FIRSTRAND NAMIBIA HOLDINGS
FY19 Results Review
September 2019

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FirstRand Namibia Holdings

FY19 Results Review

Target Price (c)	***4087***
Current Price (c)	3339

Year End 30 June	2018	2019	F2020	F2021	F2022
Net interest income (N$m)	1,821	2,012	2,173	2,289	2,464
Non-interest income (N$m)	1,796	1,820	1,939	2,082	2,246
Profit (N$m)	1,061	1,086	1,134	1,181	1,267
HEPS (c)	398	410	428	445	477
DPS (c)	204	208	217	226	253
DY (%)	4.6	5.9	6.5	6.7	7.6
P/E (x)	11.2	8.5	7.8	7.5	7.0
P/BV (x)	2.3	1.7	1.6	1.6	1.5

Source: FNB, IJG, Bloomberg

Recommendation	BUY
NSX Code	FNB
Market Cap (N$m)	8,962
Shares in Issue (m)	267.6
Free float (%)	24
52 week high	4450
52 week low	3330
Expected Total Return (%)	28.9%

FY19 Results Review

FirstRand Namibia released their results for the year ended 30 June 2019. All in all, the results seemed to be more or less in line with our expectations, with headline and basic earnings both increasing by 3.0% y/y. Profit after tax increased by 2.4% y/y to N$1.086 billion. However, despite the economic backdrop, the group was able to maintain a return on equity of 20.8%. This indicates that the overall business model remains resilient despite the current recessionary environment.

Total deposits grew by 13.8% y/y or N$4.340 billion from N$31.546 billion in FY18 to N$35.886 billion. Much of the increase in funding came from the issuance of negotiable certificates of deposit, which increased by N$2.440 billion or 40.1% y/y. Banking sector liquidity has been reasonably high in the Namibian market over the last 12 months and a large amount of the capital influx could be attributed to the change in domestic asset requirements, which now require pension funds to invest 45% of their assets locally.

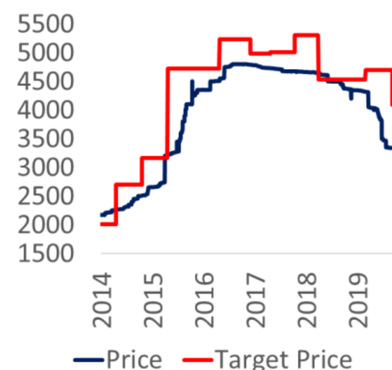
Total assets grew by 12.0% or N$4.729 billion on the back of strong growth in deposits. However, total advances grew by only 6.2% or N$ 1.766 billion. As a result, a large amount of the funding raised was directed to investment securities, which increased by N$2.541 billion. Of this N$1.376 billion was invested in government treasury bills while N$1.111 billion was added to the company's government bond position. Total investment securities totalled N$7.809 billion and made up 18% of the balance sheet.

The group remained well capitalised at levels significantly above the minimum regulatory requirements. Capital adequacy ratio for the group was 19.9% and Tier 1 capital 17.6%. Seeing as there are few lending opportunities currently in the market and the bank is arguably overcapitalised, the group decided to pay a special dividend of 250 cps.

Total interest income increased by 7.9% y/y to N$3.865 billion. The average interest on advances increased slightly from 9.8% to 9.9%, while the average interest earned on investment securities declined from 8.8% to 7.6%. Interest rates are not expected to change much over the forecast horizon, with one rate cut currently priced into the South African forward rate agreement market. The bank's net interest margin is expected to widen slightly as the bank rolls out of more expensive funding sources over the next three years.

The total impairment charge increased by 67.5% y/y from N$128.3 million to N$214.8 million. This represented an increase from 0.45% of advances to 0.71%. However, much of the increase could be attributed to the transition to IFRS 9. Nonetheless, there has been some decay in the age of the book but FNB's NPLs compare very favourably to the rest of the market. We expect impairments to continue their upward trend but commend FNB on its prudent credit risk management.

FNB Share Price vs Target Price



Dividends

Dividend (final): 117c/share

Dividend (special): 250c/share

Declaration date: 13 August 2019

Last day to trade: 13 September 2019

Ex-date: 16 September 2019

Record date: 20 September 2019

Payment date: 04 October 2019

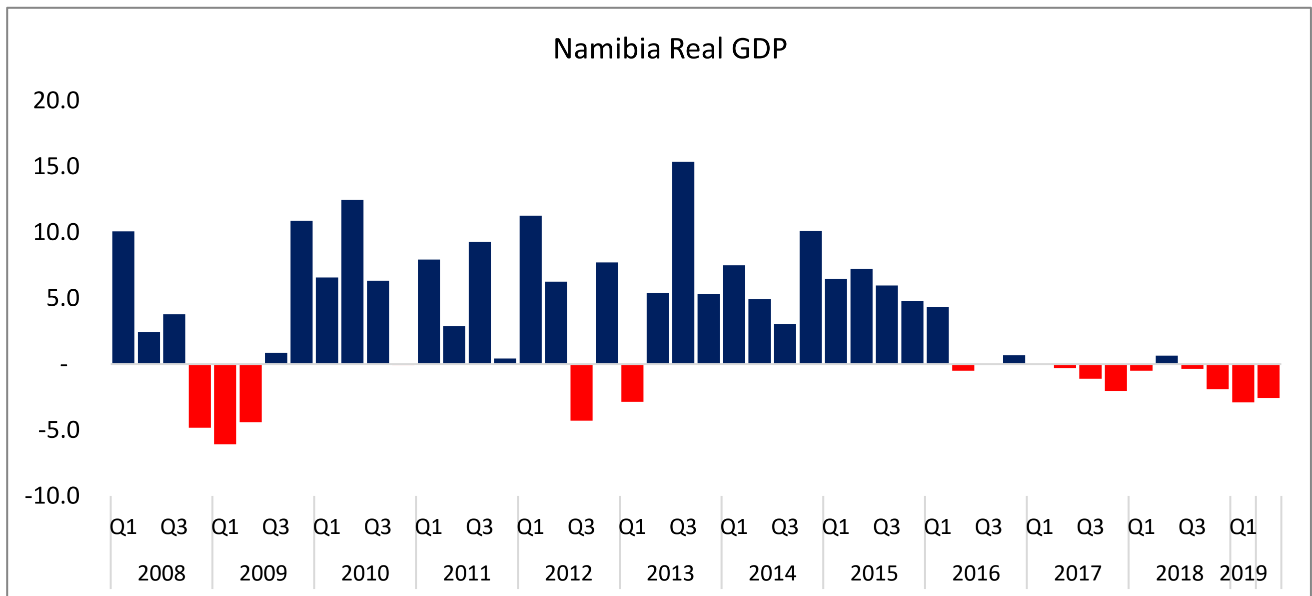
Non-interest revenue increased by 4.2% y/y (normalised) to N$1.820 billion in FY19 and showed strong growth in card commissions and banking fees. However, cash deposit fees and other commissions declined as the trend of migration to digital channels continues. Costs were well contained, and savings on many smaller line items added up to a normalised increase of only 6.5%. This is while IT costs and salary costs continued to grow at 8.7% and 11.2% respectively. The cost to income ratio increased (on a normalised basis) to 52.9%.

Our target price has been revised lower to N$c4087 per share on the back of deteriorating macroeconomic drivers. However, we believe the decline in price has been overdone and see value in the share at the current market price. We have revised our valuation inputs and have included an extra 1.0% in the cost of equity as a country risk premium and have also revised our long-term sustainable return on equity down by 1.0% to 19.0%. Coupled with an expected full year dividend of 214 cps, we still expect a total return of 28.9%, should the price revert to its intrinsic value. As a result, we maintain our BUY recommendation on this counter.

Banking Macro

Growth environment

Growth in Namibia remains lacklustre. The latest quarterly GDP release pointed to a contraction of 2.6% y/y making it the fourth consecutive quarter of contraction the country has experienced. The data shows that eight of the last twelve quarters have posted contractions on an annual basis, while the quarters of growth have been marginally positive at best.



Source: NSA, IJG

In their July 2019 economic outlook, the Bank of Namibia projected the domestic economy to contract by 1.7% in 2019, following a contraction of 0.1% in 2018. This was quite a revision from the 0.3% contraction expected for 2019 in their April 2019 outlook. The revision was due to weaker growth prospects in major sectors such as agriculture, diamond mining and wholesale and retail trade sectors.

The deterioration in agriculture outlook has been as a result of the ongoing drought, which was declared a state of emergency in May 2019. According to the *crop prospects, food security and drought situation report,* published by the Ministry of Agriculture, Water and Forestry during April 2019, the country is expecting a substantial

reduction in harvest of over 42.0% below the average production, while 64,526 heads of livestock were estimated to have died between October 2018 and April 2019 as a result of the drought.

The expected contraction in diamond mining is largely attributed to the routine maintenance of the main mining vessel which has kept it out of production for the second quarter of 2019 and some rebound is expected in 2020. However, diamond mining remains under pressure as the price of rough diamonds has been declining in 2019. The RapNet Diamond Index for 3-carat stones dropped 12% in the first half of 2019, while the PolishedPrice.com Composite Rough Diamond Index has also posted a decline of 9.8% YTD. According to a Rapaport, the decline in prices is largely due to increased supply of polished stones from India, combined with lower global high-end consumer demand, especially from the United States.

Finally, domestic consumer demand remains depressed as disposable incomes have been and will likely remain under pressure and structural unemployment has risen. This has had an adverse effect on wholesale and retail trade, which continued to contract. Wholesale and retail trade is possibly the best yardstick to measure the health of the consumer, and the deterioration is outlook is worrying. These trends are not likely to reverse in the medium term and as a result growth is expected to remain low over the next two years. According to the Bank of Namibia, the country is expected to post growth of 0.8% in 2020 and 1.2% in 2021.

Interest Rates

Internationally, the call for lower interest rates have resurfaced. The Federal Reserve cut interest rates by 25 basis points in July 2019, the first rate cut since the 2008 sub-prime crisis. The minutes of the July meeting stated that the move shouldn't be viewed as an indication that there is a "pre-set course" for future cuts, but rather as a "mid-cycle adjustment" of interest rates.

However, in an abrupt departure from the previous message, the Federal Reserve chair, Jerome Powell, announced a second rate cut in September, as was anticipated by the market following a poor August jobs report. Many attribute the lower hiring figures to the ongoing US-China trade dispute. The data showed that the US added only 130,000 new jobs in August, falling way short of the 170,000 consensus.

United States | Instrument: Futures: Fed Funds - Effective | Fed Effective Rate 2.30

1) Overview | 2) Future Implied Probability

Current Implied Probabilities | 3) Add/Remove Rates

Dates: Meeting / Calculation | Calculated 09/19/2019 | Based on rate 1.75-2.00

Meeting	Hike Prob	Cut Prob	0.75-1	1-1.25	1.25-1.5	1.5-1.75	1.75-2	Fwd Rate
10/30/2019	0.0%	41.3%	0.0%	0.0%	0.0%	41.3%	58.7%	1.80
12/11/2019	0.0%	64.7%	0.0%	0.0%	16.5%	48.2%	35.3%	1.70
01/29/2020	0.0%	81.0%	0.0%	7.6%	31.1%	42.3%	19.0%	1.58
03/18/2020	0.0%	86.7%	2.3%	14.7%	34.5%	35.3%	13.3%	1.51
04/29/2020	0.0%	89.4%	4.8%	18.6%	34.6%	30.9%	10.6%	1.46
06/10/2020	0.0%	91.4%	7.5%	21.8%	33.9%	26.9%	8.6%	1.41
07/29/2020	0.0%	92.8%	9.7%	23.6%	32.8%	24.1%	7.2%	1.37
09/16/2020	0.0%	94.0%	12.0%	25.1%	31.4%	21.3%	6.0%	1.33
11/05/2020	0.0%	94.8%	13.7%	26.0%	30.1%	19.3%	5.2%	1.29

The last decision was not unanimous as seven members of the Federal Reserve Open Markets Committee voted in favour of the September cut, two members voted for no move and one for a larger cut. Although the fed has

yet to decide if further rate cuts are warranted, the market is pricing in two more cuts, the first one as soon as December.

