FIRSTRAND NAMIBIA HOLDINGS
1H19 Results Review
March 2019

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FirstRand Namibia Holdings

1H19 Results Review

Target Price (c)	***4694***
Current Price (c)	4320

Year End 30 June	2017	2018	F2019	F2020	F2021
Net interest income (N$m)	1,765	1,821	1,996	2,196	2,423
Non-interest income (N$m)	1,554	1,796	1,932	2,090	2,266
Profit (N$m)	1,113	1,061	1,112	1,207	1,335
HEPS (c)	419	398	419	455	503
DPS (c)	204	204	210	228	252
DY (%)	4.3	4.6	4.9	5.3	5.8
P/E (x)	11.2	11.2	10.3	9.5	8.6
P/BV (x)	2.7	2.3	2.0	2.0	1.8

Recommendation	HOLD
NSX Code	FNB
Market Cap (N$m)	11,560
Shares in Issue (m)	267.6
Free float (%)	24
52 week high	4655
52 week low	4200
Expected Total Return (%)	13.5%

Source: FNB, IJG, Bloomberg

1H19 Results Review

First Rand Namibia released their results for the interim period ended 31 December 2018. Overall, the results were resilient in the face of a protracted economic downturn. Profit after tax increased by 5.2% y/y to N$552.7 million while basic earnings per share increased by 5.5% to 208.9 cents per share. An interim dividend of 91 cents per share was declared, unchanged from the 2018 interim dividend declared.

Total advances, to banks and customers, grew by 3.6% y/y to N$34.7 billion, while advances to customers increased by only 1.8% y/y to N$29.1 billion, compared to PSCE growth of 7.4%. According to management, the below market growth was due to very low individual credit demand coupled with low mortgage advances growth. Mortgage loans increased year on year by 2.7% to N$13.4 billion and constitute 45% of advances. Overdrafts grew by 12.1% and total interest income grew by 6.7%. At the same time investment securities, made up mostly of treasury bills and short-term government bonds, grew by 31.0%, to N$5.0 billion. This is a clear sign that the company was building up its liquidity buffers and chose its advances carefully.

Deposits grew at a faster pace than advances, increasing by 7.0% y/y to N$37.4 billion. Retail funding made up the bulk of the increase in deposits, as call deposits increased by N$1,084 million (or 15.7%). Savings accounts, although making up a small percentage of the funding book, displayed strong growth of 26.5% y/y. This was due to the increased use of initiatives like the savings pocket product. Net interest income grew by 10.5% y/y to N$ 1,001.1 million supported by marginal growth in deposits and advances.

Non-performing loans increased to 2.31% of gross advances, up from 1.69%. Impairment losses increased as expected, mostly as a result of the implementation of IFRS 9. The total impairment charges increased year-on year to N$ 117.2 million, an increase of N$41.1 million. N$18.0 million of this increase was directly attributable to IFRS 9 portfolio impairments. The impairment charge stood at 0.39% of gross advances, up from 0.26%, which is still reasonably low and remains within the bank's risk appetite.

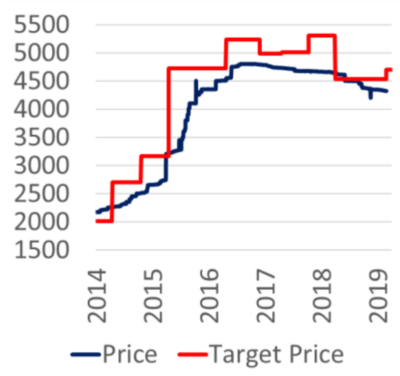
Non-interest revenue increased by 6.4% y/y. This was mainly due to a 7.2% increase in fee and commission income, which it the main source of non-interest revenue. Fee and commissions make up 88.8% of the group's total non-interest revenue. According to the group, the positive performance justifies the move to digital channels and more than offsets the reduction in traditional channel transaction volumes.

Operating costs increased by 6.9% to N$ 1,020.1 million, causing the cost to income ratio to decline from 52.1% to 51.7%. On a normalised basis, adjusting for the closure of EBank in the base year, operating costs increased by 7.4%. Staff costs made up 54.5% of operating expenses and increased by 5.3%, slightly above NCPI of 5.1%. IT costs increased by 9.1% as a result of increases in data line capacity and lines for new ATMs.

The economic outlook remains quite bleak, as there are no clear catalysts for growth on the horizon. The headwinds facing the economy, such as the worsening government fiscus and policy uncertainty have not been addressed and will continue to deter investment for the medium term. Nonetheless, our growth forecast expects an uptick in growth solely due to the low base set. Similarly, private sector credit extension is also expected to show marginally positive real growth.

Using a panel of standard valuation techniques, a cost of equity of 14.2% and a sustainable growth rate of 10.0%, we derive a target price of N$c4594 per share. Coupled with an expected dividend of 210 cps, we expect a total return of 13.5%. Seeing as this is below our cost of equity and the risks to our outlook is skewed to the downside, we maintain our **HOLD** recommendation on FNB.

FNB Share Price vs Target Price



Dividends

Dividend (interim): 91c/share

Declaration date: 31 January 2019

Last day to trade: 15 March 2019

Ex-date: 18 March 2019

Record date: 22 March 2019

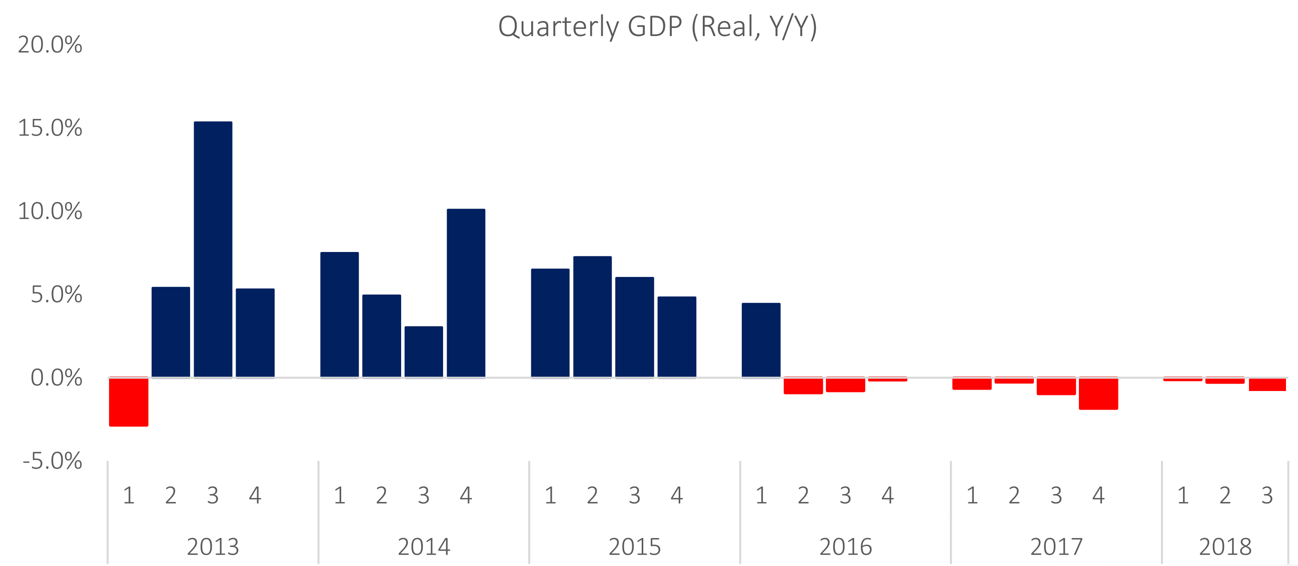
Payment date: 05 April 2019

Banking Macro

Growth environment

The Namibian economy currently finds itself in a precarious position. Quarterly GDP has recorded ten consecutive quarters of negative growth, marking this the longest recession in Namibian history. Some have even gone as far as calling the downturn a depression, due to its prolonged nature. Irrespective of the terminology, the slowdown has been felt across economic sectors and it is undeniable that the macro environment has had a particularly strong bearing on banking profitability.

Third Quarter 2018 GDP statistics pointed to a year-to-date contraction in real GDP of 0.4%. However, as per our 2019 Outlook, growth for 2018 is set to be marginally positive. Contractions in agriculture and fishing, as well as manufacturing and a large proportion of tertiary industries are expected to be offset by growth in mining and quarrying. Uranium and diamond mining output rose significantly, contributing enough to counteract the decrease in consumer and business activity recorded in tertiary industries, pushing our expectations for growth in 2018 to 0.2%.



Source: IJG, MoF

The growth outlook for 2019 and beyond remains quite muted. Many of the internal factors contributing to the current decline have not been addressed. Government is continuing with its pro-growth fiscal consolidation efforts, which is a bit of a misnomer, as recurring consumptive expenditure continues to be prioritised over development spending. This was most recently witnessed in the mid-term budget tabled in November which saw N$1.77bn reallocated from the development budget to the operational budget.

The government continues to run large fiscal deficits, and as a result government debt continues to rise. As per the latest budget forecasts, the funding requirements are roughly N$8.3 billion, N$8.7 billion and N$8.0 billion over each of the next three financial years.

Additionally, business and consumer confidence remain low as investor unfriendly policies such as NEEEF and the Namibian Investment Promotion Act (NIPA) remain an overhang to the investment environment, acting as disincentives for both local and foreign direct investment.

Given the current circumstances, we expect real GDP growth of 0.9% in 2019. The growth being driven by a marginal rebound in tertiary sector activity as government ups operational expenditure and consumers start to find their feet. After which we expect real growth to stabilise around the 3.4% level in 2020 and 2021.

Interest Rates

Generally, 2018 was a year of monetary policy tightening in developed markets, especially as witnessed in the US. Following four policy rate increases of 25 bps each in 2018, the first Federal Open Markets Committee (Fed) meeting of 2019 delivered a starkly dovish message. As a result, the expectation is for the US federal funds rate to remain unchanged in 2019, with a cut in the rate now more likely than an increase (based on Federal Fund futures rates).

