Securities (Pty) Ltd.
Member of the NSX

FNB NAMIBIA HOLDINGS

1H17 Results Review

APRIL 2017

FNB Namibia Holdings

1H17 Results Review

Target Price (c)	5012
Current Price (c)	4730

Year End 30 June	2015	2016	F2017	F2018	F2019
Net interest income (N$m)	1,453	1,654	1,680	1,816	1,845
Non-interest income (N$m)	1,260	1,507	1,612	1,741	1,898
Profit (N$m)	999	1,218	1,206	1,317	1,339
HEPS (c)	378	436	455	497	505
DPS (c)	183	213	211	224	227
DY (%)	5.6	4.5	4.5	4.7	4.8
P/E (x)	8.7	10.9	10.4	9.5	9.4
P/BV (x)	2.5	3.1	2.6	2.3	2.0

Recommendation	HOLD
NSX Code	FNB
Market Cap (N$m)	12,657
Shares in Issue (m)	267.6
Free float (%)	20
52 week high (c)	4850
52 week low (c)	4551
Expected total return	8.5%

Source: FNB, IJG, Bloomberg

1H17 Results Review

FNB Namibia released its results for the six months ended 31 December 2016. Profit for the period increased by only 0.3% to N$599.2 million, from N$597.4 million in 1H16. Earnings per share decreased by 0.1% to 226.3 cents, from 226.5 cents in 1H16.

Net interest income grew to N$886.7 million from N$815.5 million, or 8.7%, while non-interest income expanded by 4.7%, from N$744.2 million to N$778.9 million. Total income from operations expanded by 8.1% from N$1.57 billion to N$1.70 billion while operating expenses grew by 16.9% from N$677.6 million to N$791.9 million over this period. Due to the fact that income grew at a rate of 8.1%, while expenses swelled by 16.9%, the cost to income ratio of the company deteriorated to 46.3% from 42.4% a year ago.

Performance in 1H17 has been adversely influenced by a higher cost of funding. Although interest income grew by 16.0%, interest expense grew by 26.6% due to an increase in the cost of deposits. Due to a slower growth in customer deposits, more NCD's, and debt securities were issued pushing up the average interest rate paid which has squeezed the net interest margin.

Non-interest income expanded by 4.7%, from N$744.2 million in 1H16 to N$778.9 million in 1H17. The low growth figure was largely due to the high base set by the prior year's fair value gains from forex trading. Fair value gains decreased by 31.2%, from N$108.3 million to N$74.5 million. Net fee and commission income, on the other hand, expanded by 10.9%, or by some N$67.3 million.

Total operating expenditure increased by 16.7% to N$791.9 million, from N$677.6 million in 1H16. Staff related costs, which currently amount to more than 55% of operating expenses, were up 22.3%. Staff numbers grew by 9.2% while average salaries increased by 8.6%. Other operating costs, which make up slightly more than 40% of operating expenses, were up by 7.8%, largely due to increased computer and processing related costs.

The group's total assets grew by 6.7% to N$34.7 billion. Advances grew by 8.4%, in line with private sector credit extension which grew by 8.9%. PSCE growth has been slowing since mid-2015, thus a slowdown in advances was inevitable. As such, the book now stands at N$27.0 billion.

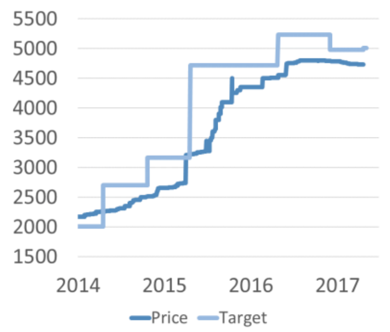
The bank's assets remain of a high quality, with total impairments for 1H17 of N$13.4 million, less than half of the N$31.7 million observed in 1H16. As a percent of the total book, this represents just 10 basis points, down from 13 basis points in the same period of the previous financial year. Non-performing loans have also remained quite stable, despite the difficult macroeconomic climate. From a level of 92 basis points in 1H16, NPLs now stand at 1.00% of the total book.

At the end of March 2017, FNB announced that all regulatory requirements have been met and FNB Namibia will acquire 100% of Pointbreak and EBank. This represents an area of future growth in non-interest income from asset management fees, larger customer base and a larger insurance book.

The bank declared an interim dividend of 91cps, unchanged from 1H16. This represents a payout ratio of 40.2% also unchanged from 1H16. The share went ex-dividend on 27 February 2017, and the payment date will be 15 March 2017.

For the purpose of valuing the company, we establish a **cost of equity, of 14.7%,** which consist of a risk-free rate of 10.7%, an equity risk premium of 3.0% and a liquidity premium of 1.0%. Based on this cost of equity, a conservative **long-term growth rate for the company of 9.0%,** and a **long term sustainable Return on Equity of 25.0%** we believe a **Price to Book multiple of 2.79x can be justified** on this share. Given **expected book value per share of 1,797c in FY17**, we derive **a target price of N$c5012 per share**. Coupled with an **expected final dividend of 120 cps**, we expect a **total return of 8.5% in 2H17**. Due to the low expected return and tough economic environment, which may continue for an extended period of time, we maintain our **HOLD** recommendation on FNB Namibia.

Share Price (c)



Dividends

Dividend (interim): 91c/share

Declaration date: 31 January 2017

Ex-date: 27 February 2017

Record date: 3 March 2017

Payment date: 15 March 2017

Analyst

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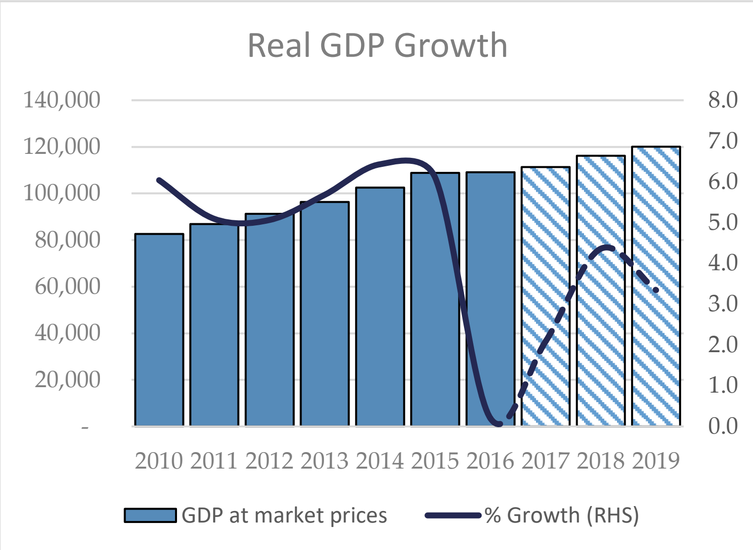
Macro backdrop