Similarly, the Eurozone is troubled by the uncertainty created by both trade wars and Brexit. The European Central Bank cut its key interest rates by 10 basis points to -0.5% from -0.4% in September. This was coupled with a controversial €2.6tn quantitative easing programme of bond buying.

Christine Lagarde, who is set to take over from Mario Draghi as European Central Bank head, as well as the ECB chief economist Philip Lane have both expressed their support for the European Central Bank's extraordinary measures – such as the quantitative easing programme and negative interest rates, and have made it clear the ECB will not hesitate to cut rates further into the negative should they deem it necessary. The market is pricing in one more 10 basis point cut in the second quarter of 2020.

Euro Zone | Instrument: OIS: Eurozone OIS | Current Rate -0.50

1) Overview | 2) Future Implied Probability

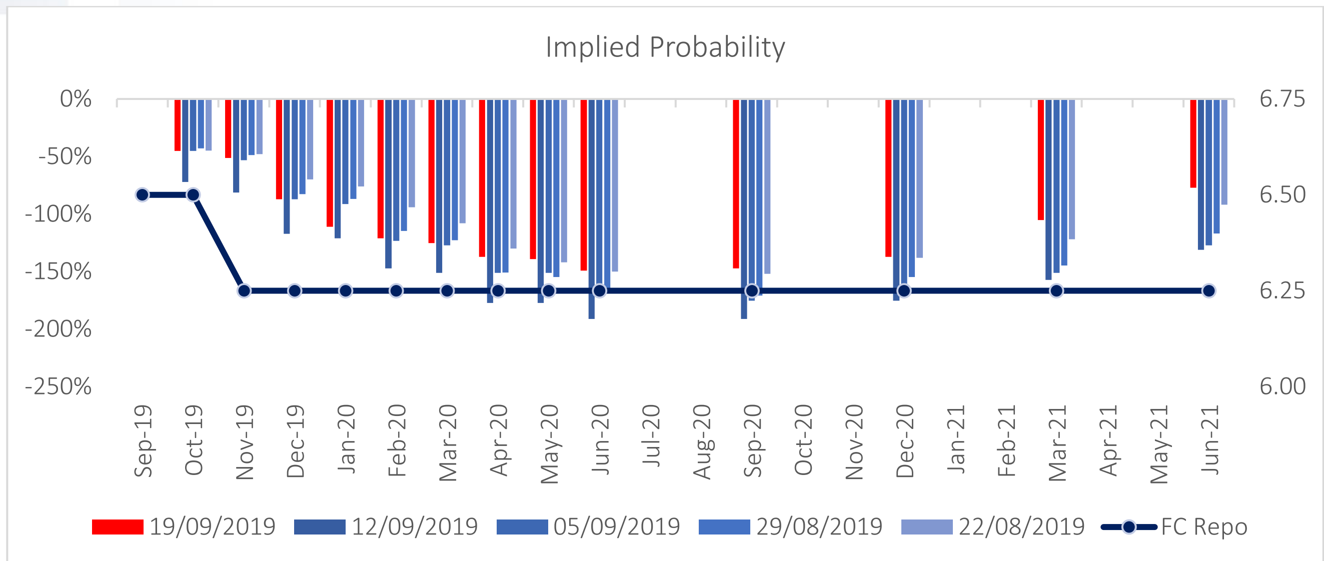
Current Implied Probabilities | 3) Add/Remove Rates

Dates: Meeting / Calculation | Calculated 09/18/2019 | Based on rate -0.50

Meeting	Hike Prob	Cut Prob	-0.8	-0.7	-0.6	-0.5	-0.4	Fwd Rate
10/24/2019	15.0%	0.0%	0.0%	0.0%	0.0%	85.0%	15.0%	-0.45
12/12/2019	8.5%	36.8%	0.0%	0.0%	36.8%	54.7%	8.5%	-0.49
01/23/2020	6.9%	46.9%	0.0%	6.8%	40.1%	46.2%	6.9%	-0.51
03/12/2020	3.7%	68.6%	3.2%	22.5%	43.0%	27.7%	3.7%	-0.56
04/30/2020	4.3%	67.6%	3.1%	22.0%	42.5%	28.1%	4.2%	-0.55
06/04/2020	2.1%	82.4%	13.1%	32.8%	34.9%	15.5%	2.0%	-0.61
07/16/2020	3.4%	79.5%	12.1%	31.1%	34.7%	17.2%	3.2%	-0.60
09/10/2020	2.9%	82.3%	15.3%	31.7%	31.8%	14.8%	2.7%	-0.61

Source: Bloomberg

Being in a very similar boat to the rest of the world, South Africa also faces low growth and low inflation. Minutes of the July 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 the biggest risk. This was especially evident following the attack on Saudi Arabian oil facilities and the spike in prices witnessed following global oil supply fears. Forward rate agreements have increased slightly, indicating only one cut is likely after the midterm budget speech in October.

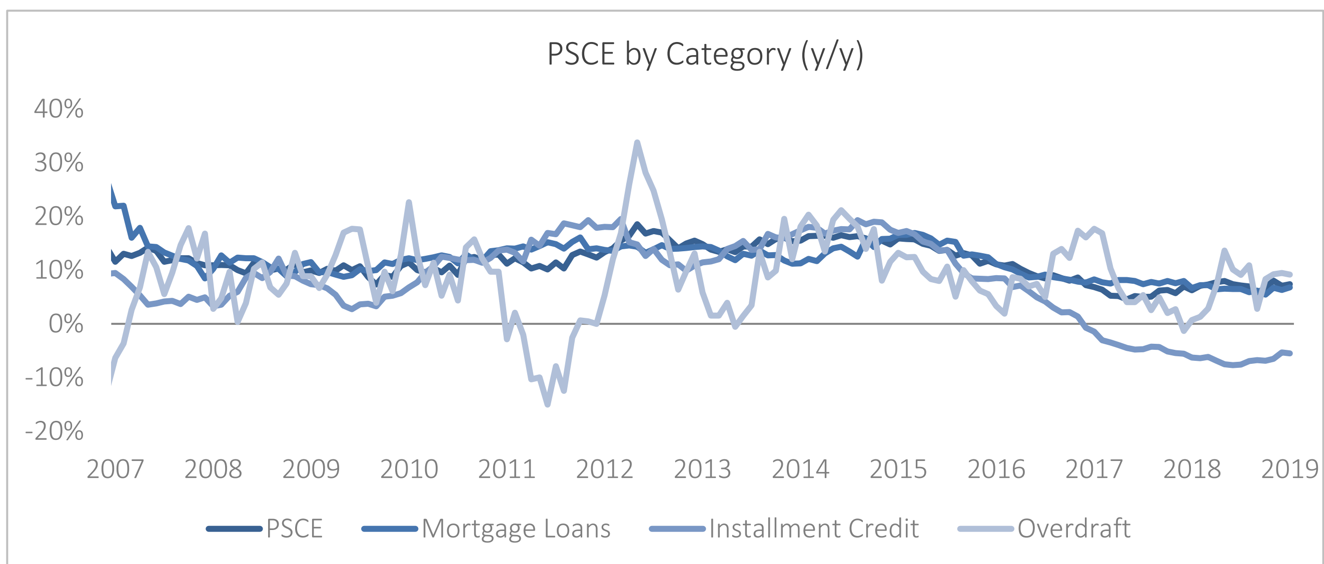


Source: Bloomberg, IJG

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 25 basis point rate cut.

PSCE

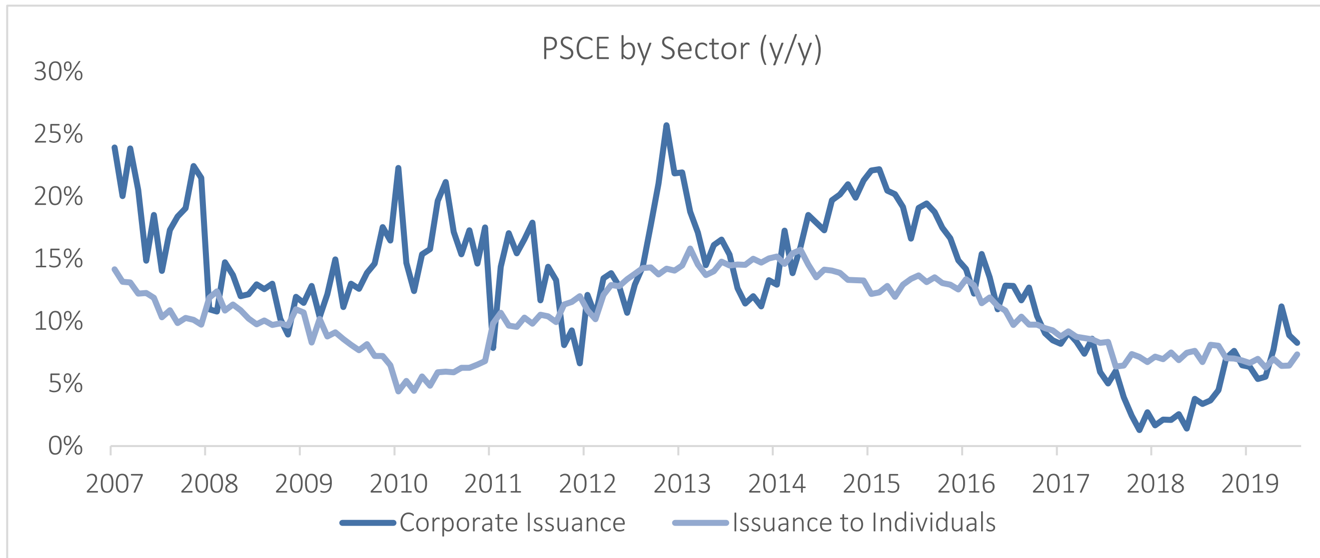
From the peak in 2016, there has been a marked slowdown in private sector credit extension. Corporate lending took a plunge in 2018 and has since seen some recovery in the Namibian market. However, much of the year-on-year growth has been driven by the 'Other Loans and Advances', 'Overdraft' and 'Other Claims' categories, which grew by 21.6% y/y, 10.1% y/y and 14.9% y/y respectively.



Source: Bank of Namibia, IJG

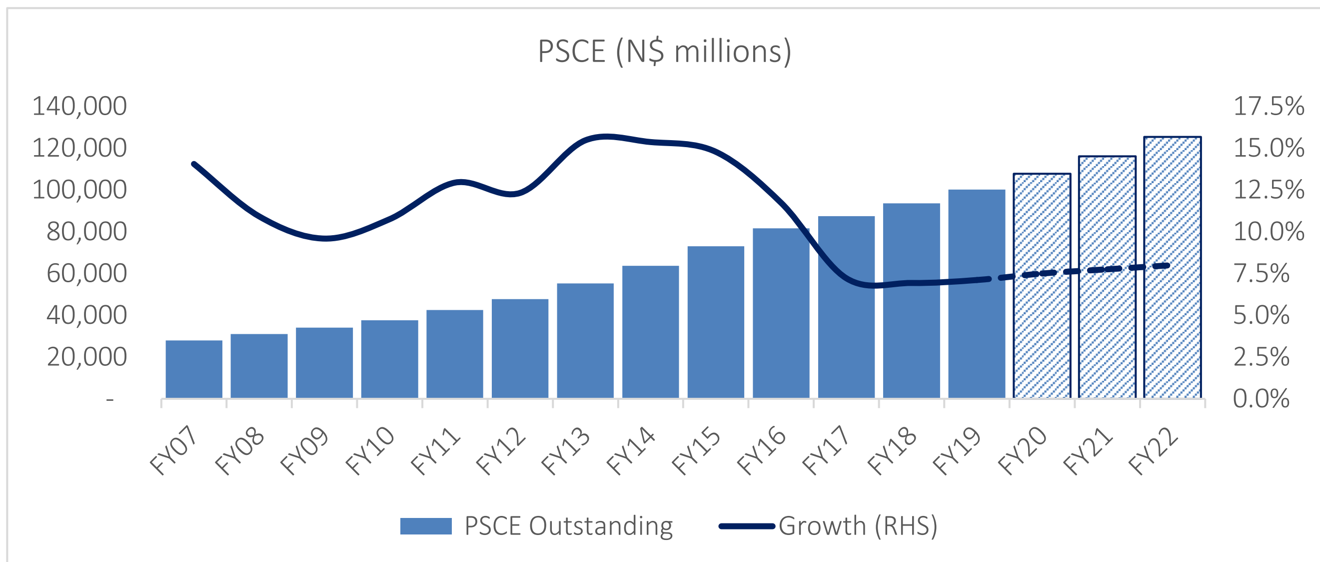
This is comparable to the more traditional types of financing such as instalment credit and mortgage lending, which grew by 5.7% and contracted by 7.1% respectively. This would lead us to believe that large amounts of

corporate lending have been short-term in nature and have been used mostly for cash flow management instead of long-term capital projects.