United States | Instrument: Futures: Fed Funds - Effective | Fed Effective Rate 2.40

1) Overview 2) Future Implied Probability

Current Implied Probabilities 3) Add/Remove Rates

Dates: Meeting / Calculation | Calculated 02/21/2019 | Based on rate 2.25-2.50

Meeting	Hike Prob	Cut Prob	2-2.25	2.25-2.5	2.5-2.75	2.75-3	3-3.25	Fwd Rate
03/20/2019	1.9%	0.0%	0.0%	98.1%	1.9%	0.0%	0.0%	2.40
05/01/2019	1.8%	2.0%	2.0%	96.1%	1.8%	0.0%	0.0%	2.39
06/19/2019	1.9%	2.0%	2.0%	96.0%	1.9%	0.0%	0.0%	2.39
07/31/2019	3.8%	2.0%	2.0%	94.2%	3.8%	0.0%	0.0%	2.40
09/18/2019	3.8%	3.0%	2.9%	93.3%	3.7%	0.0%	0.0%	2.39
10/30/2019	4.7%	2.9%	2.9%	92.3%	4.7%	0.1%	0.0%	2.40
12/11/2019	4.5%	8.0%	7.8%	87.5%	4.4%	0.1%	0.0%	2.38
01/29/2020	4.0%	17.2%	16.2%	78.8%	3.9%	0.1%	0.0%	2.36

Source: Bloomberg

Similarly, European markets are also not looking at much change in official policy rates. In the last ECB policy meeting, President Mario Draghi struck a more downbeat tone, acknowledging that “risks surrounding the euro area growth outlook have moved to the downside”. This comes shortly after the ECB ended its massive asset-buying program in December. As a result, European interest rates are set to remain at present record-low levels.

Euro Zone | Instrument: OIS: Eurozone OIS | Current Rate -0.40

Current Implied Probabilities — Dates: Meeting | Calculated 02/21/2019 | Based on rate -0.40

Meeting	Hike Prob	Cut Prob	-0.5	-0.4	-0.3	-0.2	-0.1	Fwd Rate
03/07/2019	0.0%	0.8%	0.8%	99.2%	0.0%	0.0%	0.0%	-0.36
04/10/2019	1.6%	0.8%	0.8%	97.7%	1.6%	0.0%	0.0%	-0.36
06/06/2019	2.1%	0.7%	0.7%	97.2%	2.1%	0.0%	0.0%	-0.36
07/25/2019	5.6%	0.7%	0.7%	93.7%	5.5%	0.1%	0.0%	-0.36
09/12/2019	8.0%	0.7%	0.7%	91.3%	7.7%	0.2%	0.0%	-0.35
10/24/2019	20.5%	0.6%	0.6%	78.9%	19.3%	1.3%	0.0%	-0.34
12/12/2019	34.2%	0.5%	0.5%	65.3%	29.6%	4.4%	0.2%	-0.32

Source: Bloomberg

The United Kingdom economic outlook is clouded by immense uncertainty around the politics of Brexit and reactions to the eventual outcome. However, most market commentators agree that policy rates are currently low and should increase once Brexit is resolved. The market seems less sure and sees the current policy rates remaining unchanged for the 2019 calendar year, with the balance of probability shifting towards a hike early in 2020.

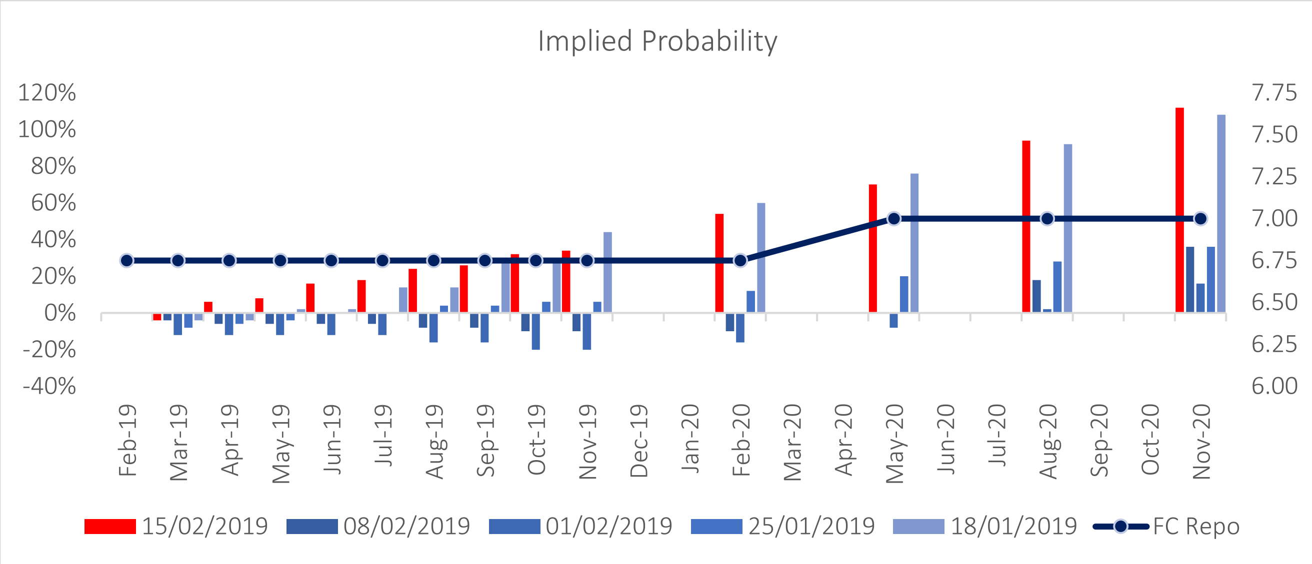
United Kingdom | Instrument: OIS: United Kingdom OIS | Current Rate 0.75

Current Implied Probabilities — Dates: Meeting | Calculated 02/21/2019 | Based on rate 0.75

Meeting	Hike Prob	Cut Prob	0.25	0.5	0.75	1	1.25	Fwd Rate
03/21/2019	0.0%	0.2%	0.0%	0.2%	99.8%	0.0%	0.0%	0.70
05/02/2019	4.0%	0.2%	0.0%	0.2%	95.8%	4.0%	0.0%	0.71
06/20/2019	4.0%	0.8%	0.0%	0.8%	95.2%	4.0%	0.0%	0.71
08/01/2019	26.7%	0.6%	0.0%	0.6%	72.7%	25.8%	1.0%	0.77
09/19/2019	29.7%	0.6%	0.0%	0.6%	69.7%	27.7%	2.0%	0.78
11/07/2019	30.4%	0.6%	0.0%	0.6%	69.0%	28.1%	2.2%	0.79
12/19/2019	39.9%	0.5%	0.0%	0.5%	59.6%	33.8%	5.8%	0.82
01/30/2020	50.3%	0.4%	0.0%	0.4%	49.3%	38.3%	10.7%	0.86

Source: Bloomberg

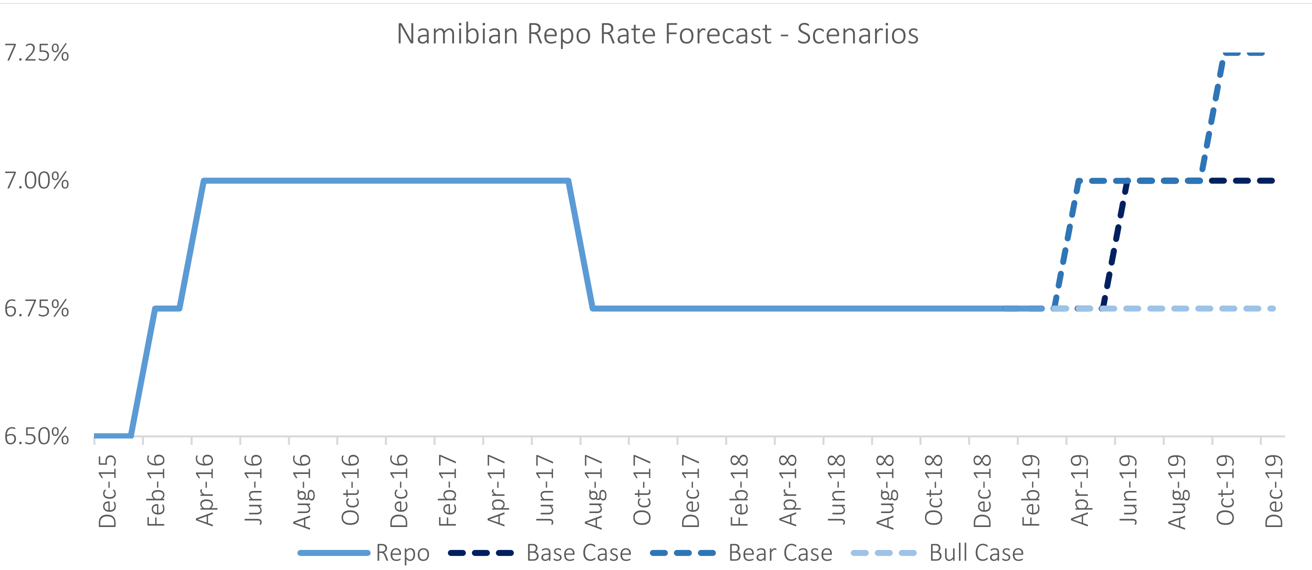
Expectations of interest rate increases in South Africa have also moderated since the beginning of 2019. Using the Forward Rate Agreement (FRA) curve as a measure of market expectations, one 25bps interest rate increase is expected either at the end of 2019 or early in 2020. IJG sees this scenario as likely as the risks to the South African Reserve Bank's (SARB) inflation outlook remain skewed to the upside in our view. Two of the most notable risk factors are increases in electricity tariffs and a negative ratings assessment of SA's sovereign debt from Moody's in March.



Source: Bloomberg, IJG

Namibia has not changed its policy rate since August 2017 as it remains very accommodative towards (heavily indebted) consumers. However, the Namibian repo rate is currently on par with the South African rate at 6.75%, following the SARB's 25bps rate hike in November 2018.

The SARB's interest rate trajectory will have significant bearing on Bank of Namibia's (BoN) MPC decisions and we believe that the BoN may be proactive and increase the repo rate by 25 bps early in the year as a buffer, to potentially avoid a situation where the Namibian repo rate is below the South African rate which may lead to capital outflows.