Growth environment

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



Source: NSA, IJG

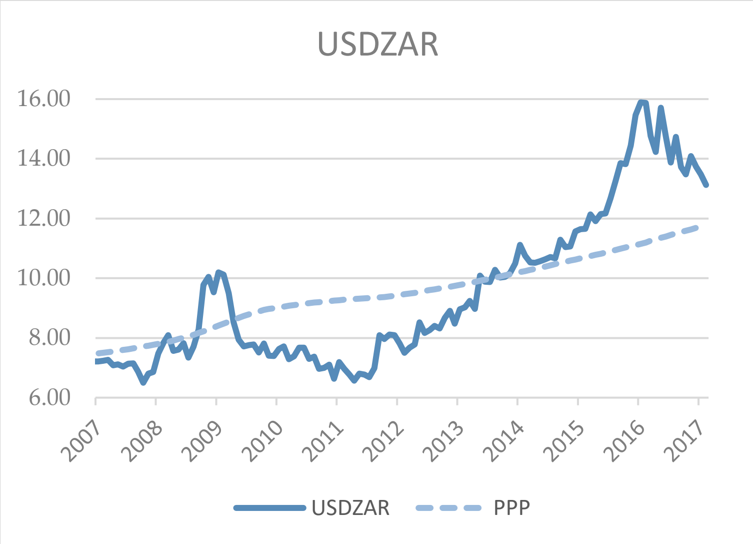
However, the picture has changed significantly and the growth environment in Namibia has deteriorated significantly over the last two years. After running expansive monetary and fiscal policy for the first half of the decade, the Ministry of Finance started to close the taps in the mid-term budget in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

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

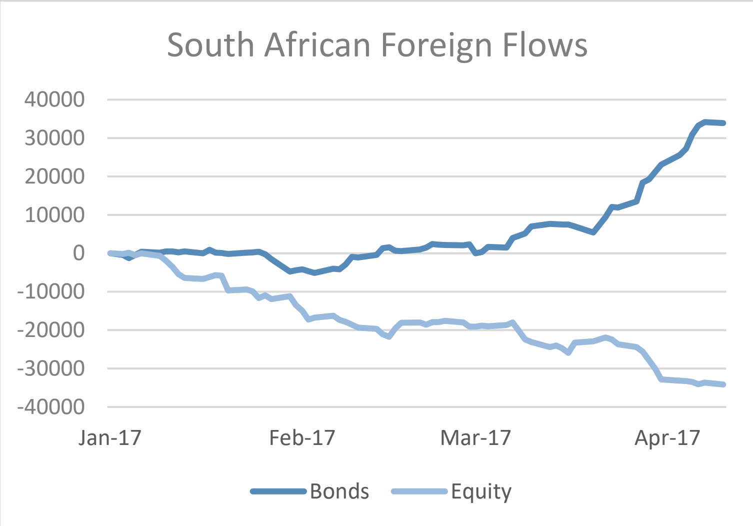
In addition to the slowing local economy, the downgrade of the South African credit rating has added another headwind for the economy. S&P were quick to respond with a downgrade of the foreign currency rating following the axing of the well-respected Minister of Finance Pravin Gordhan and his deputy.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

Exchange Rate

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



Source: Bloomberg, IJG



Source: Bloomberg, IJG

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

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

Inflation

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

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

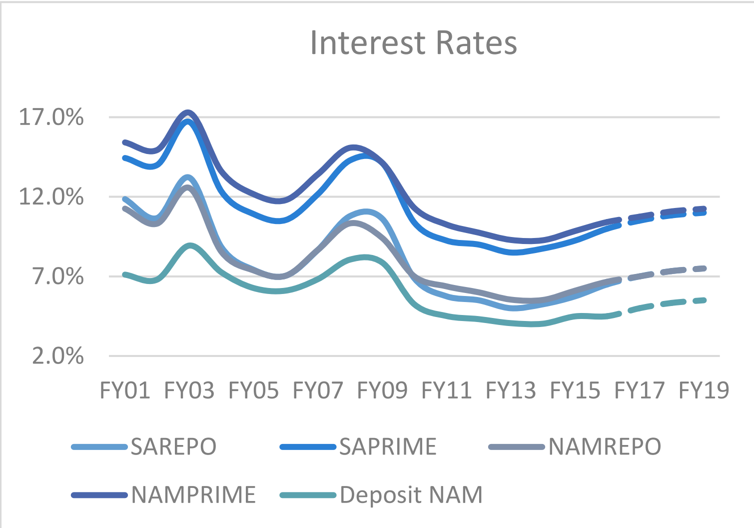
Secondly, petrol prices have been increased twice this year. Despite the oil price in rand having been flat year to date, the ministry of mines and energy continue to report under recoveries. Additionally, an increase in the fuel levy has been announced in this year's budget, however the magnitude of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

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

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

Interest Rates

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



Source: Bloomberg, IJG

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

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

Funding costs

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

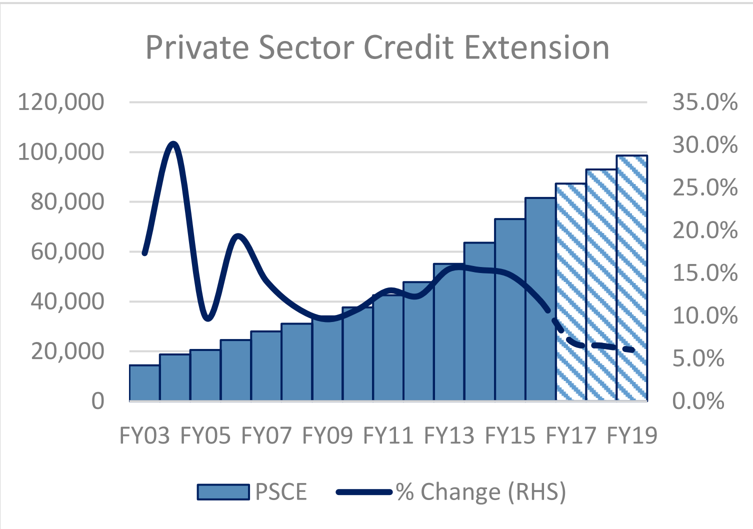
The large amount of government debt issuance combined with lower government spending has resulted in a difficult funding environment for banks. Firstly, the fiscal positon of government has become more strained, the management of government cash balances and payments have become more stringent. As a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

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

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

Credit demand and supply

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



Source: Bank of Namibia, IJG

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

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

Developments

Acquisition of Point break and EBank

At the end of March 2017, FNB announced that all regulatory requirements have been met and FNB Namibia will acquire 100% of Pointbreak and EBank. Approval was required, and has been received, from Namfisa, the Bank of Namibia, Competition Commission and South African Reserve Bank. The effective date of the transaction was 31 March 2017.