Source: Bank of Namibia, IJG

Similarly, issuance to individuals seemed to have found a bottom around the 6.5% to 7.0% range, but much of the growth has stemmed from 'Other Loans and Advances' which was up 22.9% y/y compared to mortgage loans which remained at the 6.5% level while instalment credit outstanding declined by 4.2%.

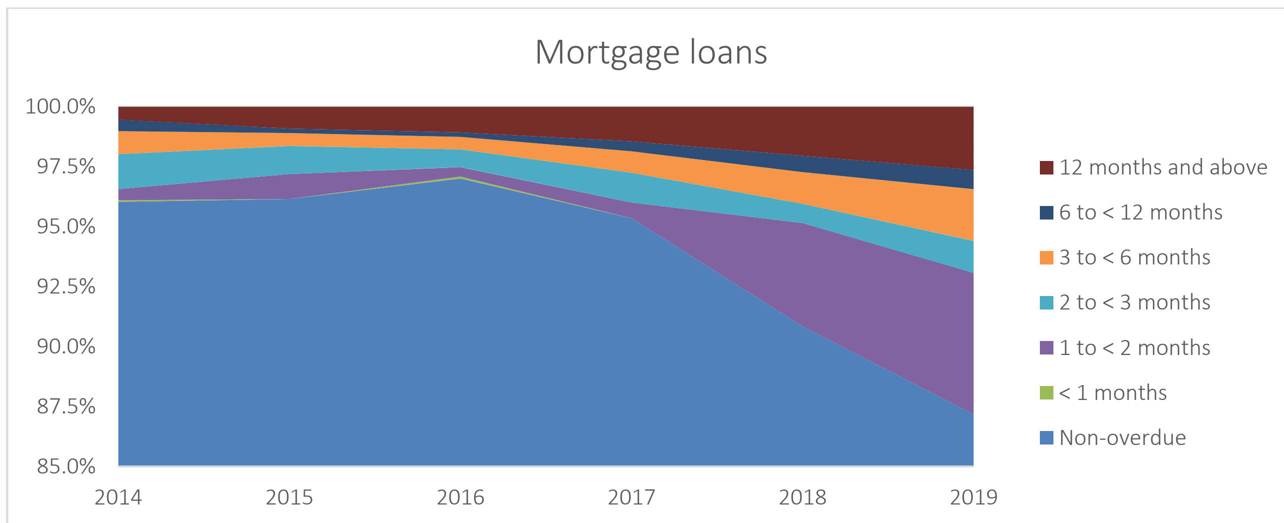


Source: Bank of Namibia, IJG

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. 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.

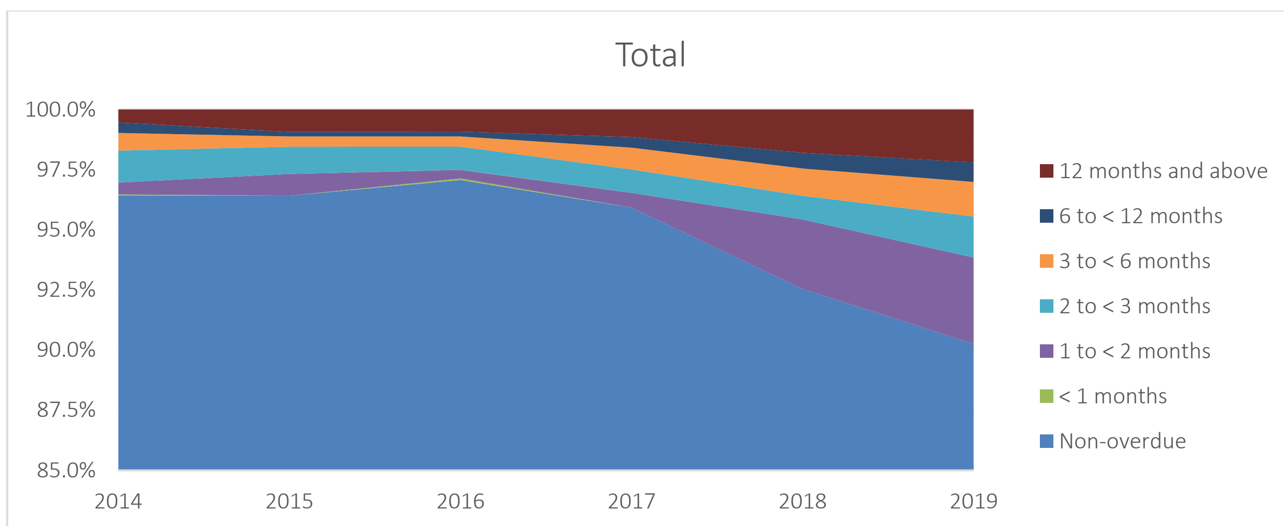
Banking Sector Credit

The effect of the economic slowdown is clearly evident in banking sector arrears and has filtered through to the results of most of the commercial banks. Lower disposable incomes and higher unemployment has resulted in the age of the industry's exposures deteriorating significantly over the last six months.



Source: Bank of Namibia, IJG

Mortgage loans have been one of the worst hit categories with 12.8% of the country's loans in arrears. 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.



Source: Bank of Namibia, IJG

Higher non-performing loans will translate into higher impairments for the sector. It also seems as if the implementation of IFRS 9 could not come at a worse time for the banking sector as many of the loans currently classified as stage 2 would previously not have been provided for. Additionally, the poor economic outlook will further increase portfolio impairment charges. Namibian banks historically had unreasonably low credit loss ratios and the implementation of the new standard will likely be a more accurate reflection and provides for impairments before they happen, softening the blow of once-off write-offs. Additionally, in the unlikely event

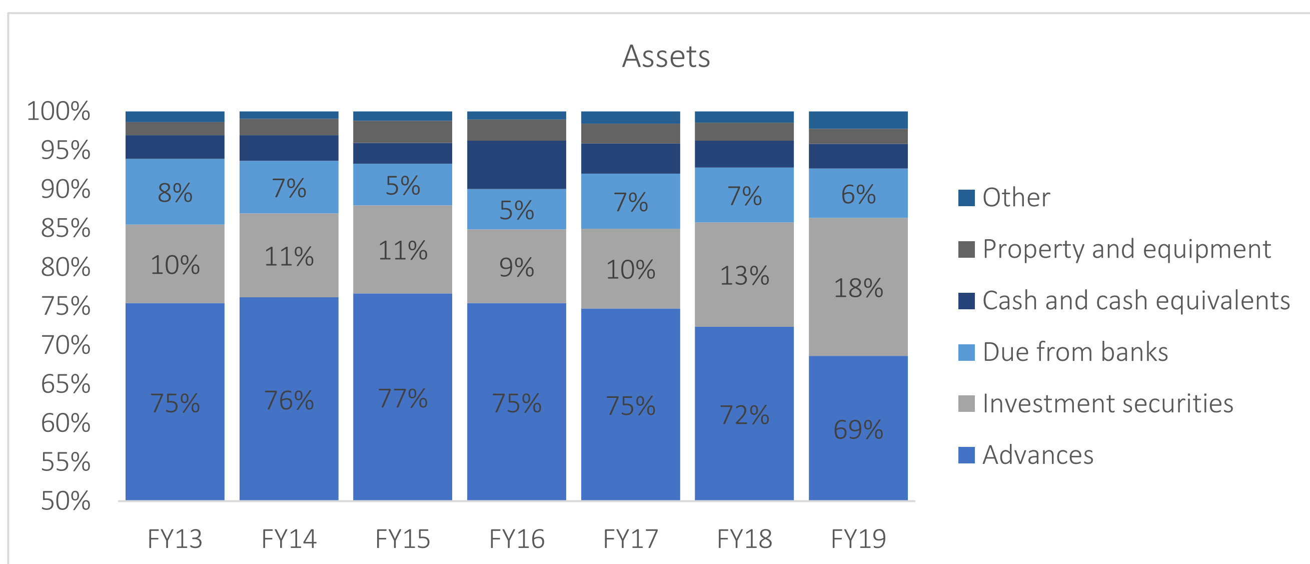
that the outlook for the Namibian economy quickly changes for the positive, there is a chance of provisions being released.

Net Interest Income

Asset Base

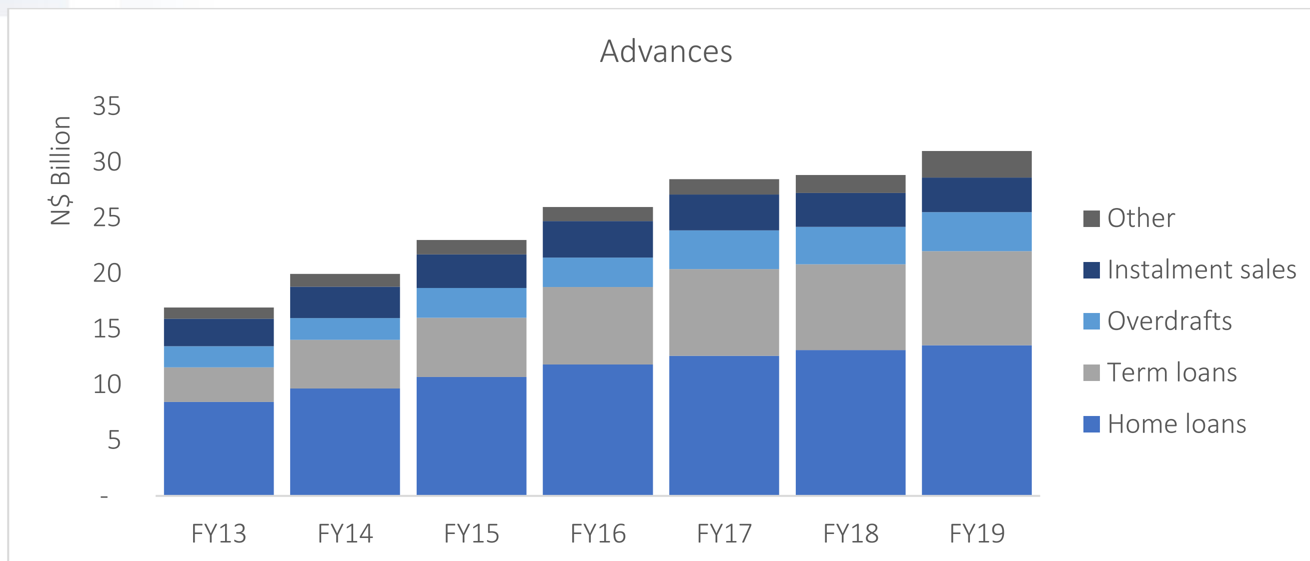
Total assets grew by 12.0% or N$4.729 billion on the back of strong growth in deposits. However, total advances grew by only 6.2% or N$ 1.766 billion. As a result, a large amount of the funding raised was directed to investment securities, which increased by N$2.541 billion. Of this N$1.376 billion was invested in government treasury bills while N$1.111 billion was added to the company's government bond position. Total investment securities totalled N$7.809 billion and made up 18% of the balance sheet.

