.65%	25.68	23.51	21.70	20.17	18.85	17.71	16.71	15.82	15.03
11.90%	27.47	24.93	22.84	21.10	19.63	18.36	17.25	16.29	15.43

Source: IJG

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