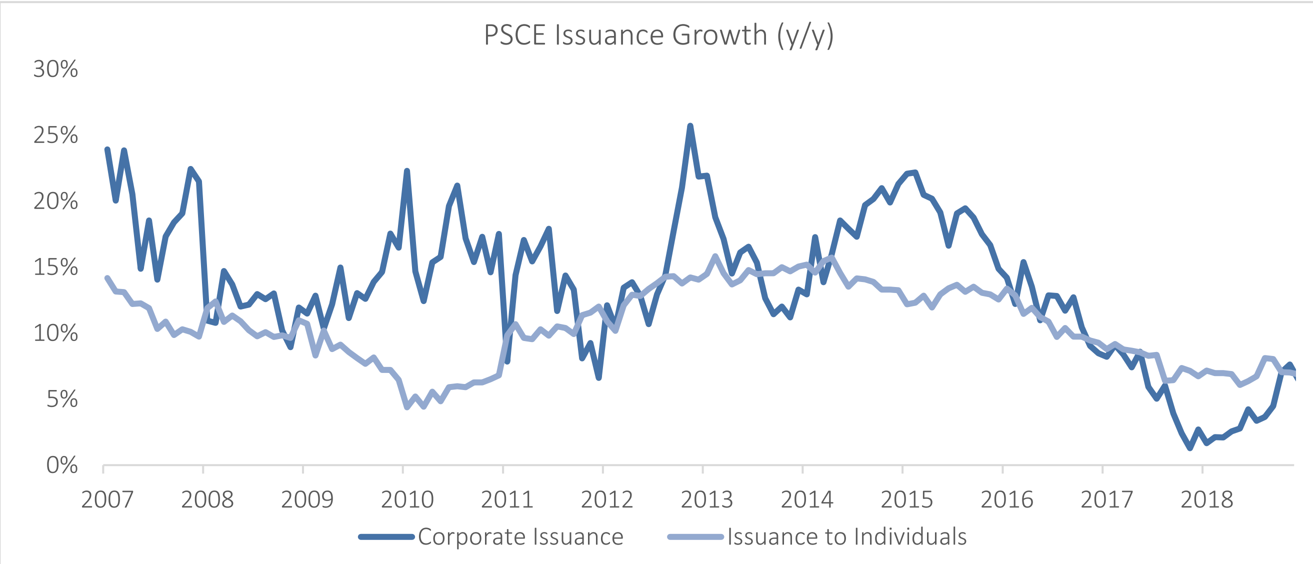
Source: IJG

As a result, we have sketched three interest rate scenarios. The base case assumes BoN hikes rates once, in anticipation of South African rates rising. In the bull case scenario, South African inflation expectations moderate and we see no hike in either country. Finally, the bear case sees a negative ratings assessment from Moody's, a depreciation of the currency, higher inflation expectations and two interest rate hikes of 25bps. The three scenarios have little impact on the profitability of banks but will be marginally positive for the bottom line. This is due to the fact that lending rates adjust nearly immediately, while deposit rates take some time to adjust giving the banks some windfall net interest.

PSCE

Growth in private sector credit extension has been quite low over 2018, delivering growth of 7.4% y/y from December 2017 to December 2018. This is still an uptick from the 5.2% y/y growth witnessed in the previous calendar year. The acceleration has mostly been due to the recovery in growth of credit extended to corporates which was up by 6.5% y/y.

However, a significant part of this corporate credit resurgence has been in the form of overdrafts (+12.3% y/y) and other loans and advances[1] (+25.7% y/y), while instalment credit (-9.5% y/y) and leasing transactions (-11.7% y/y) continued its decline and corporate mortgage advances grew by only 2.6% y/y.



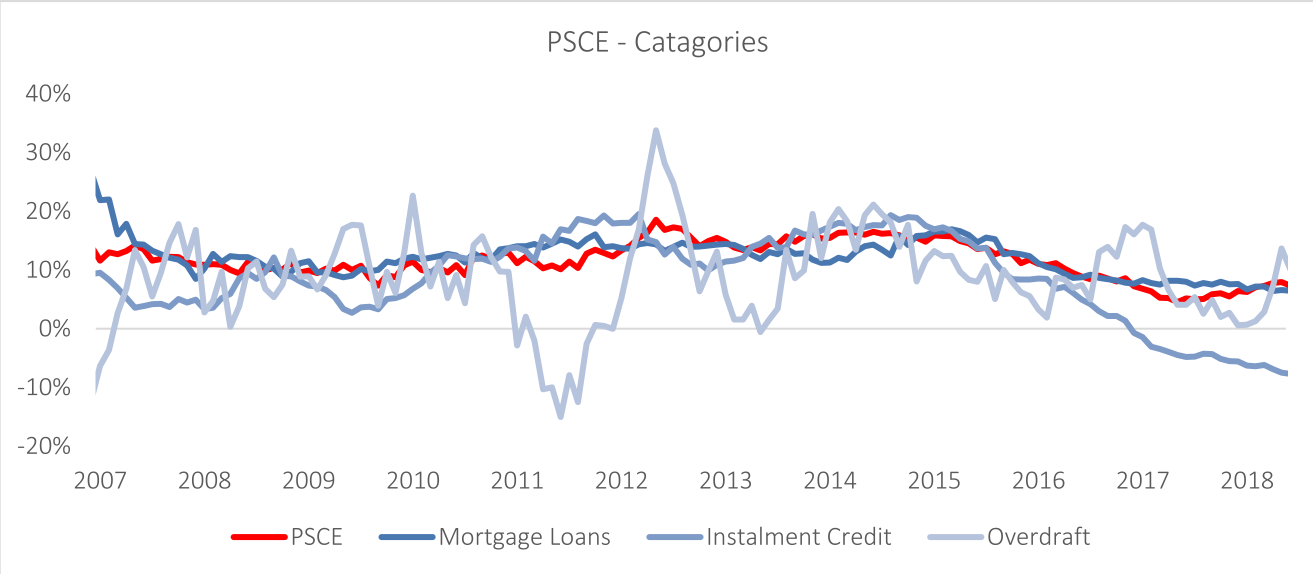
Source: Bank of Namibia, IJG

Loans to individuals grew by 6.9% y/y in 2018, which was largely driven by decent growth in mortgages (+7.7% y/y) and other loans and advances (+17.7% y/y), while overdrafts grew marginally (+4.2% y/y). Instalment credit

[1] Other loans and advances are made up of term loans, personal loans and credit cards.

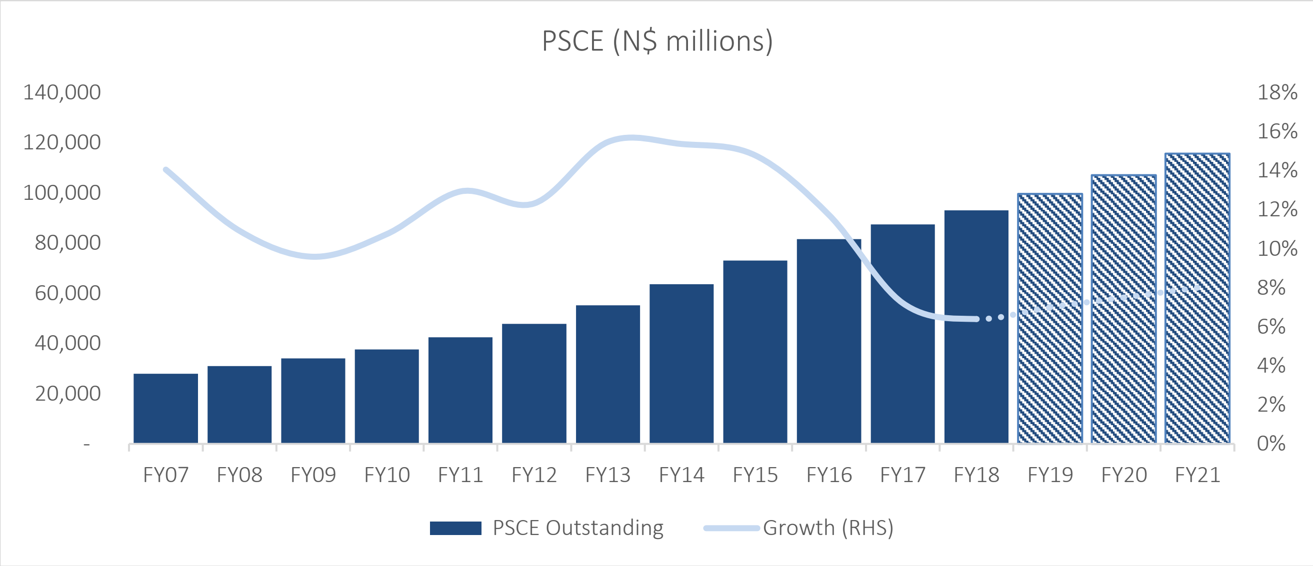
to individuals also posted a 6.5% y/y decline, while leasing transactions grew by 620% y/y from N$19.3 million to N$138.9 million.

The rest of the 7.4% total credit growth figure was as a result of other financial corporations (+28.1%) and the non-resident private sector (+120%). According to the Bank of Namibia, the sharp increase to non-residents was as a result of a product launched by one of the commercial banks which caused a once off increase of N$720.0 million in March 2018.



Source: Bank of Namibia, IJG

Households remain indebted. Thus, increases in consumption will likely not be credit driven as it was in the past, but will rely on increasing disposable incomes. According to the Bank of Namibia's Financial Stability Report, the latest debt to disposable income ratio stands at around 83.3% (compared to 71.2% in South Africa). Although the uptick in credit extension has been a welcome development, the growth stemming from overdrafts and personal loans may not be sustainable in the long term if being used for consumptive purposes and not being put to productive use. Generally, only consumption booms that are accompanied by an increase in investment tend to be sustainable.