As previously mentioned in the FY19 initial impression, the scarcity of lending opportunities has been the main reason for the accumulation of liquid assets. This was also the reason for the special dividend, as the bank has become overcapitalised and the large proportion of risk-free securities in the form of government bonds and treasury bills has become a drag on overall performance.



Source: FNB, IJG

Another interesting development has been the large increase in derivative securities on the company's balance sheet. According to the statements, the group transacts in derivatives for two purposes: "to create risk management solutions for clients and to manage and hedge the group's own risk". The notional value of derivative assets has increased from N$1.543 billion in FY18 to N$6.230 billion, while derivative liabilities have increased from N$2.668 billion to N$6.591 billion. Roughly 60% of these derivatives are currency hedges while 40% are interest rate hedges. This would indicate that FirstRand has grown its risk management book quite aggressively in the last year which should be a driver of non-interest revenue going forward.

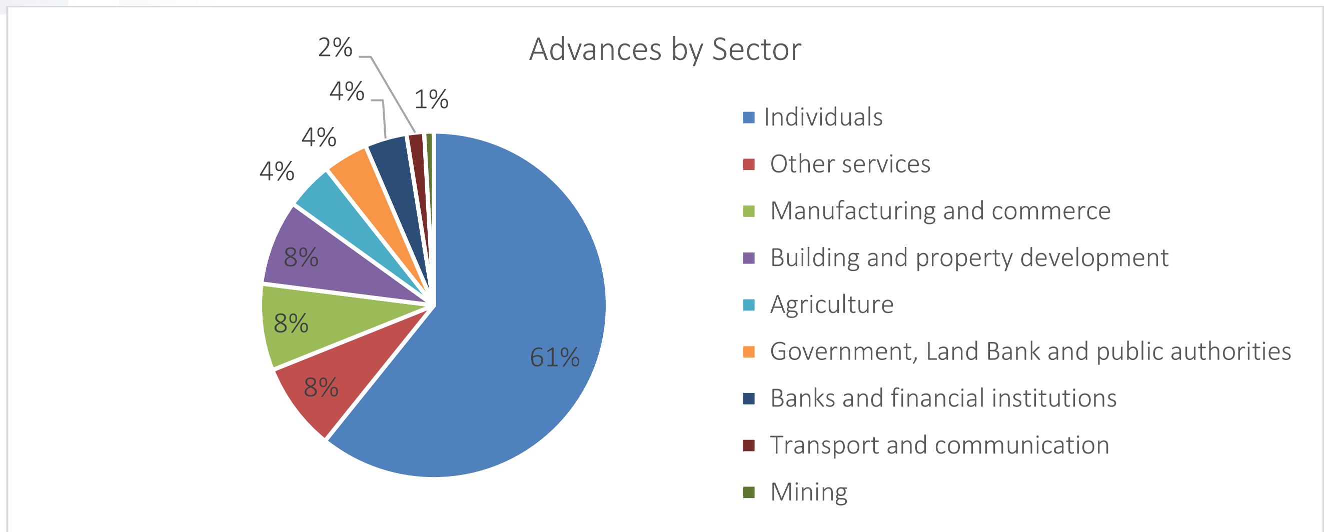


Source: FNB, IJG

The 6.2% growth in advances was driven largely by term loans, which grew by 9.6% y/y or N$736.2 million. Term loans now make up N$8.433 billion or 27.2% of total gross advances. On the other hand, mortgage loans growth remained slow, increasing by only 3.3%. Mortgage loans now make up N$13.549 billion or 43.7% of the total advances book, from 45.5% in FY18. Management has indicated that they expect growth in mortgage loans to remain relatively slow over coming years. They have also added that the relaxation in the loan to value regulations will not impact their lending practices, which have generally applied more stringent affordability metrics.

We expect advances to continue to grow at roughly 6.0% over the next three years, driven mostly by increases in term and cash management accounts, slightly below our expectations for overall private sector credit extension. As management have repeatedly pointed out, their objective is not to aggressively grow market share, but rather to provide a sustainable return on equity for the shareholders. Thus, the lower than overall market growth does not concern them as much as extending quality, recoverable, credit.

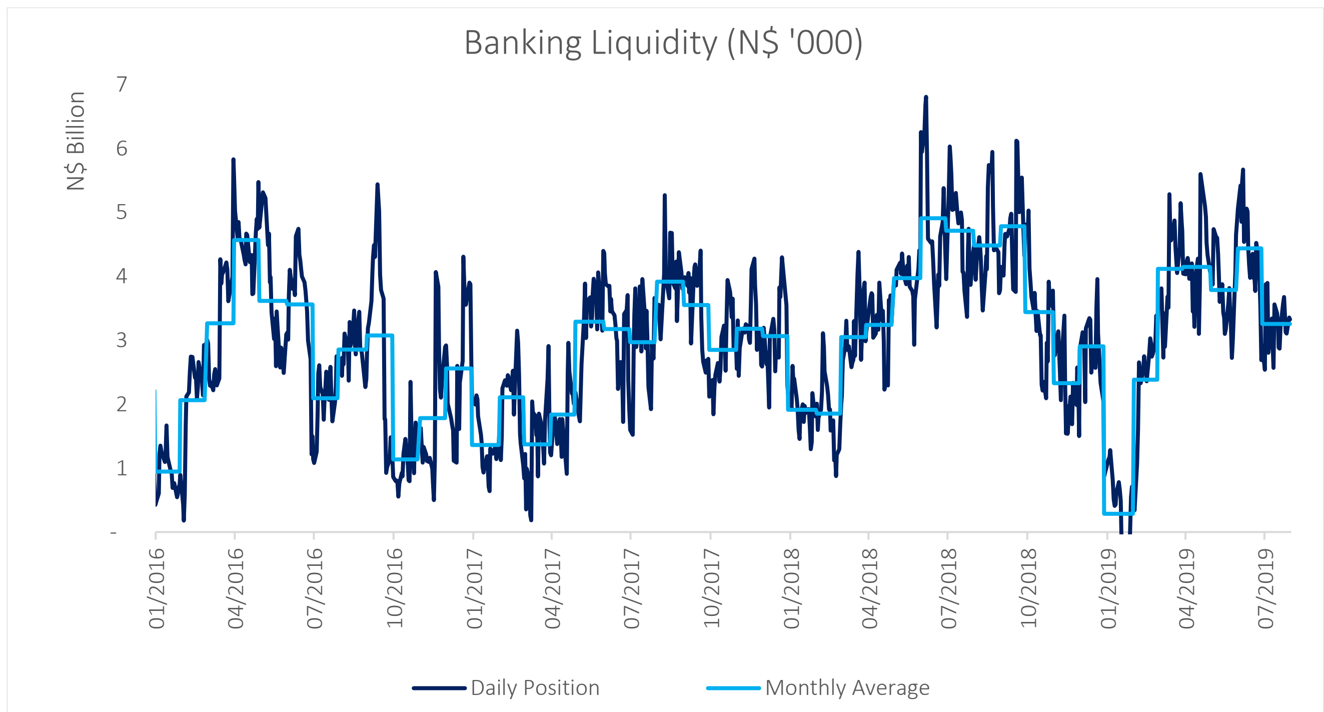
Overdrafts and cash managed accounts grew by 4.7% to N$3.515 billion or 11.3% of the book. However due to their shot term nature the closing balance may vary widely from the annual average amount outstanding. Instalment sales displayed growth of 1.2% despite June 2019 vehicles sales showing a 5.7% contraction on a rolling 12-month basis.



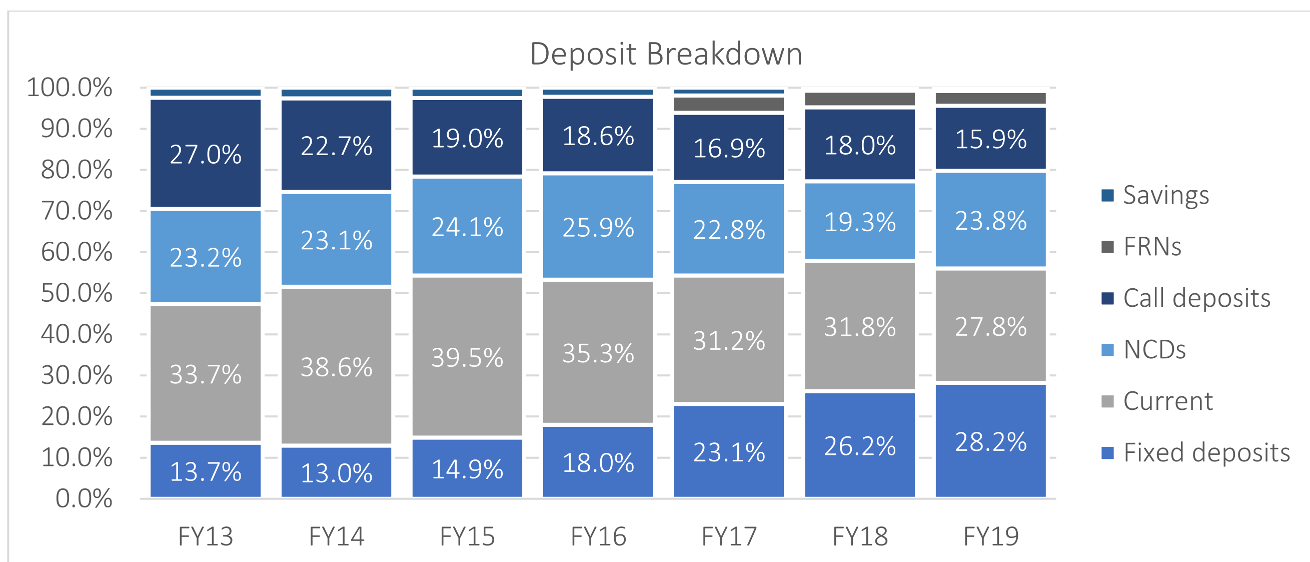
The sectorial makeup of the book remained relatively unchanged. Individuals still make up the majority of loans, but this has decreased from 64% in FY18 to 61% in FY19, with most of the growth in the corporate space seen in the "other services" sector.

Funding

Average liquidity has been reasonably high in the Namibian market over the review period. Save for a large dip in the month of January, the frequently low levels of 2016/2017 have not been witnessed in the last two years. A large amount of the capital influx could be attributed to the change in domestic asset requirements, which now require pension funds to invest 45% of their assets locally. This was combined with zero net issuance of treasury bills by the Namibian government, which normally compete for the same pool of funds. As a result of the increased demand and generally lower interest rates, yields on banks deposits have been falling and many banks are quite a comfortable position in regard to deposit funding.



FNB Namibia has used the opportunity to grow its funding book in FY19. Total deposits grew by 13.8% y/y or N$ 4.340 billion from N$31.546 billion in FY18 to N$35.886 billion. Some of the increase in funding being earmarked for the payment of the special dividend. Much of the increase in funding came from the issuance of negotiable certificates of deposit, which increased by N$2.440 billion or 40.1% y/y. Fixed, and notice deposits made up the rest of the increase, climbing by 22.7% or N$1.873 billion.