Pointbreak was established in 1999 as a private equity company and has since grown its offering to Investment Management and Wealth Management services to the private, corporate and institutional markets. Pointbreak currently has about N$8.50 billion worth of assets under management and has offices in Windhoek, Swakopmund and Cape Town. Pointbreak Wealth Management provides a full range of financial services to its private client base, including Money Market and financial transactional services, Investment portfolio management, retirement planning, trusts, will and estate planning, and short term insurance broking. The Investment management division includes corporate money market unit trusts, direct and indirect property portfolios and the management of the Stimulus Private Equity portfolio.

The addition of Pointbreak to the FNB stable should increase the investment management capabilities of the bank and coincides with the launch of Ashburton Investments in Namibia. FNB will also acquire very valuable human capital in the form of the Pointbreak team, should they decide to stay on. This will provide FNB clients with a wide range of investment opportunities, while complimenting the business of FNB well.

EBank Ltd was established by the Pointbreak Group. Their model provides affordable transactional banking services through a network of retail partners and merchants. EBank also provides access to banking services such as savings accounts, electronic payments and the purchase of electricity and pre-paid MTC airtime, through a choice of 3 channels, namely Mobile USSD, Mobisite or Internet Banking.

The acquisition of EBank, in our opinion, was a tag along purchase, included in the price of Pointbreak. The bank has yet to achieve critical mass, and at the end of the 2016 financial year had just less than 50,000 customers. Due to the high operating costs and the cost of establishing banking infrastructure the bank was still operating at a loss, although displaying strong growth in client numbers, transaction volumes and transaction values as well as making inroads into the corporate market. At the end of FY16, the book value of the bank stood at N$25.1 million, while total equity contributions amounted to N$42.8 million.

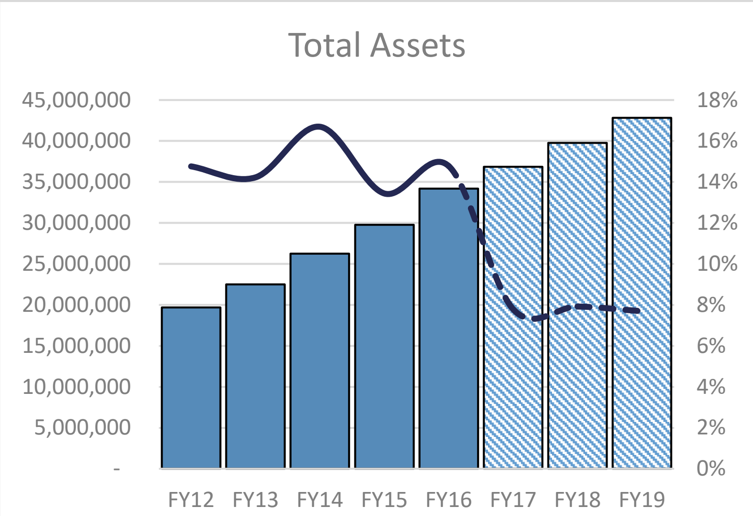
The acquisition should have benefits for FNB. In essence the bank may be able to assimilate the client base into their current operations. Management indicated that although EBank will no longer operate as a completely separate bank, which requires its own banking license, the brand will not be assimilated into FNB and will continue to operate as usual. The end goal is to eventually enable FNB's eWallet service will be made available to EBank's client base, providing convenient and affordable banking services. Furthermore, as part of the acquisition transaction, the insurance book of Namsure Insurance Brokers, a subsidiary of Pointbreak, will be acquired by FNB Insurance Brokers.

The total purchase consideration has yet to be disclosed, and is estimated (using back of the envelope calculations) to be in the region of N$300 million. Although this is a relatively small value in terms of FNB's balance sheet, it indicates a clear strategy of diversifying away from traditional banking, into new sources of non-interest revenue.

Asset base

Asset growth

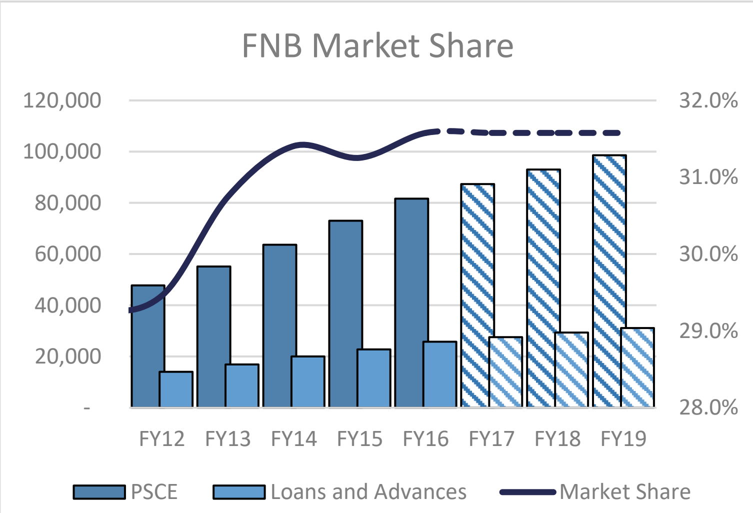
After nearly a decade of exceptional double digit growth, driven by major expansion of their loan book, FNB's total assets now amount to N$34.67 billion. Total assets grew by 6.7% from N$32.48 billion in 1H17. This was driven largely by growth in advances which increased by 8.4%, in line with private sector credit extension, which grew by 8.8% over the same period. The loan book now makes up 77.9% of total assets, while the rest is made up mostly of investment securities (11.0%) and cash equivalents (5.4%).



Source: CGP, IJG

Since we expect a slowdown in private sector credit extension over the next few years, we do not expect to see the strong growth in advances that have been witnessed over the last five years. As a result, we forecast growth in total assets of just under 8% per annum over the next three years.

FNB has maintained a healthy market share which has been hovering around the 30% level over the last five years and is currently around 31.5%. Management have indicated that they set their targets on maximising return on assets and return on equity, rather than aggressively pursuing market share, whether this is from an advances or deposit perspective.