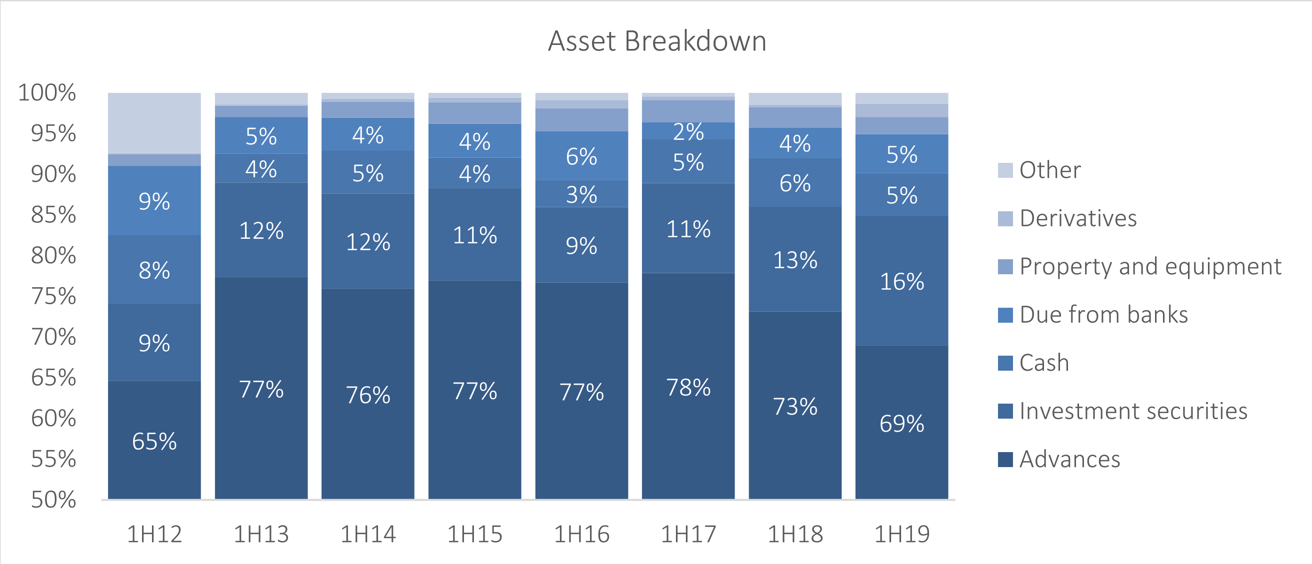
Source: Bank of Namibia, IJG

We expect to see some recovery in the rate of PSCE growth, on the back of modest economic growth and supported by an accommodative interest rate environment. We do not anticipate a return to the double-digit growth as was seen in the first half of the decade but anticipate that credit extension will likely grow at roughly with the same rate as nominal GDP. As a result, we have pencilled in a modest 7.0% y/y growth for FY19, 7.5% y/y for FY20 and 8.0% y/y growth for FY21.

Net Interest Income

Asset Base

The FirstRand asset mix has been relatively stable over the last decade. However, advances as a percentage of total assets have been on the decrease, down from 78% of total advances at the end of the 2016 calendar year to 69% in December 2018. At the same time, investment securities have increased from 11% to 16% of total assets. This is a clear sign that FirstRand Namibia have substituted advances growth in favour of purchasing investment securities, made up primarily of treasury bills and government bonds.

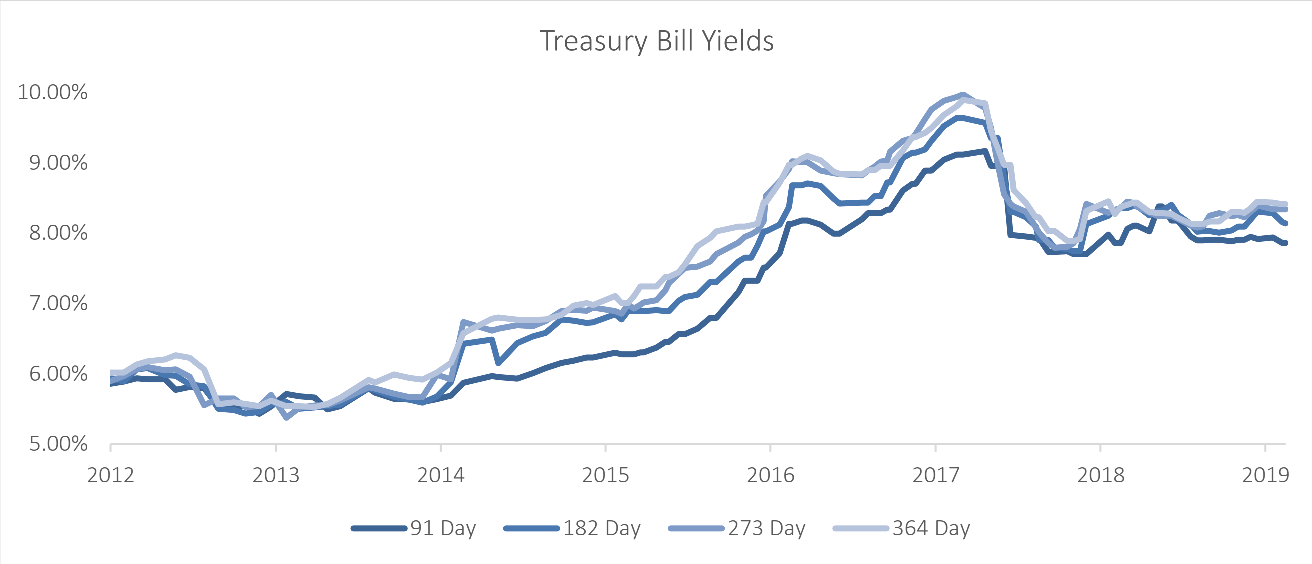


Source: FNB, IJG

In IJG's opinion, this is a sign of prudent balance sheet management as the bank would rather invest in "risk free" government securities such as treasury bills or short dated government bonds than taking on credit risk in the current economic environment.

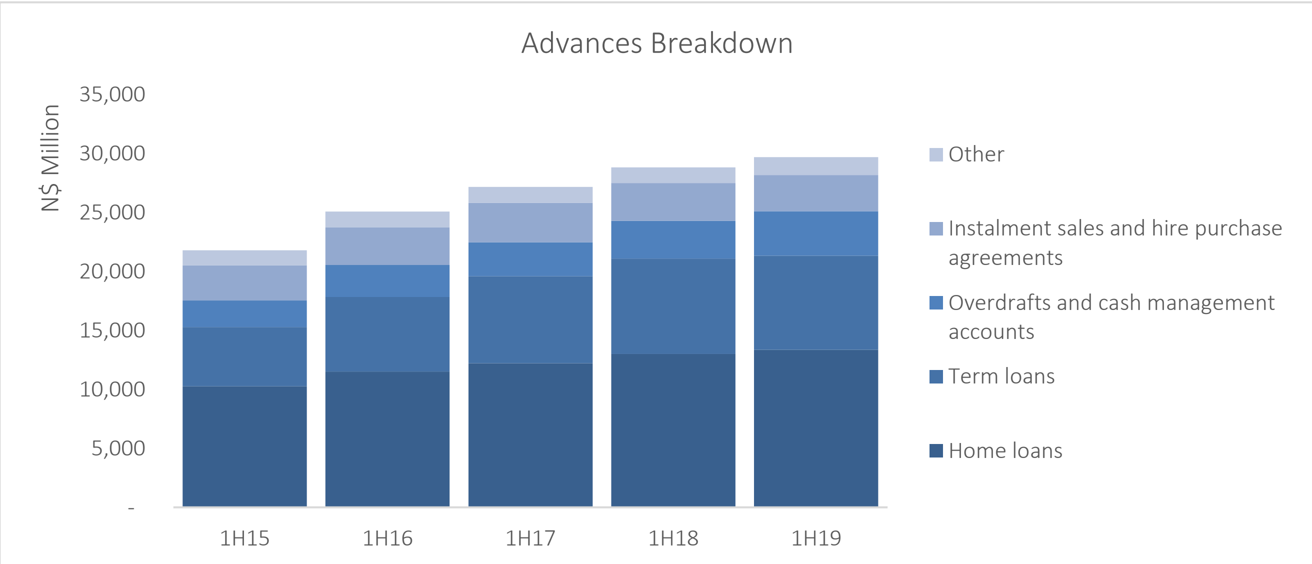
This allows the company to cherry pick lending opportunities and build up its liquidity buffers should liquidity shortages arise (as was the case in early 2017). Recently we have seen banking sector liquidity deteriorate from N$2.8 billion in December 2018 to N$261.1 million in January 2019. Additionally, the yields on treasury bills are reasonably attractive, ranging between 7.9% and 8.4% for highly liquid and low risk assets. At the end of FY18, FirstRand had N$3.67 billion invested in treasury bills and another N$1.08 billion invested in government and government guaranteed stock.

Another notable change has been the increase of credit extended to other banks, which has increased steadily from 2% of total assets in December 2016 to the current 5%. However, these advances are normally short term, usually ranging from overnight to 30 days.



Source: Bank of Namibia, IJG

Conventional advances posted an increase of 2.3% y/y, growing to N$29.2 billion. This was quite a bit below private sector credit extension growth of 7.4%, the slower growth was attributed to significantly slower growth in individual credit demand for term and mortgage loans and an indication of the lower risk appetite of FirstRand versus the rest of the market.



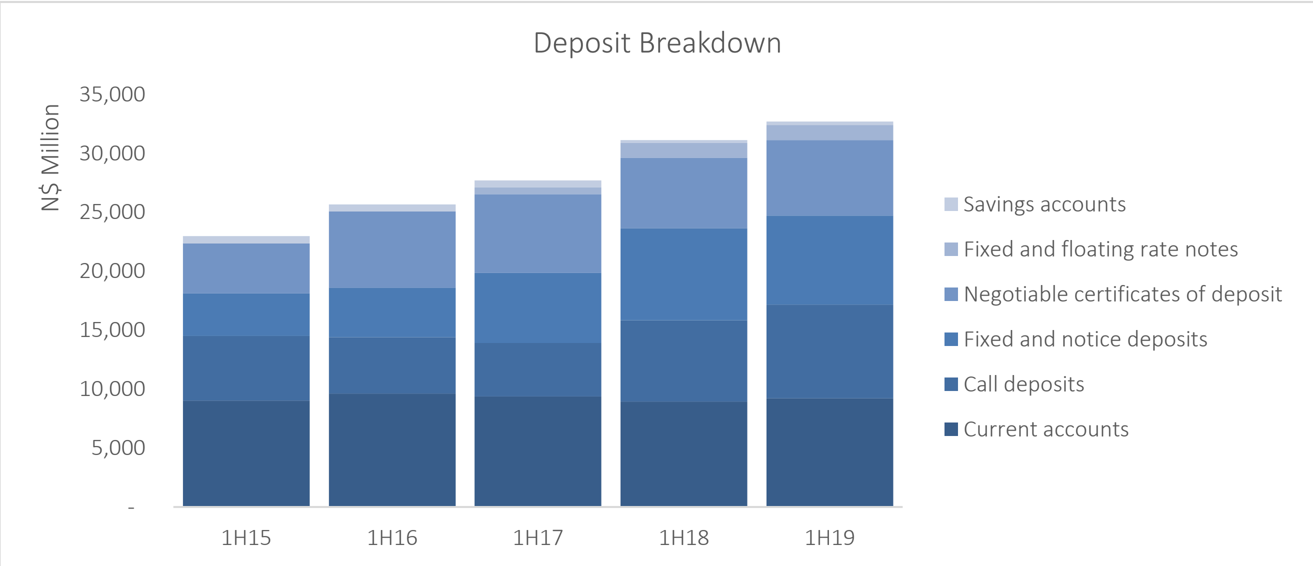
Source: FNB, IJG

This is quite evident in the numbers, as home loans grew by 2.7%, while overdrafts and card loans increased by 17.2% and 21.1% respectively. Mortgage loans currently constitute 45% of total advances which is unchanged from last year. Term loans declined by 1.1%, and now make up 27% of advances, while instalment sales declined by 3.9% and lease payments receivable decreased by 15.6%.