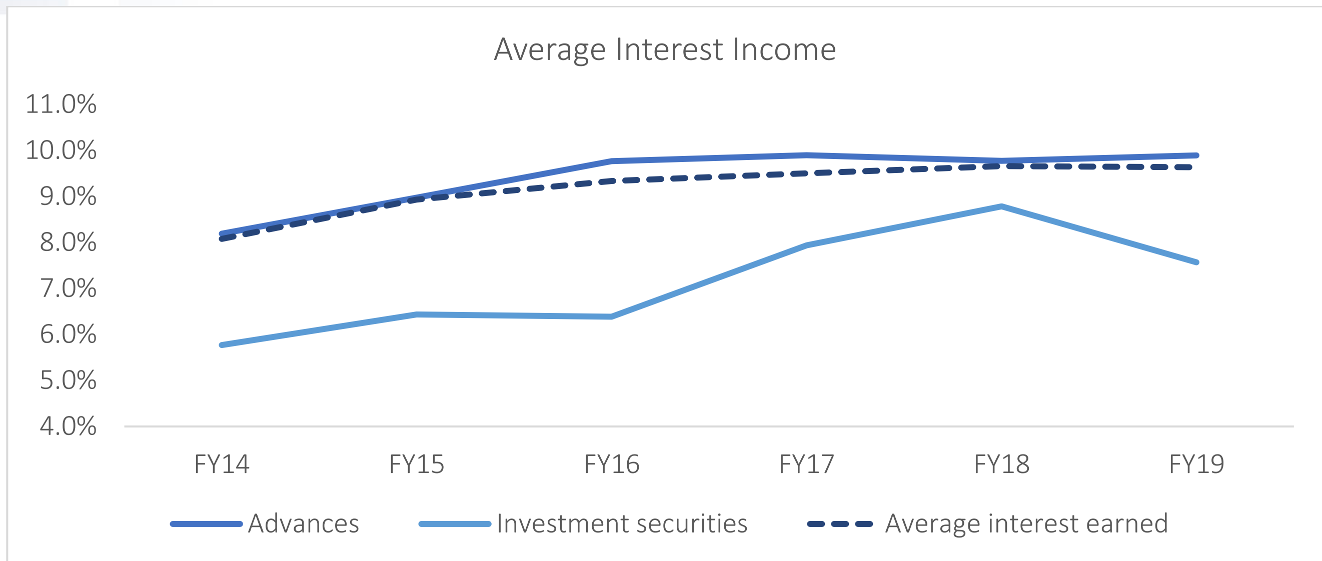


Source: FNB, IJG

Current accounts declined by 0.4% y/y while call deposits grew by only 0.1% y/y. No new floating rate notes (FRNs) were issued in the period. As a result, the overall funding mix changed a bit from last year as the split or retail (Savings, call and current accounts) to wholesale Funding (NCDs, FRNs and Fixed Deposits) has changed from 51:49 in FY18 to 44:56 in FY19. Seeing as the group is well funded, management have indicated that they are considering not rolling the N$400 million worth of tier 2 liabilities, which are callable in 2022 as well as roughly N$200 million other funding liabilities maturing over the next three years.

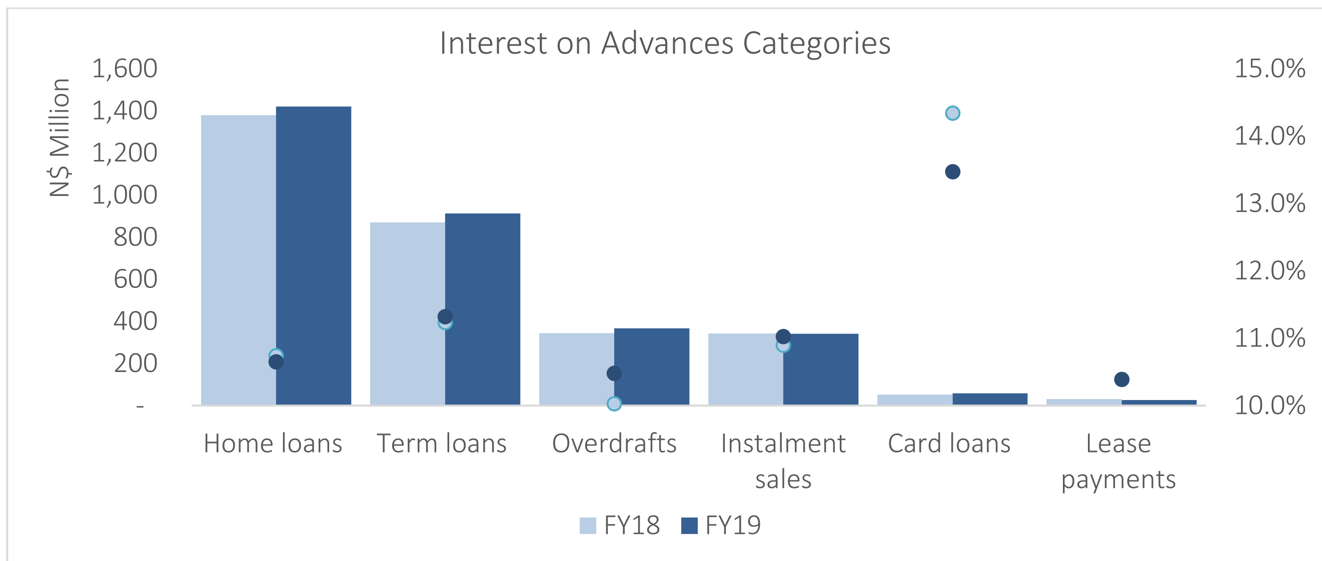
Interest Income and Expenses

Total interest income increased by 7.9% y/y to N$3.865 billion. The average interest on advances increased slightly from 9.8% to 9.9%, while the average interest earned on investment securities declined from 8.8% to 7.6%. The decline in the yields on government securities is expected to continue in the short-term, as demand on government treasury bill and bond auctions remain strong as investors compete for local assets. This further supports the claim that an increasing proportion of investment securities on the balance sheet will lead to a drag on performance.



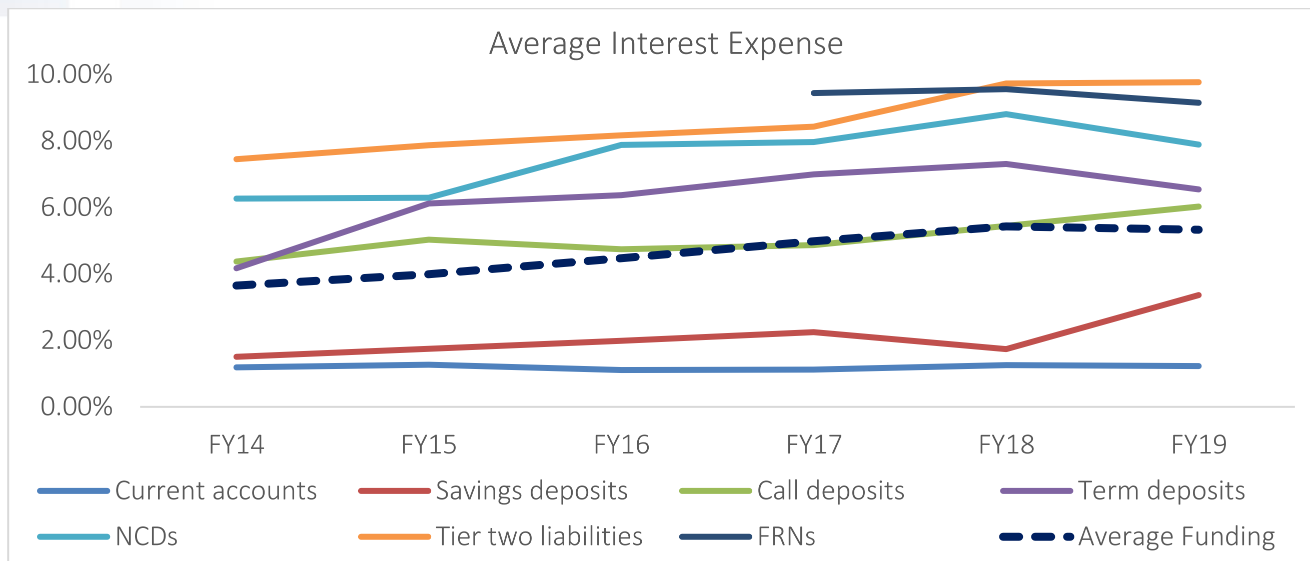
Source: FNB, IJG

As for the individual advances categories, home loans continued to be the largest contributor, flowed by term loans. On a year-on-year basis, the average interest rate charged on these categories remained relatively unchanged. Some of the increase in the average interest in advances could be explained by the increase in term loans relative to home loans.



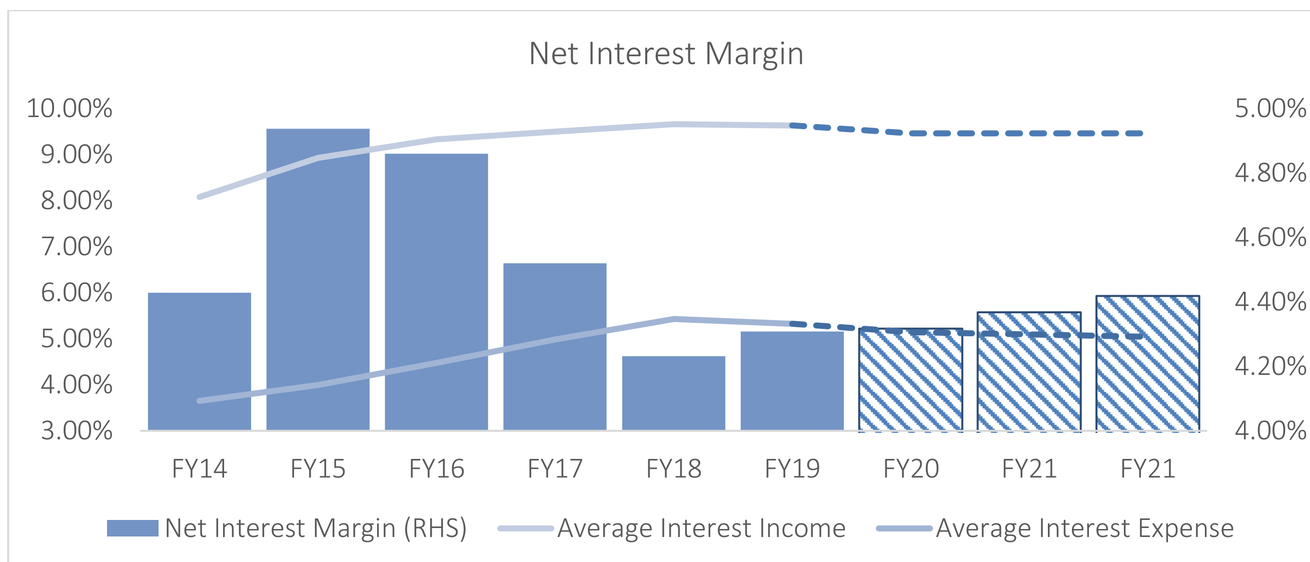
Source: FNB, IJG

Total interest rate expense increased by 5.1%, despite total advances growing by 13.8%. Although FNB's funding mix has tilted to the more expensive forms of wholesale funding, declining interest rates has allowed FNB's average cost of funding to fall from 5.4% to 5.3%. The average rate on NCDs declined from 8.8% to 7.8%, while term deposit funding dropped from 7.3% to 6.5%. Interestingly, the interest rate on savings deposits doubled from 1.7% to 3.4%, however, this only makes up 0.8% of the bank's deposit book and the effect was negligible.



Source: FNB, IJG

Seeing as the growth in interest income exceeded the growth in interest expense, net interest income grew by 10.5% y/y to N$2.012 billion. Following the decline in average interest expense while average interest income remained stable, the net interest margin improved over the last year. We expect interest rates to decrease slightly over the next two months after which we expected them to remain stable. Over the next three years we expect FNB to aim to move back to their 50:50 retail-wholesale funding split and the net interest margin to open up slightly.