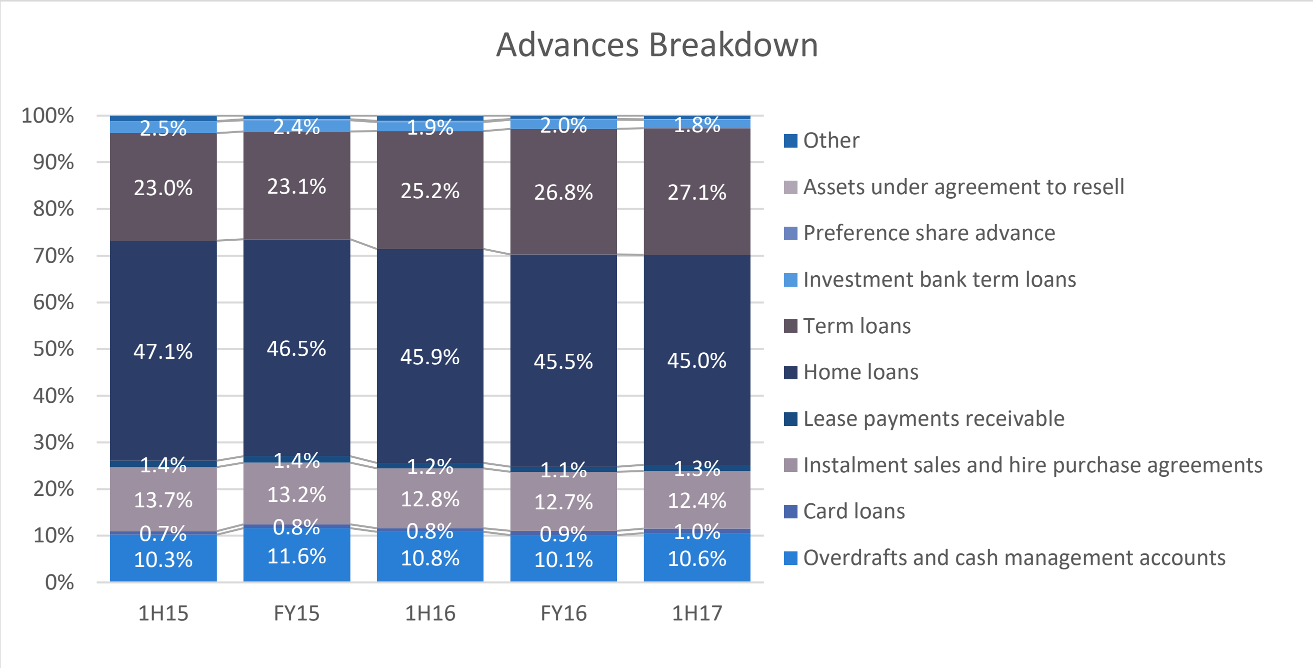


Source: CGP, IJG

Additionally, we have seen several new entrants into the local banking space over the past two years. While still small in nature, these entities are likely to be competing for market share, both from a funding and advances perspective. We do not foresee any of the new entrants claiming major market share in the next three years, however they are likely to limit strong growth for the major commercial banks. As a result, we estimate that FNB will likely maintain their market share around current levels.

Advances breakdown

Growth in advances amounted to 8.4% in 1H17 driven largely by increases in the size of the home loan and term loan books. FNB's advances remain heavily weighted towards home loans, making up 45.0% of the total book. However, this has been steadily declining over the last few years. Just five years ago, this category of loans made up more than 50% of the total loan book.



Source: CGP, IJG

Given the long-term nature of these loans, asset-liability duration matching for FNB remains key, and will become increasingly challenging as the bank becomes Basel III compliant. However, the interest rate received on mortgage loans tends to be notably higher than the average lending rate. In general, the mortgage lending rate tends to exceed the prime rate by approximately 100 basis points. Management maintain that their home loans are well diversified across the country and remain well collateralized, averaging at about 70% loan to value.

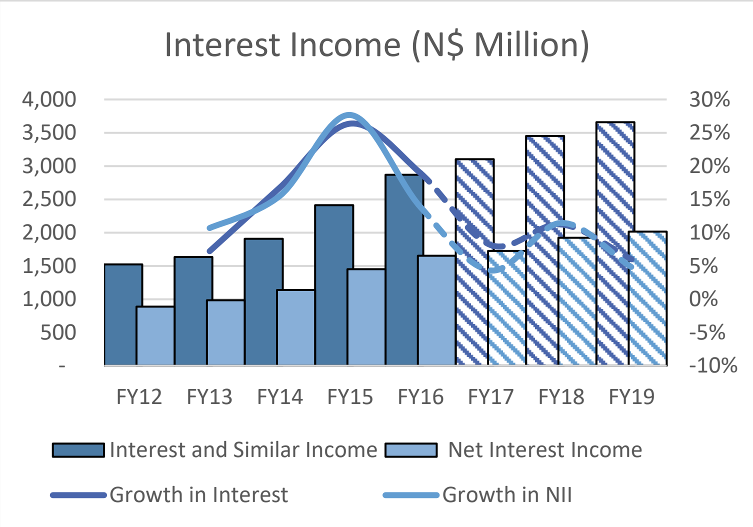
Term loans have increased by 16.5% to N$7.4 billion reflecting strong growth in the facilitation of business transactions. Term loans now account for 27.1% of total advances and remains the fastest growing and the second largest loan category for the bank.

Instalment credit displayed sluggish growth of 4.5% y/y. Instalment loans represent the third largest loan category for the bank, at N$3.3 billion, and have remained relatively constant as a percent of total loans over the last five years. WesBank, the bank's vehicle financing division grew assets by 5.7%, the slower growth being attributed to the slow-down in vehicle sales and aggressive competition in the market. According to management, WesBank remains the market leader in vehicle financing.

Overdrafts also exhibited slower growth year on year of 5.6%. However, according to management, this is an inaccurate picture due to the very short term nature of these loans and measurement taking place at financial and interim year ends. According to them, on average, overdraft balances have been higher than previous periods. This is also the impression gained from the Bank of Namibia's money and banking statistics, which indicates that overdrafts to individuals have increased by around 13.1% y/y in February.

Net Interest Income

Interest Income



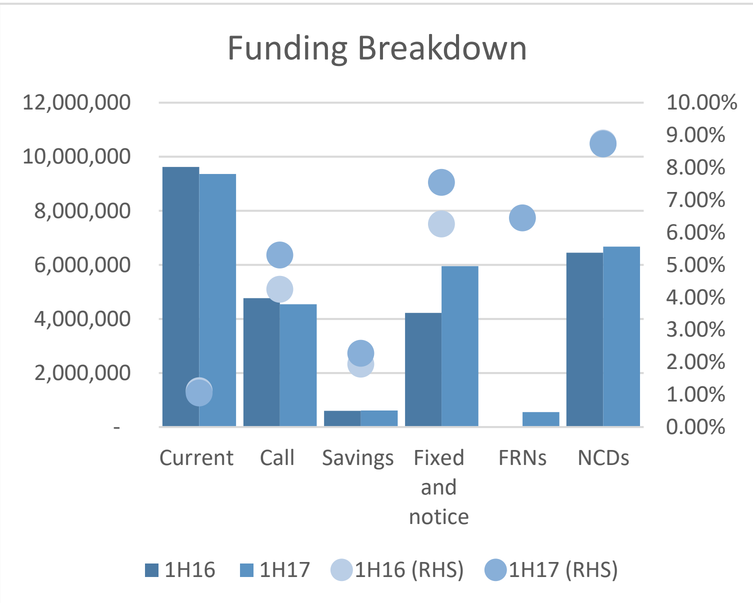
Source: CGP, IJG

Interest income expanded by 16.0% y/y, while interest expenses expanded by 26.6% in 1H17. The large increase in expenses being attributed to fast increasing funding costs for both deposits and debt securities. As a result, net interest income expanded by 8.7% in 1H17 as margins contracted.