According to management, the increase in short term advances has been part of the strategy to diversify away from the heavy weighting in long term loans. Shorter duration assets are cheaper to fund and it is easier to manage the interest rate risk. As a result, overdrafts and cash managed accounts, which currently make up 13% of the advances book, will likely stay a sizable part of the lending mix.

Funding

Deposits grew at a faster pace than advances, increasing by 7.0% y/y to N$37.4 billion. Overall there was good growth in retail deposits, as current and call accounts increased by 2.8% and 15.7% respectively. Savings accounts, although making up a small percentage of the funding book, displayed strong growth of 26.5% y/y. This was due to the increased use of products like the savings pocket, which allows customers to deposit the rounding on every card transaction to a savings account.



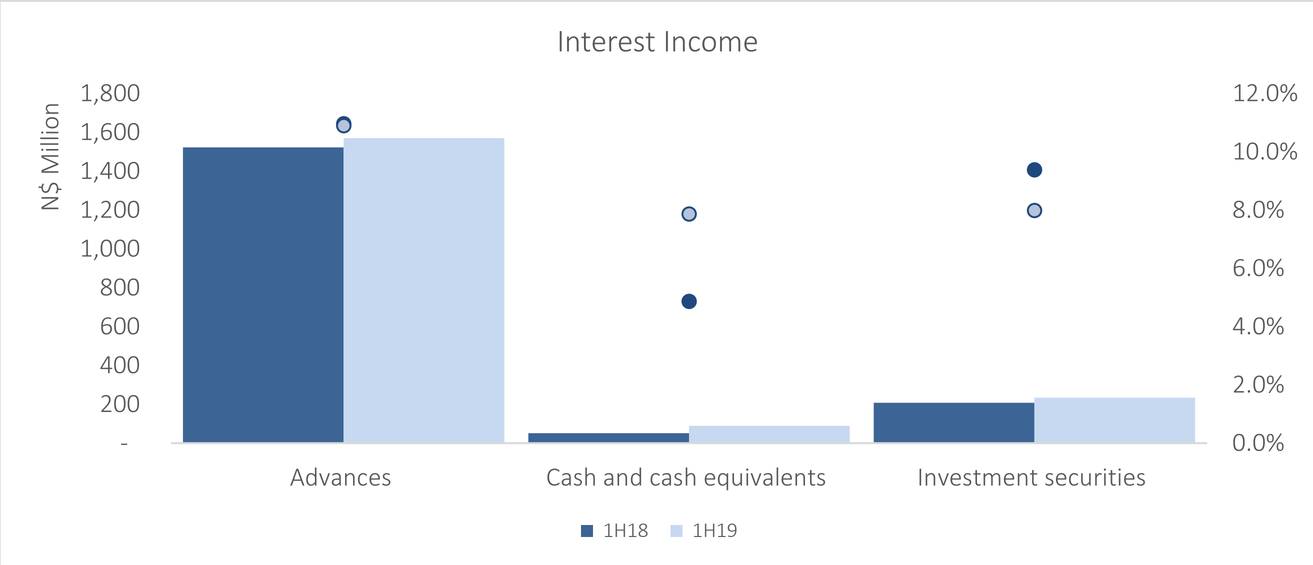
Source: FNB, IJG

Wholesale funding posted slower growth as fixed deposits decreased by 3.5% y/y, fixed and floating rate notes declined by 0.2% y/y and NCD funding increased by 7.5% y/y. The split between retail and wholesale funding remined roughly the same at 50:50.

Deposits from banks increased by 55.9%, although these are also normally short-term in nature. The increase in interbank activity is interesting and should improve liquidity in the market. However, this should dry up once Basel III is fully implemented as the liquidity coverage ratio (LCR) makes short-term interbank lending very costly. According to the new standard, when a bank issues an unsecured liability of 30 days or less, it must hold between 25% and 100% of the amount in liquid assets. Furthermore, since retail deposits tend to be sticky, the design of the LCR encourages their use as a primary funding source.

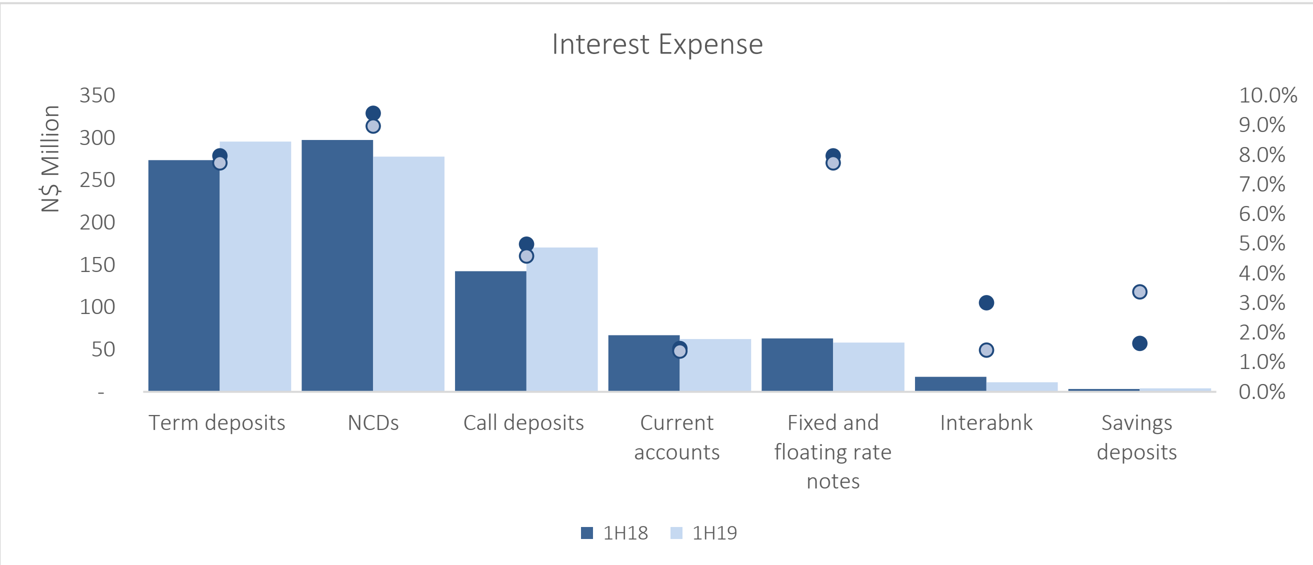
Interest Income and Expenses

Total interest income grew by 6.7% to N$1,910.1 million, while interest earned on advances grew by 3.2% from N$1,522.2 million to N$1,570.2 million. The implied interest rate based on average advances declined slightly from 11.0% to 10.9% in 1H19. This did not change much seeing as the repo rate remained unchanged, as did the administered prime and home loan lending rates.



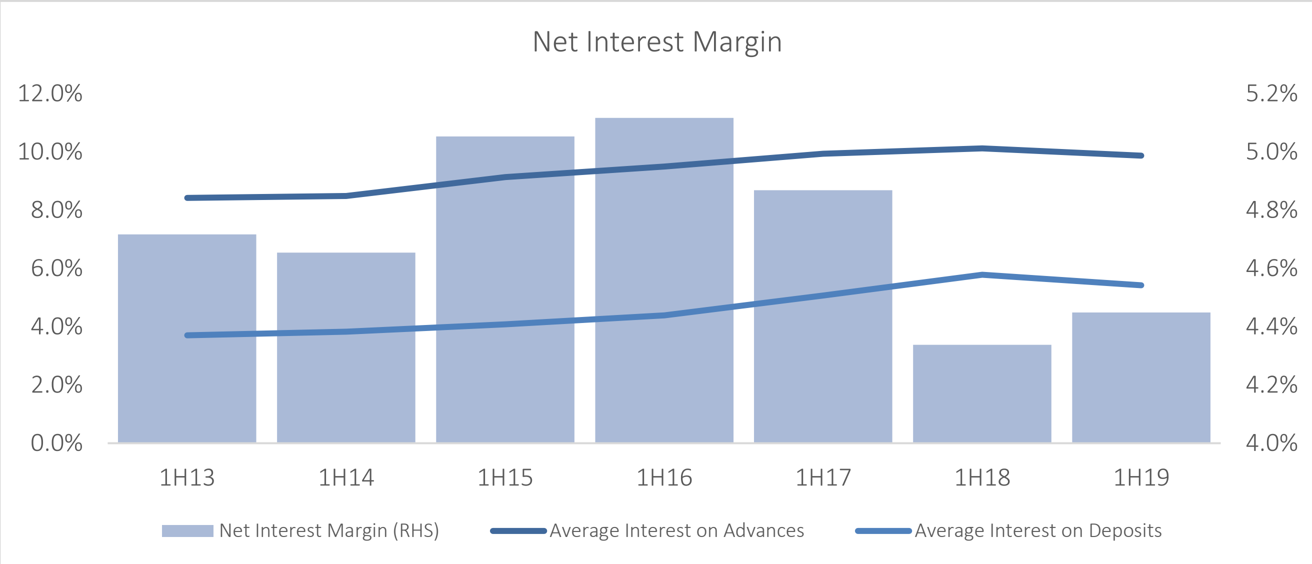
Source: FNB, IJG

Interest on cash and cash equivalents increased by 74.0%, to N$89.6 million, indicating that the group likely held higher average cash through the year. Interest earned on investment securities grew by 12.9%, although the average implied yield on these instruments dropped from 9.4% to 8.0%.



Source: FNB, IJG

Interest expense grew by 2.8% to N$909.0 million, the low growth being due to a continued focus on increasing retail deposits as opposed to the more expensive wholesale funding. Despite making up roughly half of deposits, term deposits and NCD funding continued to make up 66.1% of interest expense.