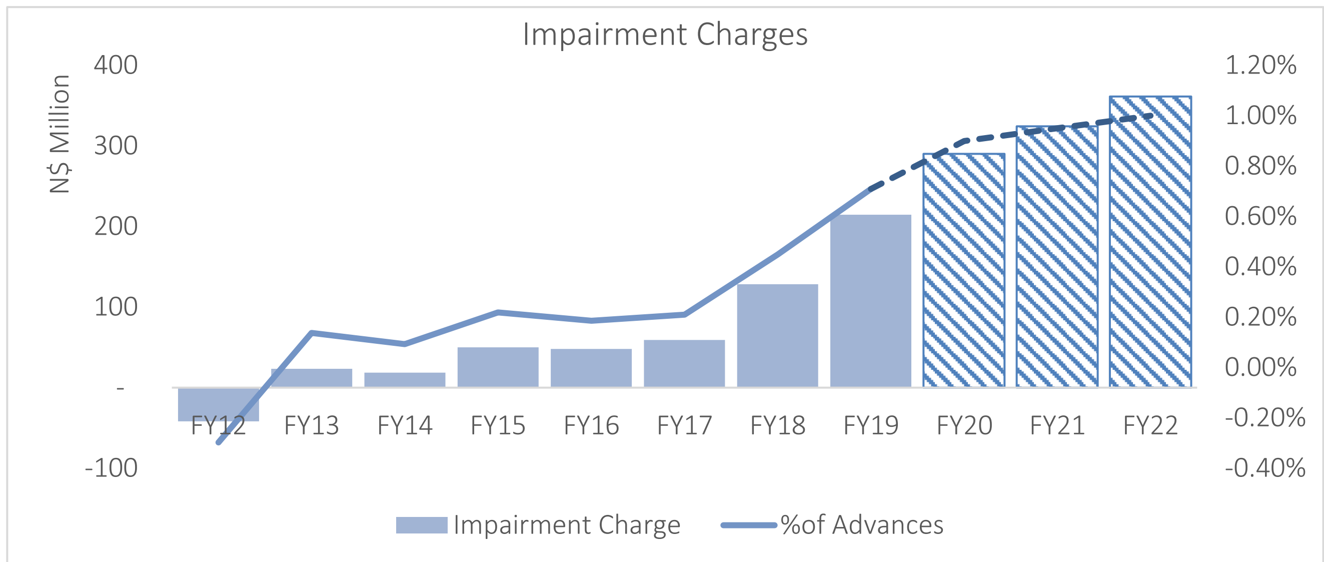
Source: FNB, IJG

Impairments

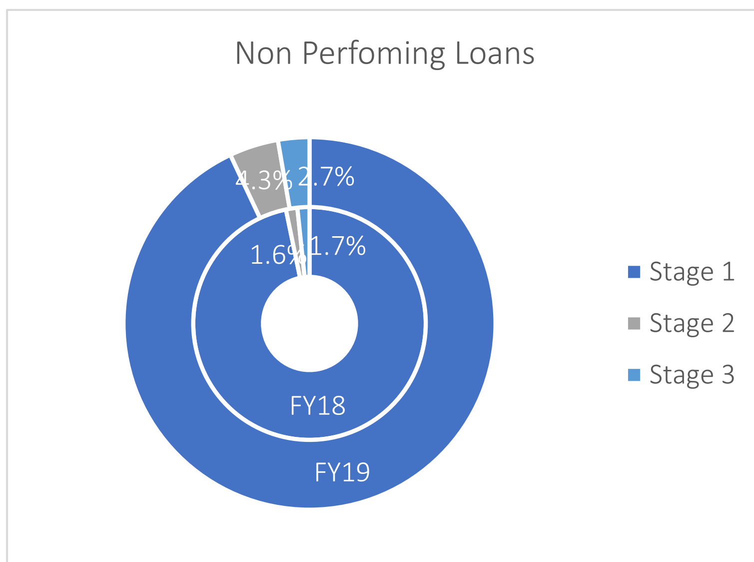
The total impairment charge increased by 67.5% y/y from N$128.3 million to N$214.8 million. This represented an increase from 0.45% of advances to 0.71%. However, the increase should be seen in the context of the change of accounting standards from IAS 39 to IFRS 9. FY19 is the first financial year that the group has adopted the new standard and has fundamentally changed the way that financial institutions calculate impairment charges. The biggest change in the standard is that IFRS 9 impairments are based on expected credit losses while IAS 39 was

based on an incurred basis. Expected credit losses thus uses forward looking information and is based heavily on macroeconomic projections.

Following the deterioration in the macroeconomic outlook, portfolio impairments on the performing book (Stage 1 and Stage 2) increased. We do not expect a blowout in impairment charges over the next three years, but do expect a systematic uptick, given the continuing economic headwinds. As a result, we have modelled an increasing impairment charge, up to 1.00% of advances by FY22.

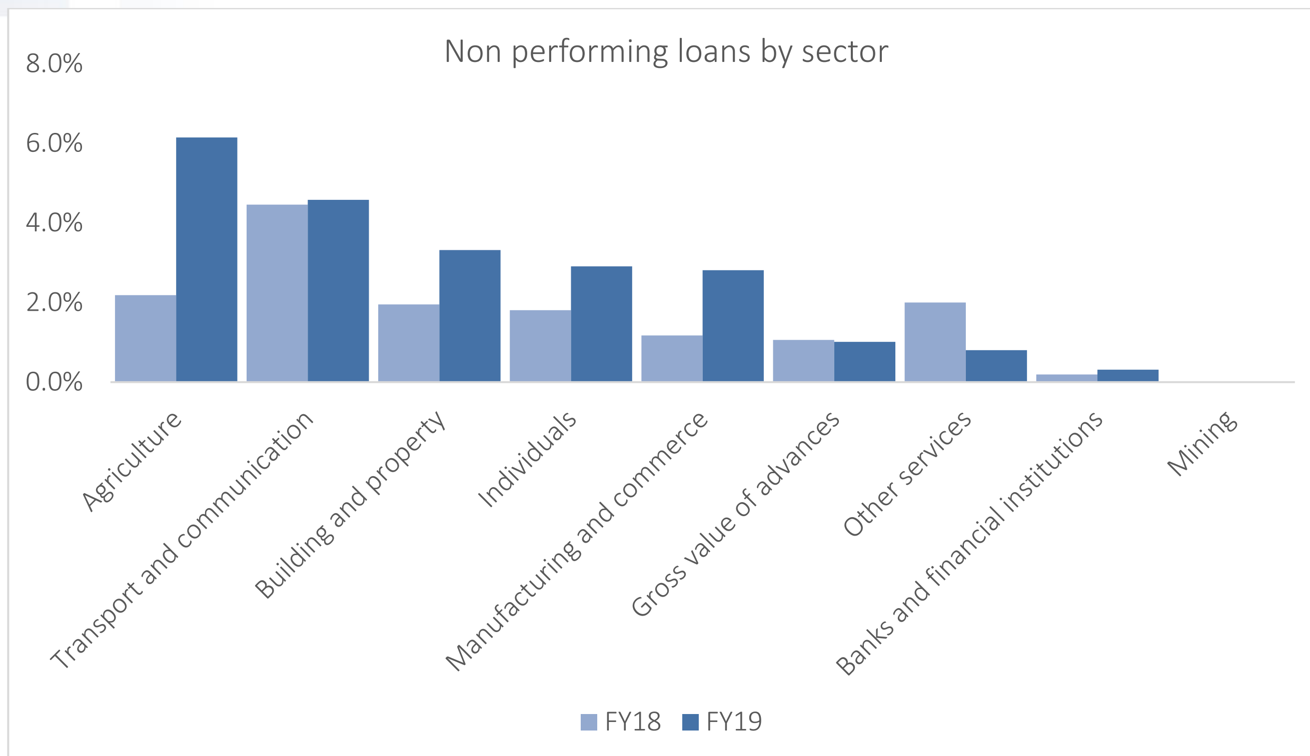


Source: FNB, IJG



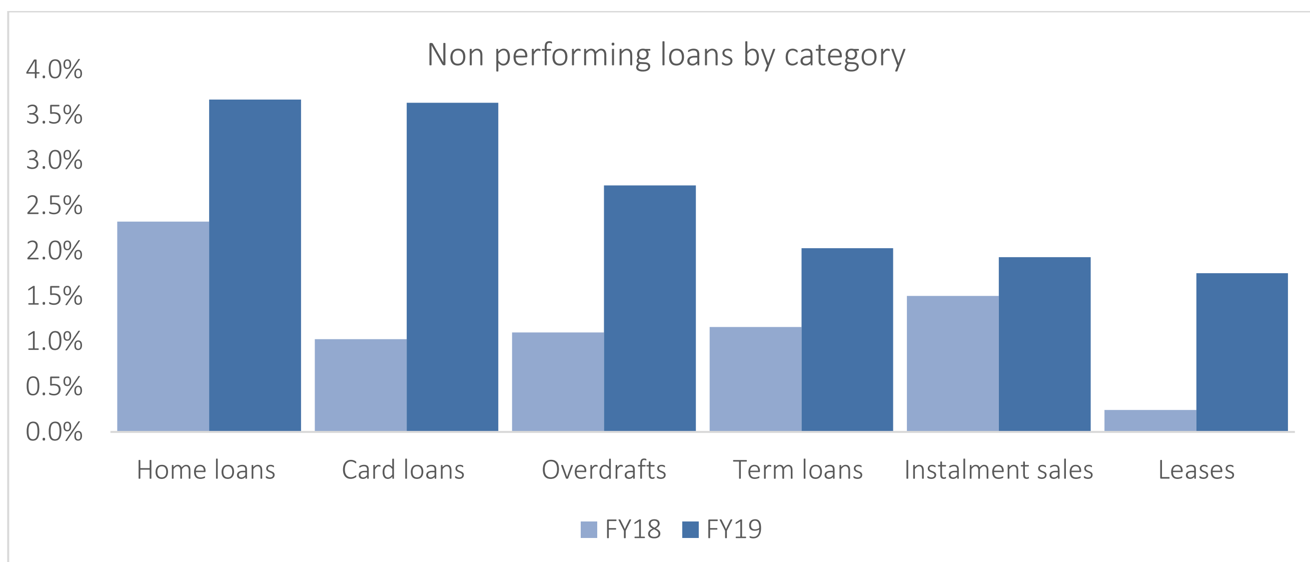
The ratio of non-performing loans (Stage 3) to gross advances increased from 1.9% to 2.7% or from N$549 million to N$845 million in dollar terms. Given the current phase of the business cycle and the industry average of 9.7% arrears, the increase does not ring any alarm bells.

However, stage 2 advances, which normally represents one missed payment, have increased from 1.6% to 4.3%, showing there is some deterioration in the age of the loan book.



Source: FNB, IJG

Unsurprisingly, the largest jump in non-performing loans came from the agricultural sector, which increased from 2.2% to 6.1% of total advances. However, agriculture makes up only 4.4% of the total portfolio. Building and property development also saw their non-performing loans tick up from 2.0% to 3.3% as the construction industry continued to contract. Individuals were the largest contributor to the overall non-performing loans, showing an increase from 1.8% to 2.9%, while this sector which makes up 61% of the loan book.