At the same time, and contrary to expectations, impairment charges came down, by a staggering 57.8%, resulting in net interest income after impairment charges increasing by 11.4%.

FNB Namibia has experienced phenomenal growth in interest income over the past half-decade. This was initially driven by fast declining interest rates through 2009 and a rapid expansion of PSCE in the country, followed by strong growth in FNB's market share. However, this growth is expected to be muted over the next three years due to the slower PSCE and less opportunity to expand market share. We expect interest income to grow by 8.1% in FY17, accelerate slightly to 11.2% in FY18 on the back of potential interest rate increases and then moderate to around 6.0% in FY19.

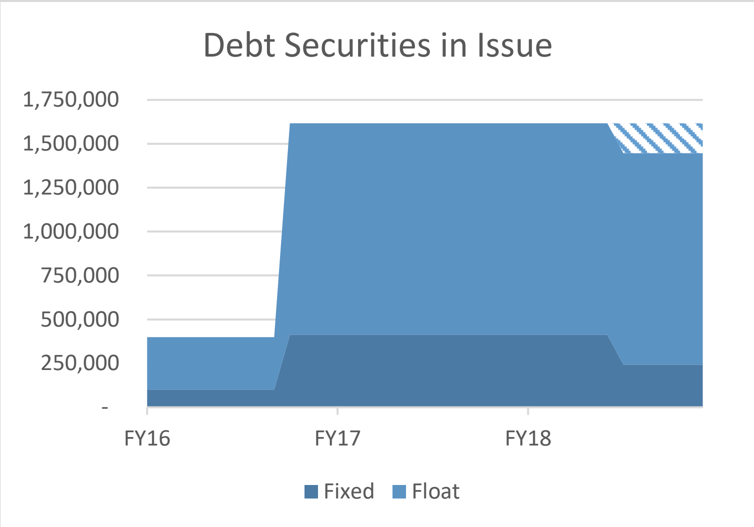
Funding mix and interest expense



Source: CGP, IJG

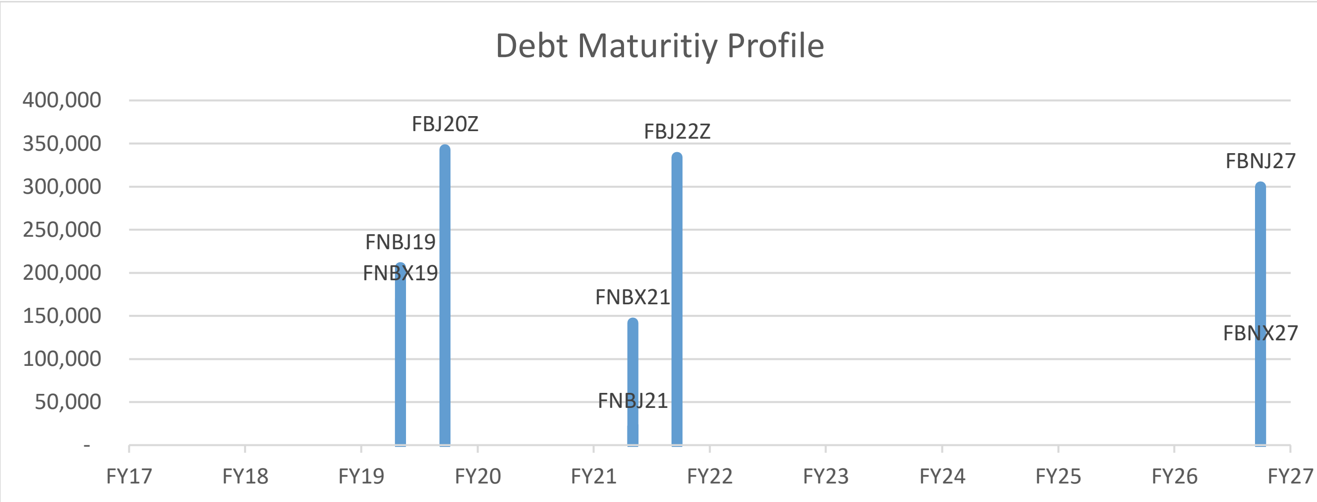
Reduced liquidity in the market was reflected in the slower growth of deposits, which increased by 7.9% to N$27.7 billion. It is evident that the sources of cheap funding, namely current, call and savings accounts, have been declining, and have been substituted with more expensive sources of funding, namely fixed and notice deposits and fixed, floating rate notes (FRNs) and negotiable certificates of deposits (NCDs)

FNB Namibia normally funded its loans from conventional deposits, carrying very little debt securities on its balance sheet. However, in November 2016 the bank issued N$540 million worth of debt securities, followed by a second round of issuance in March this year, where N$677 million worth of rand denominated medium term notes were issued. This debt is to be used for funding and to manage their currently liquidity challenges. Furthermore, FNB called their FNBX22 and FNBJ22 medium term notes and replaced them with the FBNX27 and FBNJ27 (sic) bonds of similar nominal values and which are also callable in five years' time.



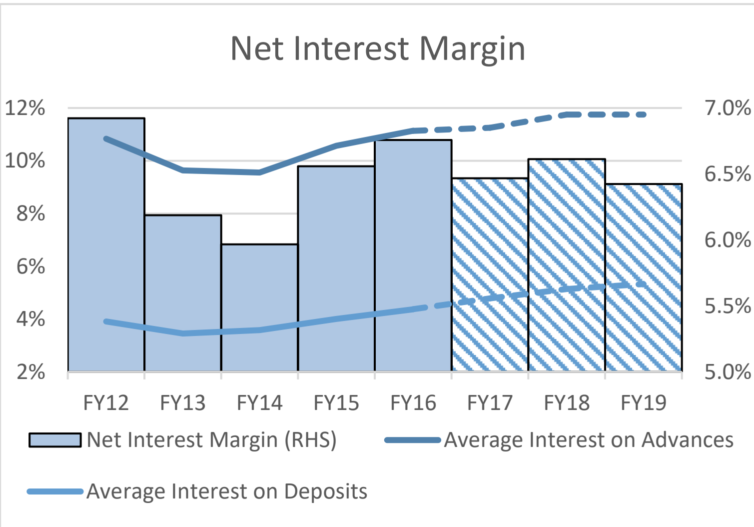
Source: CGP, IJG

Following these issuances, the bank currently has about N$1.6 billion worth of outstanding debt securities which represent roughly 5.7% of total funding. The split between fixed and floating rate debt is currently around 25:75, which would mean the bank is more exposed to increases in the South African interbank rate (3 month JIBAR). As previously mentioned, we expect that the probability of interest rate increases has increased considerably following the downgrade of South Africa to junk status.