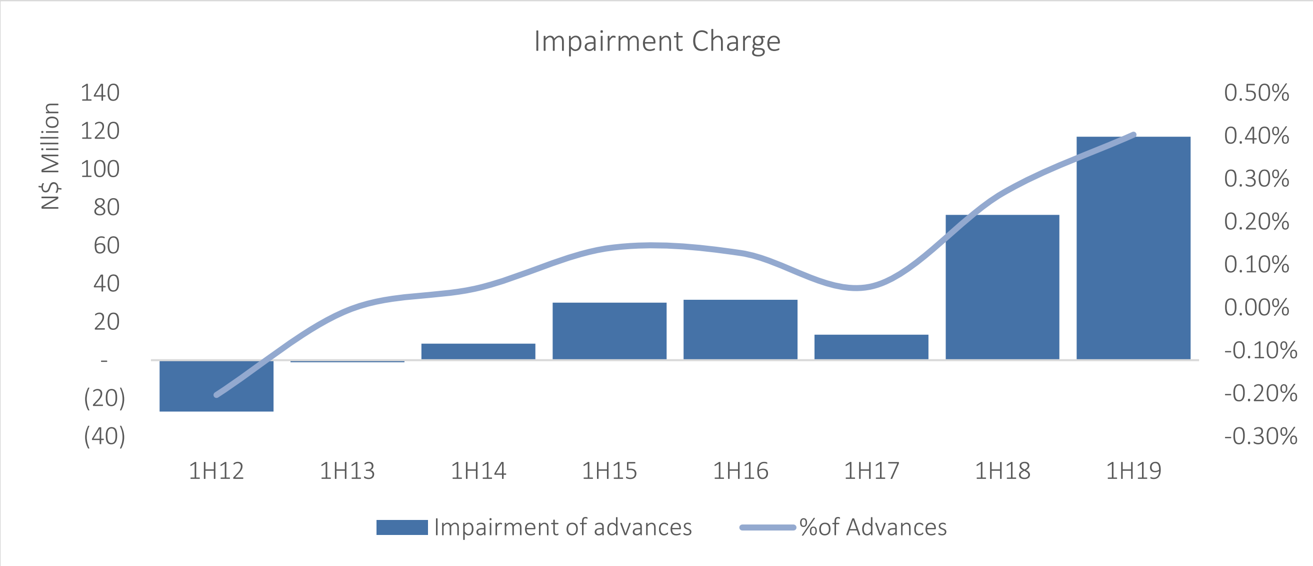


Source: FNB, IJG

The average cost of funding for nearly all deposit types declined in 1H19 compared to 1H18, which is due to a improved liquidity situation with banks do not having to compete as fiercely for deposits. The one exception to this decrease in interest cost was savings deposits, where the effective interest rate paid seems to have increased from 1.6% to 3.4% to attract more savings deposits. As a result of the decrease in average funding costs, the net interest margin increased from 4.3% in 1H18 to 4.4% in 1H19.

Impairments

As expected, credit losses increased. This was a combination of the deteriorating economic environment, combined with the implementation of IFRS 9. The impairment charge for 1H19 amounted to N$117.2 million, which equates to 0.39% of gross advances. This is an increase from the 0.26% seen in 1H18, but still relatively low in comparison with local peers. IFRS 9 increased the portfolio impairment charge from N$13.3 million to N$31.3 million, and as a result was the main contributor to the increase in impairment charge.

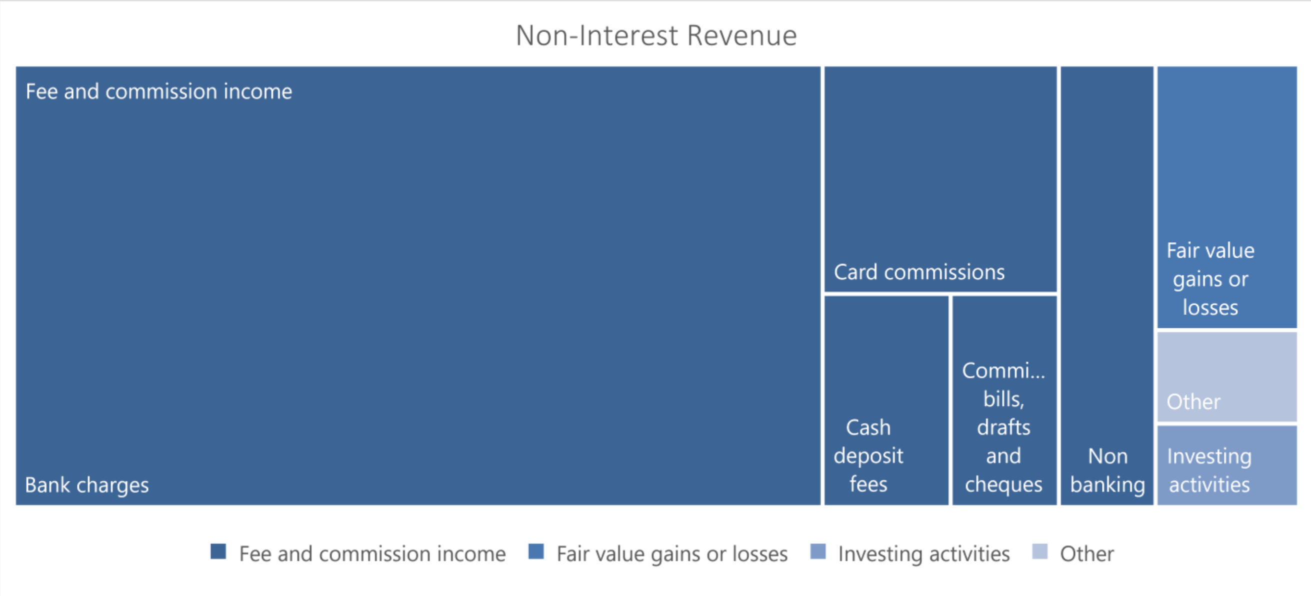


Source: FNB, IJG

Non-performing loans also accelerated, increasing from N$489 million in 2017 to N$687 million. NPLs ended the period at 2.31% of gross advances, up from 1.69% in 2017. The increase being symptomatic of the current economic climate but is still well below the industry average, which management estimates is around 3.4%. Management further added that their NPLs were relatively concentrated in their SME book and that they can deduce that small businesses are feeling the brunt of the recession. We expect non-performing loans to continue rising, albeit at a much lower pace. We expect impairment charges to remain at about 0.50% of gross advances going forward.

Non-Interest Revenue

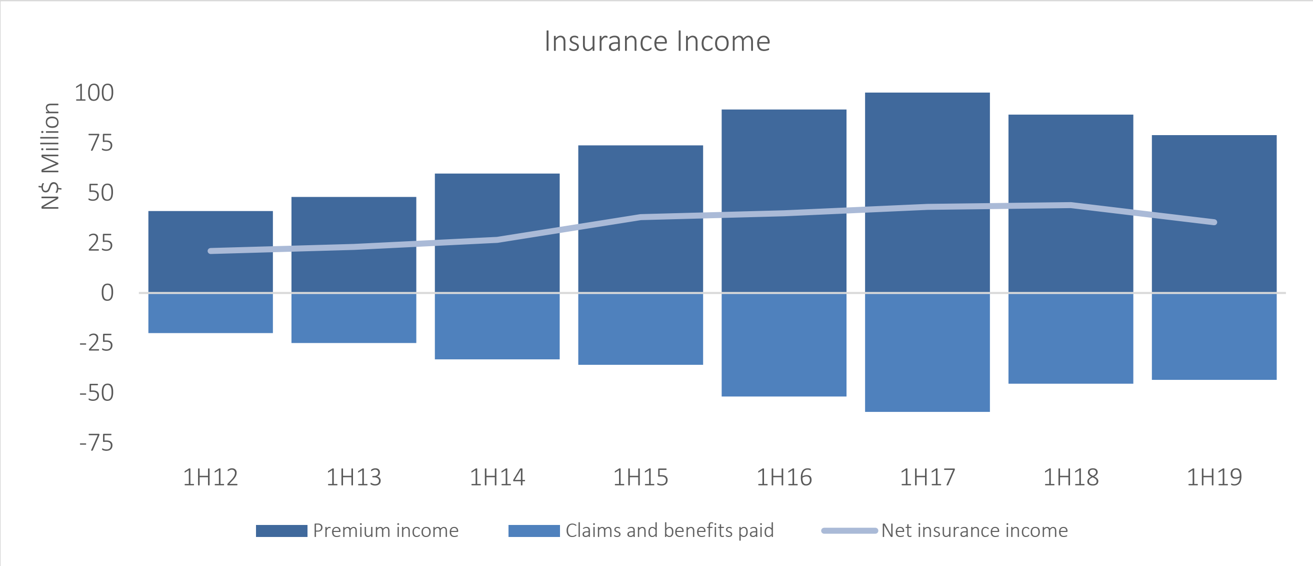
Non-interest revenue increased by 6.4% y/y. This was mainly due to a 7.2% increase in fee and commission income, which is the main source of non-interest revenue. Fee and commissions make up 88.8% of the group's total non-interest revenue. According to the group, the positive performance justifies the move to digital channels and more than offsets the reduction in traditional channel transaction volumes.



Source: FNB, IJG

Bank charges continued to make up the bulk of non-interest revenue, making up roughly 63% of total non-interest revenue. Income from bank charges grew by 8.9% to N$652.7 million. Income from cash deposit fees declined by 1.4% as regulation now exempts many small businesses from these charges.

Non-banking fee and commission income increased by 38.1% as a result of a large increase in asset management fee income, which increased from N$13.7 million in 1H18 to N$37.8 million, which would indicate that the Ashburton investment is already bearing fruit. Management indicated that the retail portion of the asset management business saw the largest growth as the bank continues to cross sell their wealth offering to banked clients and that assets under management still has ample runway for growth. The alternative assets under management, which include Stimulus Investments and a Cape Town property portfolio have not performed due to the depressed economic environment.