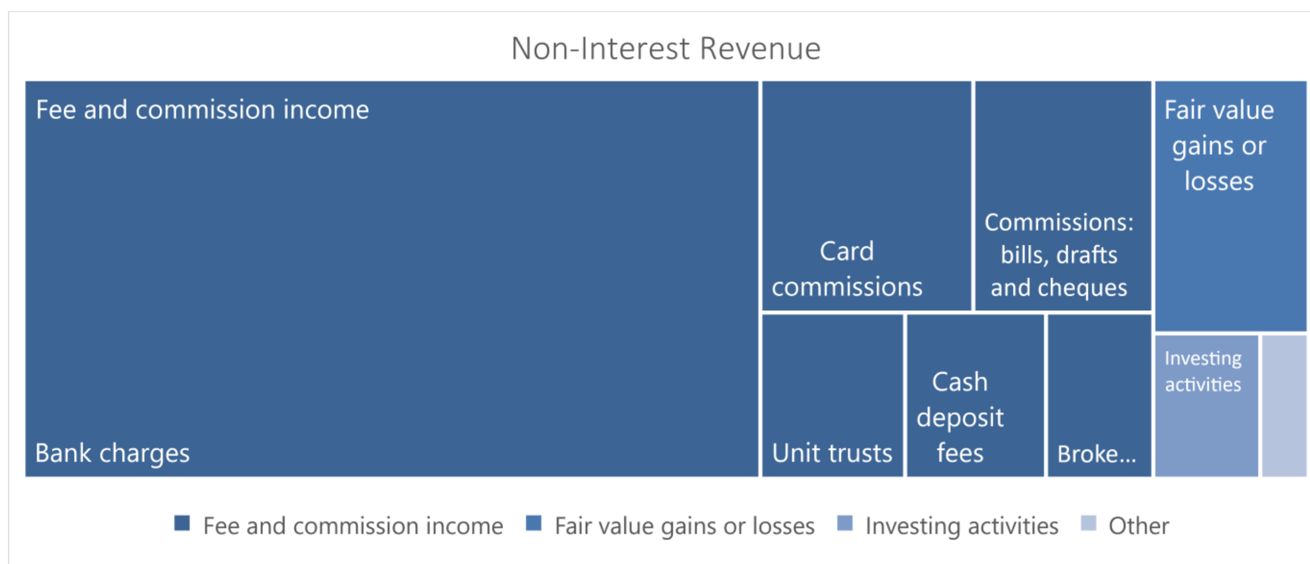
Source: FNB, IJG

Non-performing loans over different loan categories have seen considerable increases across the board. This is especially evident in card loans and overdrafts. However, this is most likely since undrawn facilities are also being provided for under IFRS 9.

The increases in the home loans category is slightly worrying, as this makes up 43.7% of the total advances book. Mortgage loan NPLs increased from 2.3% to 3.7%. However, this is a much better figure that the industry aggregate of 9.7% NPLs as suggested by Bank of Namibia's aggregated banking sector credit data.

Non-Interest Revenue

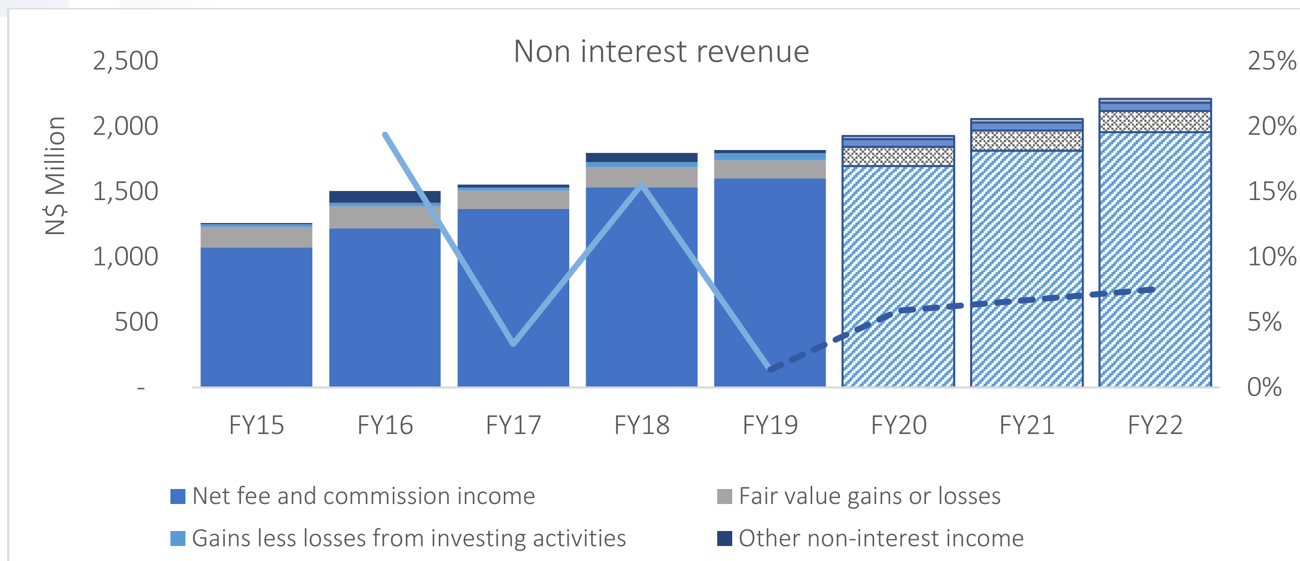
Non-interest revenue increased by 1.4% y/y to N$1.820 billion in FY19. However, normalising for the sale of property in FY18, which was a once off item, non-interest revenue showed growth of 4.2% y/y. Fee and commission showed income growth of 4.4% y/y driven largely by strong growth in card commissions (+12.0% y/y) and bank charges (+7.9% y/y). Cash deposit fees and commissions on bills, drafts and cheques declined by 3.1% and 4.0% as the migration to digital channels continues.



Source: FNB, IJG

The growth in card commissions was bolstered by the introduction of the rewards program. Rewards has encouraged a lot more use of credit cards where customers can earn up to 2.25% on of their spend as cash back. The increased use of credit cards has the added benefit that FNB has more data on consumer spending patterns and behaviour, an area which management have indicated they would like to further develop.

The insurance division continues to show low growth as the industry has been hit hard by the slowing macro environment and increased regulatory burden. Insurance premiums have declined to N$167.2 million as premium increases have been low as the value of assets insured depreciate. Additionally, there has been increased competition in the sector and an increase in lapses due to non-payment of premiums. Claims paid for the period marginally declined to N$86.2 million, yielding a net income of N$81.0 million. Despite the low growth, management have indicated that the book they currently have is of good quality and generating strong returns. Seeing as insurance is one of the group's key financial services offerings, they will continue to invest time and resources into this business.

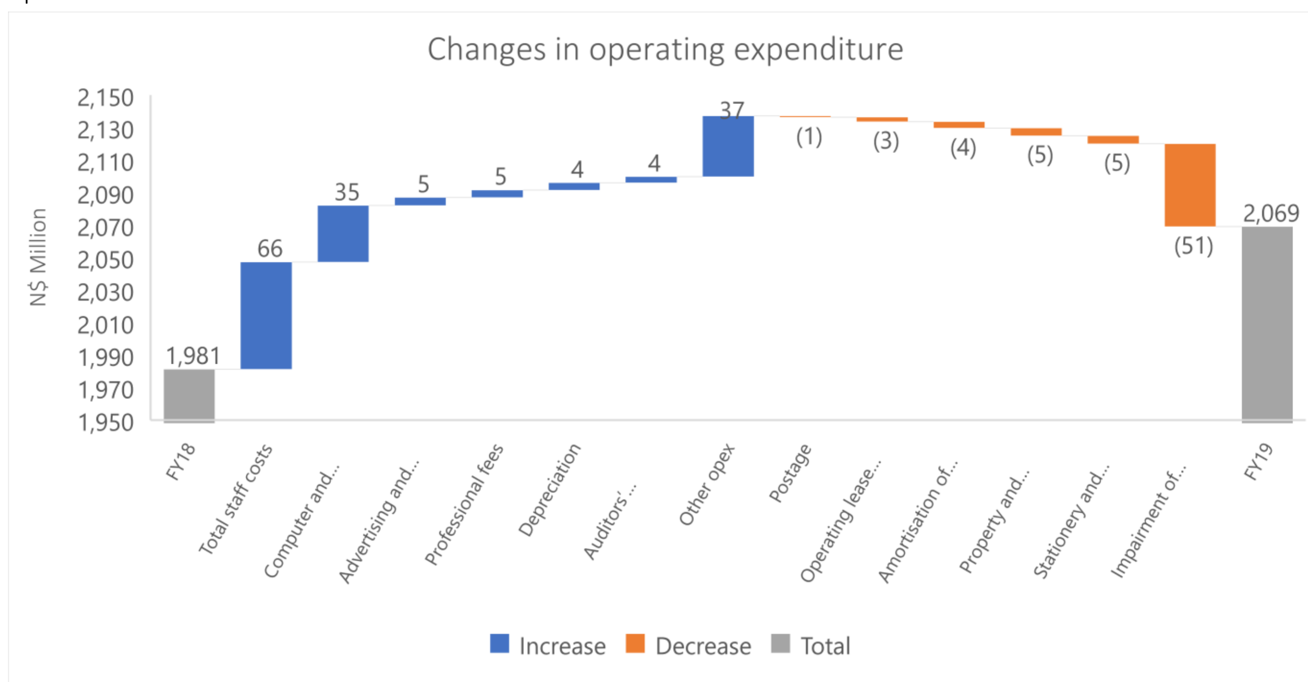


Source: FNB, IJG

Looking forward, we expect low but continued growth in non-interest revenue driven by increased transaction volumes through digital platforms. This should be accompanied by lower growth branch expenditure as less feet travel trough the physical points of presence.

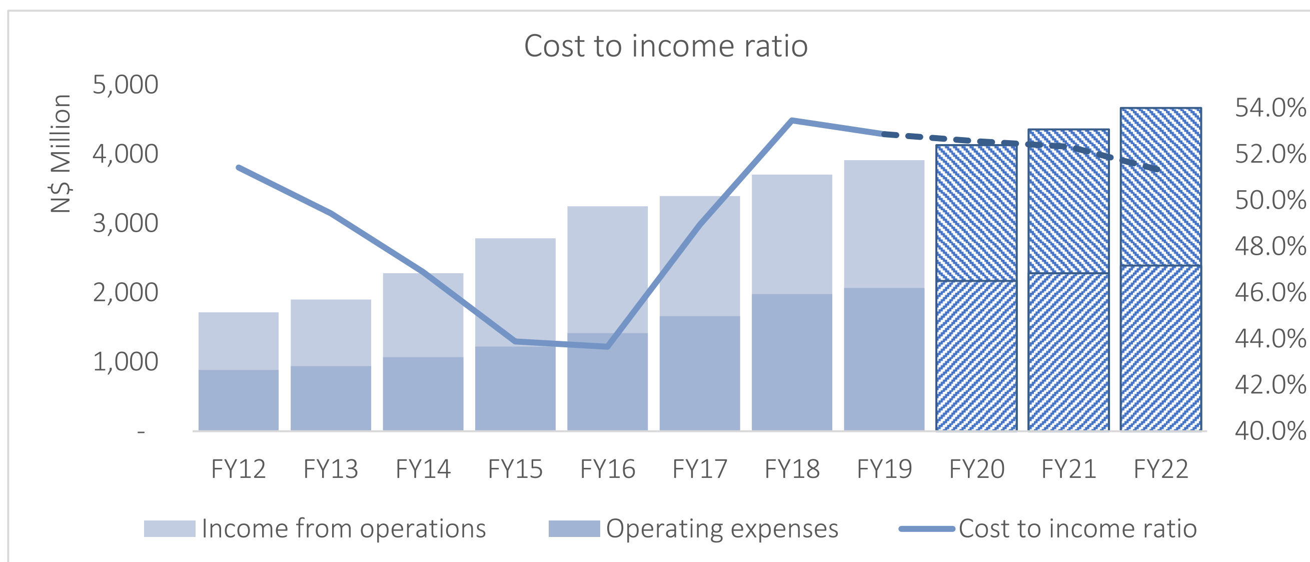
Operating Costs

Operating costs were well contained, increasing by 4.4% y/y or N$87.7 million from N$1.981 billion to N$2.069 billion. However, normalising for the impairment on the EBank trademark and software intangible assets (totalling N$39.3 million), operating costs increased by 6.5%. Staff costs accounted for the bulk of the increase, up 6.2% y/y or N$65.9 million. Staff costs made up 54.4% of total operating expenditure. IT related costs was the second largest contributor, up 11.2% y/y or N$34.8 million as the group continues their drive to digitalise operations.