Source: CGP, IJG

Interest Margin



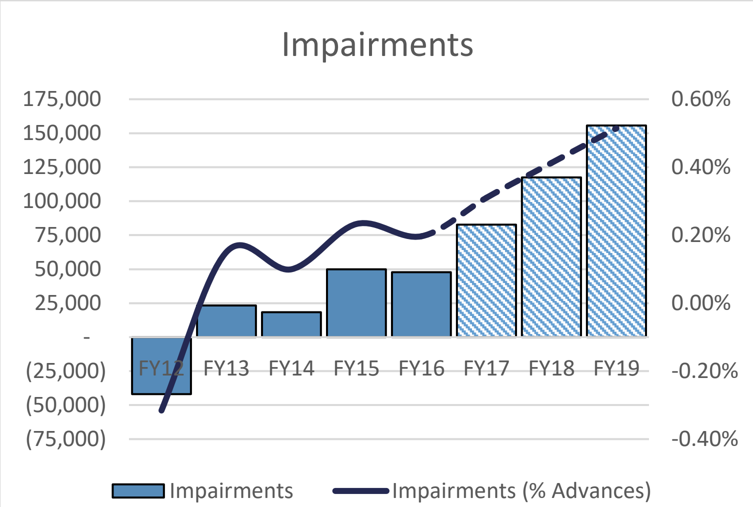
Source: CGP, IJG

Seeing as the increases in interest income have not kept pace with the increases in funding cost it follows that the net interest margin of the bank has declined.

The margin of FNB Namibia has been notably above the market average, driven by two factors: The bank's funding is relatively cheap when compared to competitors, as it carries much less debt securities on its balance sheet, and has a large percentage of its deposits in the form of current accounts, on which the lowest average rate of interest is paid. In the last year, these two specific factors changed somewhat, as current accounts decreased and the bank was pressed to take on more debt financing, which has resulted in the squeeze on the margin. However, relative to the other banks, FNB remains well ahead of its competitors. Over the last ten years FNB Namibia's net interest margin has been more than 200 basis points above the market average.

Going forward, we expect the liquidity situation to remain a headwind and funding costs to remain relatively high. The change in funding mix, which now includes more debt securities, will also result in higher overall cost in funding. As a result, we forecast the net interest margin to contract in FY17 and stay around the 6.5% level over the forecast period.

Impairment losses



Source: CGP, IJG

The percentage of non-performing loans to gross advances increased to 1.00% from 0.92% a year ago. This amounts to N$272.4 million while provisions have increased to N$184.2 million. According to management their non-performing book is appropriately secured. This still compares very well with South African banks who have an average of 3.1% of their advances classified as non-performing.

Impairments, on the other hand, have decreased in 1H17 by 57.8% to N$13.4 million from N$31.7 million in 1H16, bringing the impairments as a percentage of total advances down to only 0.10%. This is quite surprising, as one would expect that the tougher economic environment, slowing government expenditure and struggles in specific industries such as construction would have led to more of a pronounced effect on credit losses. As a comparison, FirstRand South Africa reported a credit loss ratio of 0.86% in 1H17.

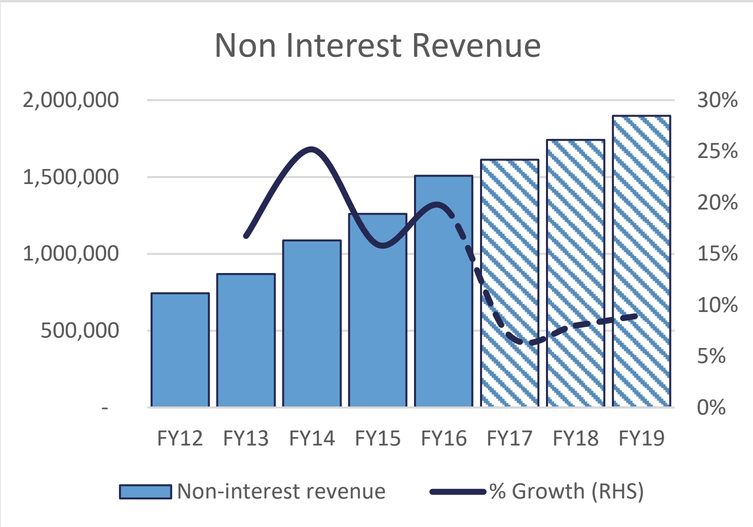
Management attribute these low levels, at least to some degree, to the proactive response both the consumers and businesses have had to the economic slowdown, quickly changing their expectations and curtailing unnecessary expenditure. However, management have conceded that the abnormally low levels of nonperforming loans and impairments are not likely to persist.

They have added that the overall historical level of non-performing loans has been a direct result of a good credit origination process. They emphasised the need for long term thinking and sustainability at the point where the loan is issued and generally subscribe to a *prevention is better than cure* approach. Furthermore, they added that should it come to the point that credit is impaired, their credit recovery centre is rated as the best in Africa, which ensures that a large amount of bad debts are recovered.

As a result of the current economic climate, we feel it is only prudent to expect higher impairment charges over the next three years. We expect impairments to increase linearly to 0.50% of total advances by FY19.