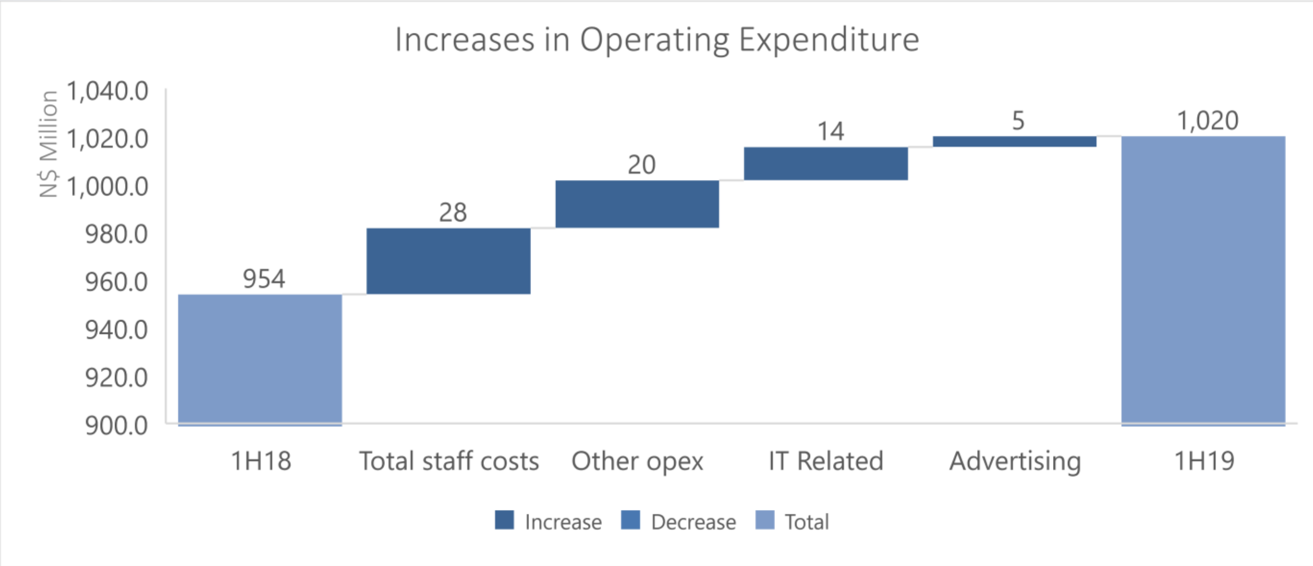
Source: FNB, IJG

Insurance premiums have declined to N$78.8 million. This is the second year of declines in premium income. According to the group this was due to increased competition and affordability challenges visible in the increase in lapses due to non-payment of premiums. Claims paid for the period declined marginally to N$43.4 million, leaving the net income from insurance at N$35.4 million.

Operating Costs

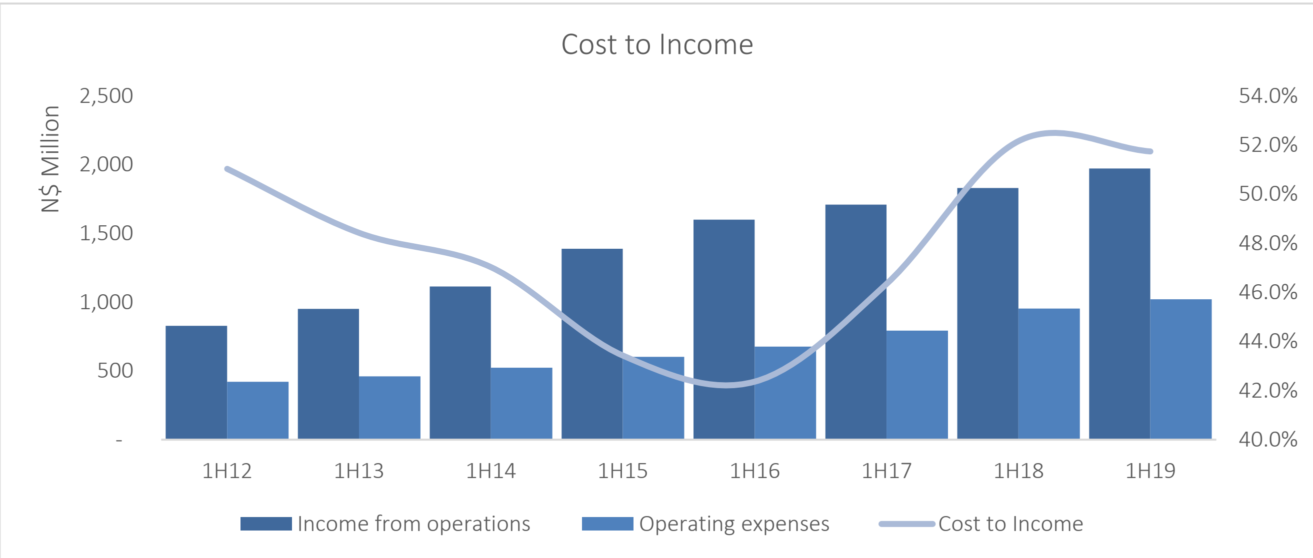
Operating costs increased by 6.9% y/y to N$1,020.1 million, which is slightly above the increase in the Namibian consumer price index of 5.1% y/y. Compared to previous years, the growth in operating expenses was well contained. The cost to income ratio declined from 52.2% to 51.7% which was largely due to well managed discretionary expenses.

Major contributors to the increases in costs were staff expenditure, IT related costs and advertising. Staff costs rose in line with inflation, increasing by 5.2% y/y. IT costs rose by 9.1%, which was as a result of upgrades of bandwidth lines for ATMs, while investment in cyber security, new product development and regulatory projects were also contributors. All other categories added N$19.9 million. Savings were achieved in a few line items, notably stationery and printing (-34.5%), telecommunications (-7.3%), professional fees (-15.8%) and travel and accommodation (-9.2%).



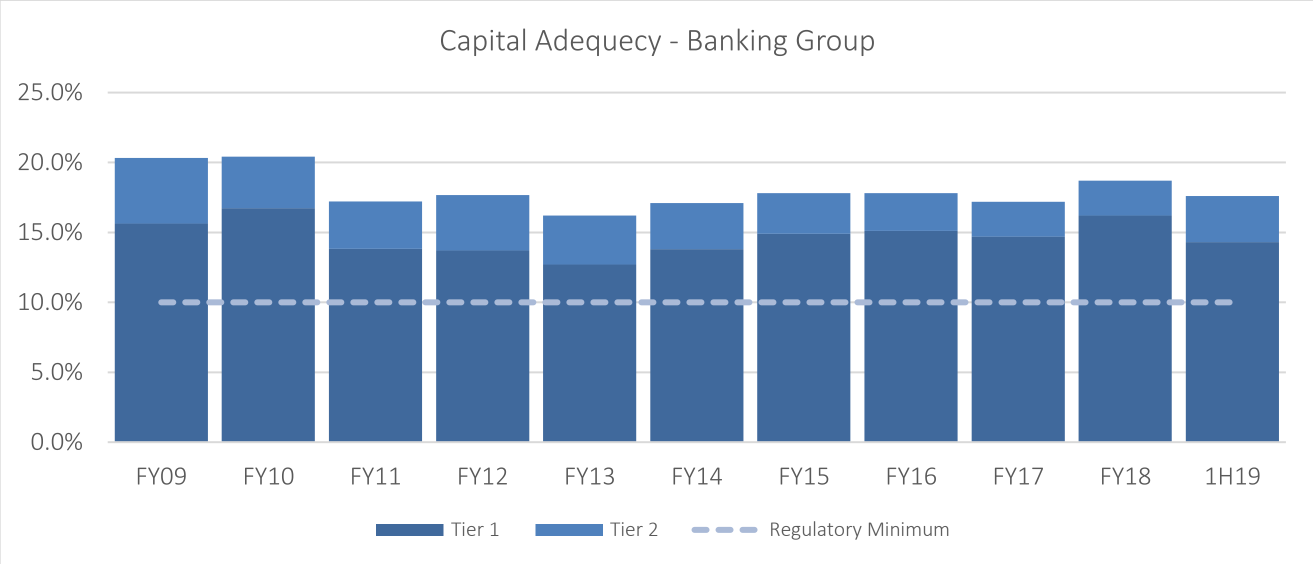
Source: FNB, IJG

FirstRand has benefitted from a superior cost-to-income ratio in the past and we expect some improvement in this ratio going forward. This is largely due to the fact that there was quite a lot of spending on digitisation and compliance in the last two financial years. Management pointed to a slow return to 50%, and below, as their target which seems very attainable, especially if there is an uptick in income growth combined with the current focus on expense management.



Source: FNB, IJG

Capital Adequacy



Source: FNB, IJG

FirstRand Namibia remains well capitalized with a total capital adequacy ratio of 18.9%, reflecting an increase on the prior year's 17.7%. Tier 1 capital for the consolidated group improved to 14.8% from 14.4% in 1H18. Total capital adequacy for the banking operations at 18.9% was well above the internal board approved target of 14.2%. The group's capital position was not impacted materially by the change relating to impairment allowances due to the implementation impact of IFRS 9.

Considering only the banking group, the total capital adequacy ratio improved from 17.3% to 17.6%. Banking operations Tier 1 capital improved to 14.3% in 1H19 from 13.8% in 1H18, although down from 16.2% in FY18. Tier 2 capital for the banking operations was 3.3% versus 3.5% in 1H18, seeing as no new Tier 2 eligible subordinated debt was raised, while risk weighed assets continued to grow. Management indicated that they have no short-term plans to raise more tier 2 capital.

Outlook

The outlook for the banking sector is not overly optimistic. Although a modest recovery in GDP growth is expected over the next three years, the country faces a tough task to get back to the spectacular growth seen in the first half of this decade. The fiscal hangover will likely last another couple of years seeing as core issues, such as consumptive spending, are not being addressed, while development spending continues to be sacrificed to feed the beast which is consumptive spending.

Business and consumer confidence and investment are likely to remain depressed while policy uncertainty looms. NEEEF, NIPA and corporate tax increases are three of the largest worries. Consumers are certain to remain under pressure over the medium-term. Although Private sector credit growth is expected to recover slightly, but without business and consumer confidence and the investment it brings, long-term growth will remain difficult to achieve.

Despite the difficult environment, FirstRand has done quite well in delivering positive earnings growth. The investments made into generating noninterest revenue, most notably the Ashburton acquisition and digitalisation drive are starting to bear fruit, while the success of cost cutting initiatives are also quite evident in the most recent financials. Management's approach to credit extension has been cautious, and the lessons learnt from the previous liquidity crunch in 2017 has left the company more prepared for the future, with adequate liquidity buffers having been built up. Thus, the company is ready to weather a prolonged recession. However, should lending activity pick up, FirstRand is in a good position to continue with business as usual.