Source: FNB, IJG

A large amount of savings has been seen in "analogue" expenses, such as postage down 15.1% y/y and stationery and printing expenses, which have reduced by 36.2%. Although small components of total operating expenses, the reduction in these line items highlight the groups focus on efficiency and cost management, which is increasingly important as revenues come under pressure. IT costs however, will likely continue to grow in the double digits as this represents continued investment into the digitisation drive.

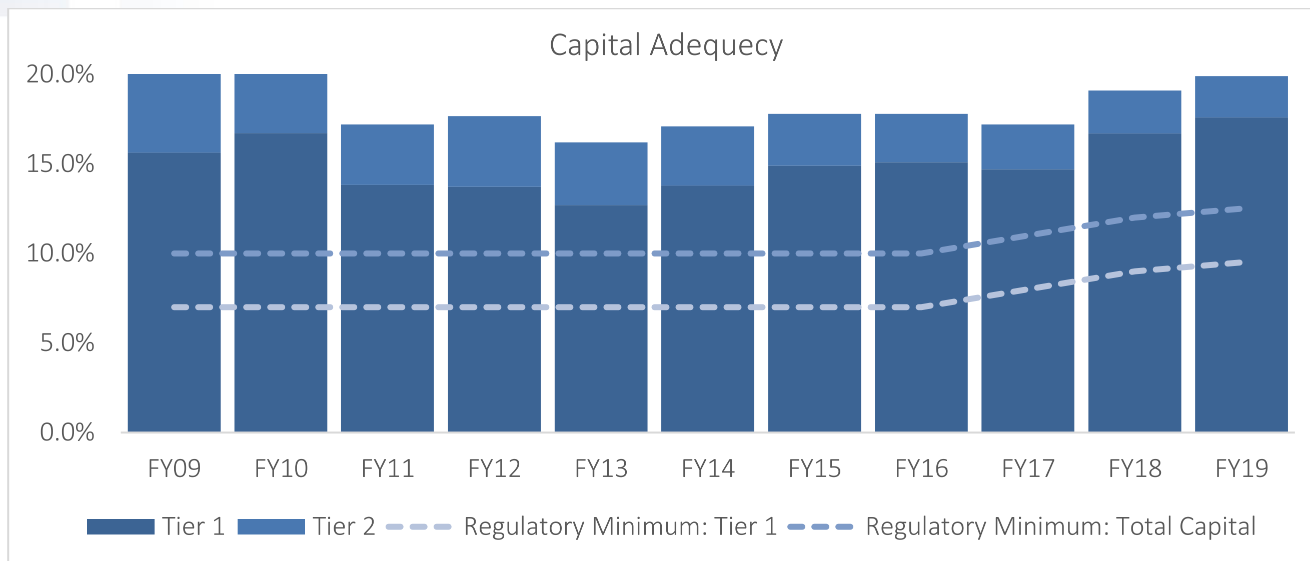


Source: FNB, IJG

As a result, we expect the cost to income ratio to trend slowly towards 50% as the investments into digitalisation start to bear fruit and non-interest revenue from digital channels starts to offset the slowdown in other non-interest revenue segments.

Capital Adequacy

The group remained well capitalised at levels significantly above the minimum regulatory requirements. Capital adequacy ratio for the group was 19.9% and Tier 1 capital 17.6%. The 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% by 2022.



Source: FNB, IJG, Bank of Namibia

Outlook

In period from about 2010 to 2016 the Rapid credit growth fuelled fast-rising house prices and elevated private sector indebtedness. Now the Namibian economy has stagnated for the last three years and some stresses are starting to show. Thus far the financial sector has been quite resilient, but the banking industry's assets quality has deteriorated.

However, FNB has always been committed to prudent credit risk management and has been very well positioned in this slowdown. This is evident when comparing the credit metrics with the rest of the industry over the last ten years and especially now that time have gotten a bit tougher. The attention to diversifying of revenue streams and focus on cost efficiency have led to a resilient bottom line. The group has made the most of the current liquidity environment to reduce their overall cost of capital and safeguard investor's return on equity, which the management is taking care to make sure is long term sustainable. Given these facts we are quite comfortable with the group's current positioning and confident in continued performance despite the environment.

Valuation

The ordinary shares of FirstRand Namibia have been valued using a panel of standard valuation techniques. 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 14.48% based on a 9.43% yield on the IJG generic 10-year bond, and equity risk premium of 4.05% and a beta of 1.0 and a country risk premium of 1.0%.

The sustainable growth rate was estimated to be 9.50% based on a long tern sustainable return on equity of 19.0%, (which has been revised lower from 20%) 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	10,752,155	41.14	10.0	9.6	1.99	2.02	5.06%	5.27%	20%
Residual Income	11,270,568	43.12	10.5	10.1	2.08	2.12	4.82%	5.03%	20%
Dividend Discount	10,295,206	39.39	9.6	9.2	1.90	1.93	5.28%	5.51%	20%
Justified Price to Earnings	10,756,484	41.16	10.0	9.6	1.99	2.02	5.05%	5.27%	20%
Justified Price to Book	10,329,076	39.52	9.6	9.2	1.91	1.94	5.26%	5.49%	20%
Weighted Average	**10,680,698**	**40.87**	**10.0**	**9.6**	**1.97**	**2.00**	**5.10%**	**5.31%**	**100%**

Source: IJG

Based on the table above, we derive a target price of N$c4087 per share. Coupled with an expected full year dividend of 214 cps, we expect a total return of 28.9%. We believe the sell-off and resultant drop in price are overdone, and as a result see value in the share at the current market price. We maintain our BUY recommendation on this counter.

IJG

Summary of Financial Statements

Year End June (N$ 000)	FY18	FY19	FY20	FY21	FY22
Interest and similar income	3,583,400	3,864,700	4,162,005	4,360,170	4,600,759
Interest expense and similar charges	(1,762,644)	(1,852,478)	(1,989,073)	(2,071,607)	(2,136,410)
Net interest income before impairment of advances	1,820,756	2,012,222	2,172,933	2,288,563	2,464,349
% Growth	*3.2%*	*10.5%*	*8.0%*	*5.3%*	*7.7%*
Impairment of advances	(128,261)	(214,809)	(289,978)	(324,514)	(362,363)
Net interest income after impairment of advances	1,692,495	1,797,413	1,882,954	1,964,049	2,101,986
Non-interest revenue	1,795,926	1,820,161	1,939,227	2,081,947	2,245,987
Net insurance premium income	185,015	167,217	163,873	160,595	157,383
Net claims and benefits paid	(96,151)	(86,201)	(84,477)	(82,787)	(81,132)
Income from operations	3,577,285	3,698,590	3,901,578	4,123,804	4,424,225
% Growth	*7.2%*	*3.4%*	*5.5%*	*5.7%*	*7.3%*
Operating expenses	(1,981,249)	(2,068,996)	(2,184,328)	(2,333,194)	(2,503,037)
Net income from operations	1,596,036	1,629,594	1,717,250	1,790,610	1,921,188
Share of profit from associate after tax	1,102	2,758	2,979	3,217	3,474
Income before tax	1,597,138	1,632,352	1,720,229	1,793,827	1,924,662
Indirect tax	(45,841)	(47,372)	(52,097)	(56,822)	(61,547)
Profit before tax	1,551,297	1,584,980	1,668,132	1,737,005	1,863,115
Direct tax	(490,589)	(499,170)	(533,802)	(555,842)	(596,197)
Profit for the period	1,060,708	1,085,810	1,134,329	1,181,164	1,266,919
% Growth	*-4.7%*	*2.4%*	*4.5%*	*4.1%*	*7.3%*

Year End June (N$ 000)	FY18	FY19	FY20	FY21	FY22
Cash and cash equivalents	1,345,842	1,390,195	1,490,195	1,590,195	1,690,195
Due from banks and other financial institutions	2,781,551	2,803,839	2,944,031	3,091,232	3,245,794
Derivative financial instruments	93,520	459,072	459,072	459,072	459,072
Advances	28,531,833	30,297,933	32,219,811	34,159,364	36,236,291
Investment securities	5,266,144	7,807,309	7,202,319	7,560,594	7,664,388
Accounts receivable	245,171	298,655	313,588	329,267	345,730
Investments in associate	25,321	28,079	29,483	30,957	32,505
Property and equipment	907,259	859,591	809,591	759,591	709,591
Intangible assets	180,613	162,552	142,552	122,552	102,552
Deferred income tax asset	32,347	28,943	31,975	31,088	30,669
Reinsurance assets	219	2,938	2,938	2,938	2,938
Tax asset	605	667	833	702	734
Total assets	**39,410,425**	**44,139,773**	**45,646,387**	**48,137,553**	**50,520,459**
Deposits	31,546,201	35,886,144	37,794,994	39,791,961	41,877,367
Due to banks and other financial institutions	897,408	427,776	427,776	427,776	427,776
Derivative financial instruments	93,520	459,072	459,072	459,072	459,072
Short trading positions	-	-	-	-	-
Creditors and accruals	378,114	385,631	405,520	389,755	393,635
Tax liability	186,646	185,530	142,803	171,660	166,664
Employee liabilities	247,337	248,927	273,820	301,202	331,322
Deferred income tax liability	323,672	400,842	327,251	350,588	359,561
Policyholders liabilities under insurance contracts	49,200	46,351	50,000	50,000	50,001
Finance lease obligation	-	-	-	-	-
Tier two liabilities	402,783	402,804	400,000	400,000	-
Other Debt Securities	-	-	-	-	-
Total liabilities	**34,394,369**	**38,725,541**	**40,318,479**	**42,219,159**	**43,997,682**
Capital and reserves attributable to ordinary equity holders of parent	4,943,411	5,352,627	5,257,922	5,839,682	6,435,134
Non-controlling interests	72,645	61,605	69,985	78,712	87,644
Total equity	**5,016,056**	**5,414,232**	**5,327,908**	**5,918,394**	**6,522,777**
Total equity and liabilities	**39,410,425**	**44,139,773**	**45,646,387**	**48,137,553**	**50,520,459**

Sensitivity Analysis

Sensitiviy Analysis

Price Per Share: 30.00, 35.00, 40.00, 45.00, 50.00, 55.00, 60.00, 65.00

Cost Of Equity: 13.50%, 13.75%, 14.00%, 14.25%, 14.50%, 14.75%, 15.00%, 15.25%, 15.50%

Legend: 8.50%, 8.75%, 9.00%, 9.25%, 9.50%, 9.75%, 10.00%, 10.25%, 10.50%

Source: IJG

Cost of Equity

Sustainable Growth Rate	13.50%	13.75%	14.00%	14.25%	14.50%	14.75%	15.00%	15.25%	15.50%
8.50%	42.03	40.30	38.71	37.25	35.89	34.64	33.47	32.38	31.35
8.75%	43.58	41.70	39.98	38.40	36.94	35.60	34.35	33.19	32.10
9.00%	45.31	43.24	41.37	39.66	38.09	36.64	35.31	34.06	32.91
9.25%	47.22	44.95	42.90	41.04	39.34	37.78	36.35	35.01	33.78
9.50%	49.38	46.86	44.61	42.57	**40.72**	39.03	37.48	36.05	34.73
9.75%	51.81	49.01	46.51	44.27	42.25	40.41	38.73	37.18	35.76
10.00%	54.59	51.43	48.65	46.17	43.94	41.93	40.10	38.43	36.89
10.25%	57.78	54.20	51.07	48.30	45.83	43.62	41.62	39.80	38.14
10.50%	61.50	57.39	53.83	50.72	47.96	45.51	43.31	41.32	39.51

Source: IJG

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