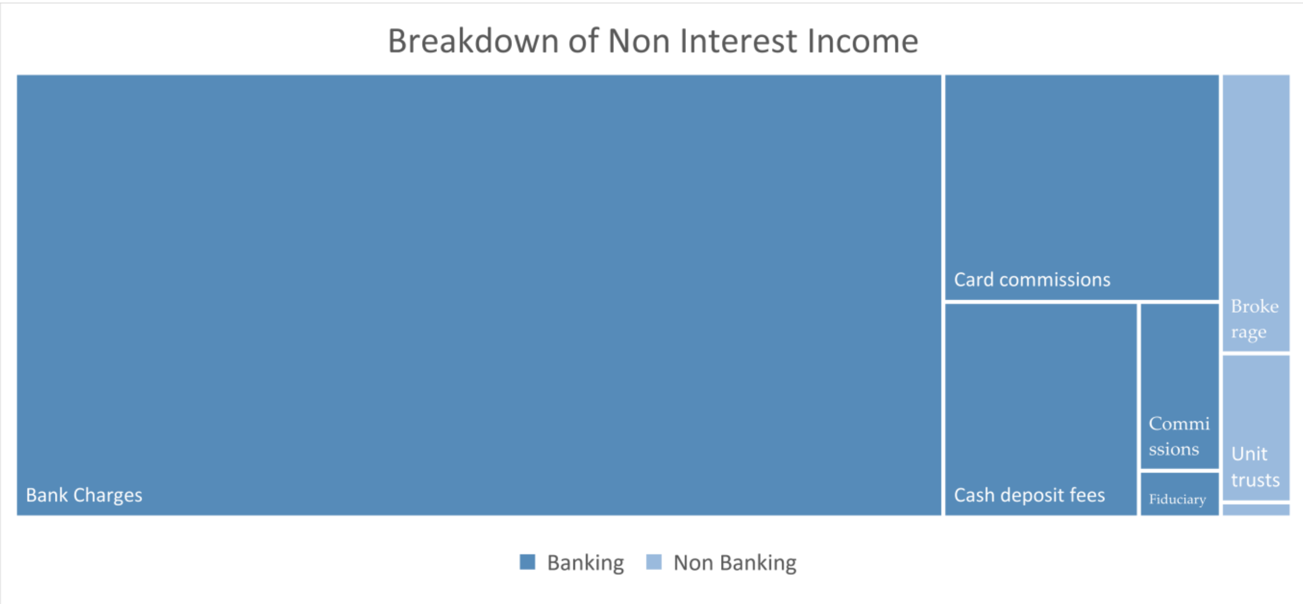
Non-interest income

Non-interest revenue increased by 4.7% to N$778.9 million from N$744.2 million in 1H16, while the customer base grew by 5% from 1H16. The slower growth being attributed to the high base set by kwanza trading activities in 1H16 as well as the reduction in cheques processed. A cheque value limit of N$100,000 was imposed in February 2016 which caused the number of cheques processed to decrease by 39%. Furthermore, branch volumes decreased by 8.0% y/y. Nevertheless, net fee and commission income expanded by 10.9% largely driven by an increase in bank charges as more of the traditional banking services are directed into electronic channels.



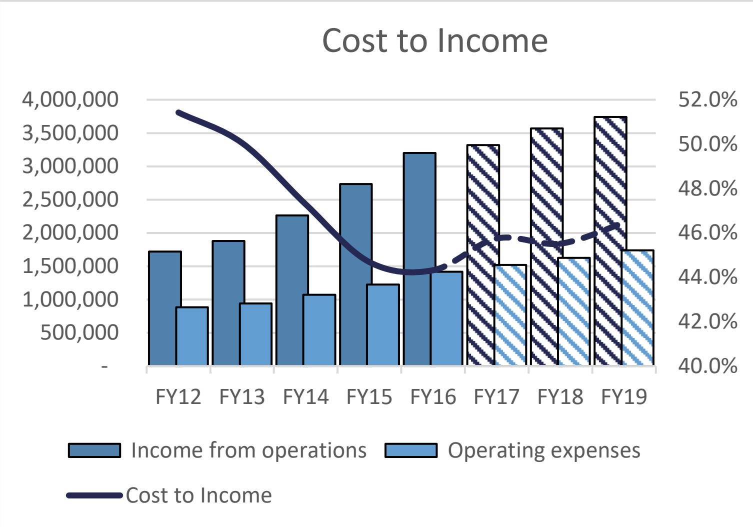
Source: CGP, IJG

Bank charges grew by 11.2% to N$547.2 million form N$492.1 million in 1H16. Bank charges remains the bank's largest source on non-interest income. This growth comes from many sources, however of late has been driven by strong expansion in electronic channels. In addition to the electronic channels, the bank is constantly adding new branches, ATMs and other infrastructure to increase its market coverage. Virtually every transaction with the bank incurs a charge, which while individually fairly small, becomes significant given the vast number of transactions done. The bank's focus is to grow the customer base to grow transactional revenue.



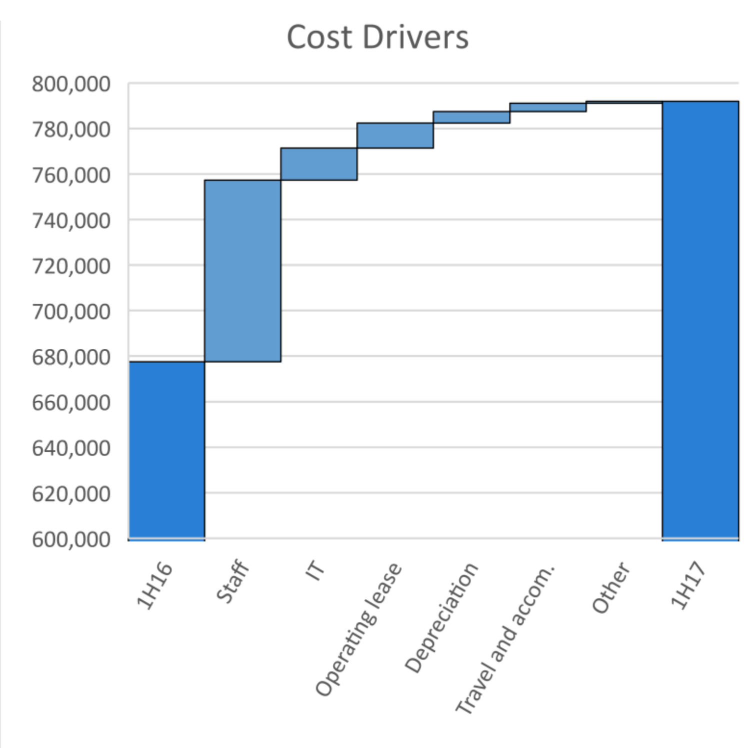
Going forward, we expect to see continued strong growth in non-interest income by FNB Namibia, driven by transaction volumes, particularly through digital channels. Moreover, as interest income growth is expected to slow going forward, we believe non-interest revenue may grow to surpass interest income as the primary revenue source for FNB Namibia. Furthermore, the addition of the asset management wing will allow the bank to grow its non-banking incomes, which was previously lacking, and diversify their non-interest income away from transactional charges, a source of income that has received a lot of attention from the regulators recently.

Operating expenses



Source: CGP, IJG

Expenses grew by 16.9% to N$791.9 million from N$677.5 million in 1H16. The sharp increase in expenditure was driven largely by increased spending to build capacity in the regulatory support divisions. This was evident in the staff costs and the increased IT costs which were 22.0% and 14.5% higher than the previous periods respectively. However, not all of these costs are ongoing. The know your customer (KYC) project made use of some temporary staff while some of the IT costs incurred were once-offs.