Valuation

To value the shares of FirstRand Namibia, several valuation methods have been used 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 14.22% based on a 10.31% yield on the IJG generic 10-year bond, an equity risk premium of 3.91% and a beta of 1.0. The sustainable growth rate was estimated to be 10.0% based on a long tern sustainable return on equity of 20.0% and an estimated pay-out ratio of 50.0%. 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	12,619,310	48.28	12.1	11.5	2.52	2.26	4.23%	4.34%	20%
Residual Income	12,978,626	49.66	12.5	11.8	2.59	2.33	4.11%	4.22%	20%
Dividend Discount	11,640,634	44.54	11.2	10.6	2.32	2.09	4.58%	4.70%	20%
Justified Price to Earnings	12,266,893	46.94	11.8	11.2	2.45	2.20	4.35%	4.46%	20%
Justified Price to Book	11,833,421	45.28	11.4	10.8	2.36	2.12	4.51%	4.63%	20%
Weighted Average	**12,267,777**	**46.94**	**11.8**	**11.2**	**2.45**	**2.20**	**4.35%**	**4.47%**	**100%**

Source: IJG

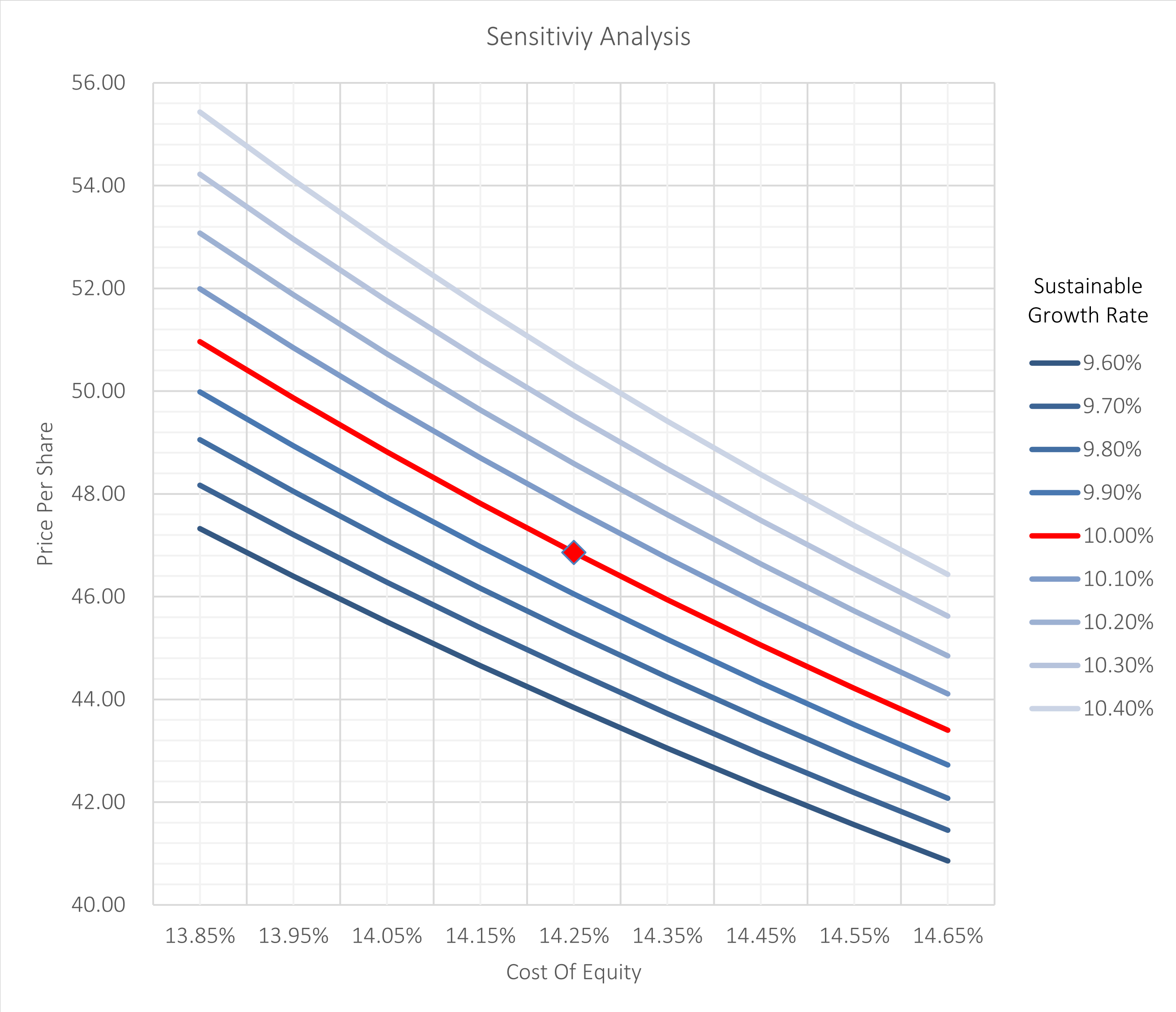
Based on the table above, we derive a **target price of N$c4694** per share. Coupled with an expected full year dividend of 210 cps, we expect a **total return of 13.5%.** Seeing as this is below our cost of equity and the risks to our outlook is skewed to the downside, we maintain our **HOLD** recommendation on FNB.

Summary of Financial Statements

Year End June (N$ 000)	FY17	FY18	FY19	FY20	FY21
Interest and similar income	3,285,633	3,583,400	3,807,482	4,094,592	4,362,445
Interest expense and similar charges	(1,521,032)	(1,762,644)	(1,811,214)	(1,898,376)	(1,939,547)
Net interest income before impairment of advances	1,764,601	1,820,756	1,996,268	2,196,216	2,422,898
% Growth	*6.7%*	*3.2%*	*9.6%*	*10.0%*	*10.3%*
Impairment of advances	(59,251)	(128,261)	(145,929)	(153,397)	(163,042)
Net interest income after impairment of advances	1,705,350	1,692,495	1,850,338	2,042,818	2,259,856
Non-interest revenue	1,553,954	1,795,926	1,932,415	2,090,159	2,266,212
Net insurance premium income	182,902	185,015	185,723	184,547	185,095
Net claims and benefits paid	(103,678)	(96,151)	(100,869)	(100,233)	(99,084)
Income from operations	3,338,528	3,577,285	3,867,608	4,217,291	4,612,079
% Growth	*4.4%*	*7.2%*	*8.1%*	*9.0%*	*9.4%*
Operating expenses	(1,663,061)	(1,981,249)	(2,183,227)	(2,388,083)	(2,590,292)
Net income from operations	1,675,467	1,596,036	1,684,382	1,829,208	2,021,787
Share of profit from associate after tax	2,515	1,102	1,212	1,333	1,467
Income before tax	1,677,982	1,597,138	1,685,594	1,830,542	2,023,254
Indirect tax	(40,767)	(45,841)	(50,566)	(55,291)	(60,016)
Profit before tax	1,637,215	1,551,297	1,635,028	1,775,251	1,963,238
Direct tax	(523,984)	(490,589)	(523,209)	(568,080)	(628,236)
Profit for the period	1,113,231	1,060,708	1,111,819	1,207,171	1,335,002
% Growth	*-8.6%*	*-4.7%*	*4.8%*	*8.6%*	*10.6%*

Year End June (N$ 000)	FY17	FY18	FY19	FY20	FY21
Cash and cash equivalents	1,466,113	1,345,842	2,209,864	2,554,147	2,558,501
Due from banks and other financial institutions	2,667,981	2,781,551	3,004,075	3,244,401	3,503,953
Derivative financial instruments	95,221	93,520	132,746	107,162	111,143
Advances	28,258,413	28,531,833	29,185,896	30,679,420	32,608,466
Investment securities	3,866,395	5,266,144	5,274,332	5,591,207	5,630,805
Accounts receivable	197,444	245,171	364,480	382,704	428,628
Investments in associate	36,025	25,321	22,380	24,040	24,295
Property and equipment	953,290	907,259	861,259	815,259	769,259
Intangible assets	232,665	180,613	135,613	90,613	45,613
Deferred income tax asset	34,634	32,347	43,356	37,852	40,604
Reinsurance assets	99	219	200	200	200
Tax asset	1,226	605	800	800	800
Total assets	**37,809,506**	**39,410,425**	**41,235,001**	**43,527,804**	**45,722,266**
Deposits	30,488,360	31,546,201	32,807,430	34,397,779	35,936,555
Due to banks and other financial institutions	1,192,537	897,408	963,639	1,017,861	959,636
Derivative financial instruments	95,221	93,520	132,746	107,162	111,143
Short trading positions	39,330	-	-	-	-
Creditors and accruals	452,815	378,114	409,296	413,408	400,273
Tax liability	56,233	186,646	99,266	114,048	133,320
Employee liabilities	211,340	247,337	272,071	299,278	329,206
Deferred income tax liability	257,240	323,672	257,040	279,317	286,677
Policyholders liabilities under insurance contracts	52,642	49,200	50,000	50,000	50,000
Finance lease obligation	-	-	-	-	-
Tier two liabilities	402,830	402,783	402,783	402,783	402,783
Other Debt Securities	-	-	-	-	-
Total liabilities	**33,268,889**	**34,394,369**	**35,663,036**	**37,352,253**	**38,879,215**
Capital and reserves attributable to ordinary equity holders of parent	4,478,919	4,943,411	5,490,982	6,085,513	6,743,002
Non-controlling interests	61,698	72,645	80,984	90,037	100,050
Total equity	**4,540,617**	**5,016,056**	**5,571,965**	**6,175,551**	**6,843,052**
Total equity and liabilities	**37,809,506**	**39,410,425**	**41,235,001**	**43,527,804**	**45,722,266**

Sensitivity Analysis



Source: IJG

Sustainable Growth Rate \ Cost of Equity	13.85%	13.95%	14.05%	14.15%	14.25%	14.35%	14.45%	14.55%	14.65%
9.60%	47.32	46.40	45.51	44.66	43.84	43.05	42.29	41.56	40.86
9.70%	48.17	47.20	46.28	45.39	44.54	43.73	42.94	42.18	41.45
9.80%	49.05	48.05	47.09	46.16	45.28	44.43	43.62	42.83	42.07
9.90%	49.98	48.93	47.93	46.97	46.05	45.17	44.32	43.51	42.72
10.00%	50.96	49.86	48.82	47.82	**46.86**	45.94	45.06	44.21	43.40
10.10%	51.99	50.84	49.75	48.70	47.70	46.75	45.83	44.95	44.11
10.20%	53.08	51.87	50.73	49.63	48.59	47.59	46.64	45.72	44.85
10.30%	54.22	52.96	51.76	50.61	49.52	48.48	47.49	46.53	45.62
10.40%	55.43	54.10	52.84	51.65	50.50	49.42	48.38	47.38	46.43

Source: IJG

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