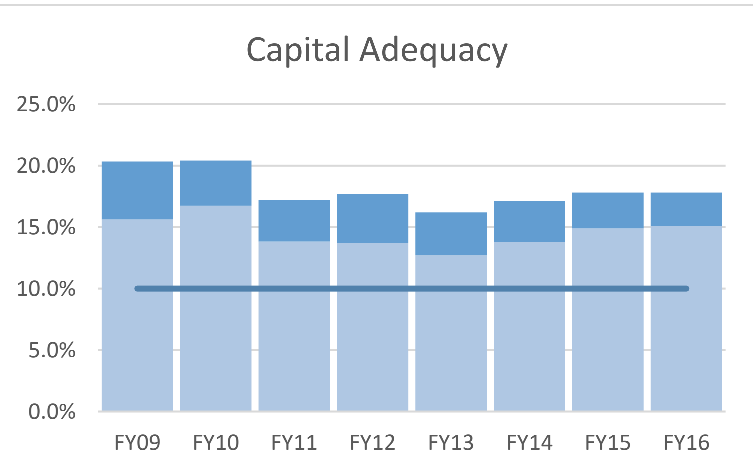
Source: CGP, IJG

Increases in continuing costs were mainly staff related, which currently amount to more than 55% of operating expenses. Staff numbers grew by 9.2% while average salaries increased by 8.6% while changes in the share incentive scheme increased the staff costs by roughly N$11 million. IT costs increased expenditure by N$14 million as more was invested into systems and delivery channels.

The increase in operational leases were attributable to increased numbers of ATMs. 32 new deposit taking ATMs were installed, which includes data lines and security costs. Furthermore, the group now rents the Windhoek branch, which used to be owner occupied.

Capital Adequacy

FNB Namibia remains more than adequately capitalized, with Tier two capital of 3.8% of risk weighted assets (RWA) and Tier 1 capital of 13.4% of risk weighted assets.



Source: CGP, IJG

Outlook

FNB Namibia remains an extremely well run and managed business with an exceptional track record to prove it. However, the company is fairly mature, and unlikely to continue to grow at the pace seen over the past 10 years. This maturity, however, does come with sizable benefits, as the size of the customer base and loan books mean that the bank will continue to generate strong revenues without major intervention.

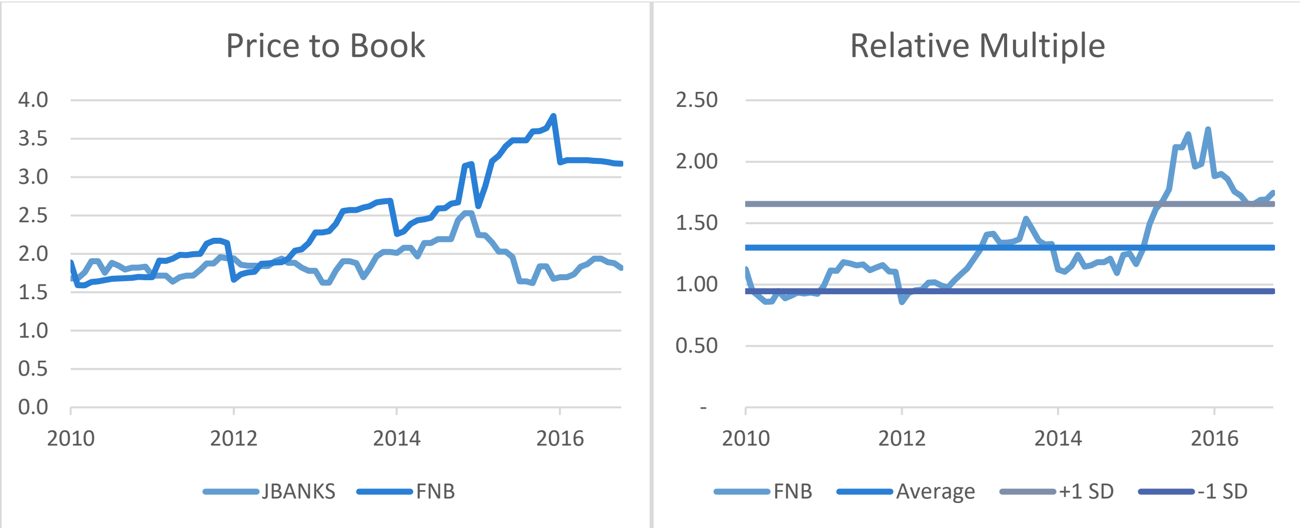
This being said the wider product offering will definitely give the bank room to grow in the essential areas of non-banking, non-interest income. The bank now offers a wide range of services, the previously unbanked sector, thanks to the EBank acquisition, to high-net-worth individuals. The premium market probably offers the best prospects as these customers require a range of services that the bank is now in a position to offer them above the traditional transactional banking services. These include short term insurance from OUTsurance, money market and long term investments as well as trust and estate planning.

The largest challenge the bank faces is the tough economic environment. Household disposable income growth is likely to slow, which may present some pressure on highly indebted consumers. This, coupled with increasing interest rates and low liquidity is likely to drive a slowdown in credit extension growth and is expected to drive an increase in NPLs and impairment losses.

Furthermore, the introduction of new banking licenses into the Namibian market may see an increase in competition. Although FNB Namibia is highly entrenched in the market, increases in competition, both from a deposit, loan and transactional services perspective remains a risk. Lastly the pressure that has been put on the funding mix, and resultantly funding costs, is likely to persist. The low liquidity environment, coupled with increased competition may put further pressure on margins.

Valuation and recommendation

For the purpose of valuing the company we establish a **cost of equity of 14.7%,** which consist of a risk-free rate of 10.7% (based on the Namibian 10-year government bond), an equity risk premium of 3.0% and a liquidity premium of 1.0%. Based on this cost of equity, a conservative **long-term growth rate for the company of 9.0%,** and a **long term sustainable Return on Equity of 25.0%,** we believe a **Price to Book multiple of 2.79x can be justified** on this share. Given **expected book value per share of 1,797c in FY17**, we derive **a target price of N$c5012 per share**. Coupled with an **expected final dividend of 120 cps**, we expect a **total return of 8.5% in 2H17**.



Source: Bloomberg, IJG

Relative to South African banks, the FNB Namibia's price to book multiple is quite high. It is currently one standard deviation higher than the average relative multiple when compared to the South African banking index. This being said, the superior return on assets and resultant return on equity does, in our opinion, justify a higher multiple. The company remains extremely profitable, having posted returns on assets of between 2.8% and 3.6% over the past five years, and returns on equity of between 25.8% and 32.2% over the same period, which drives our view that a long term sustainable ROE of 25% can be maintained.

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

Valuation Sensitivities

Target Price		ROE						
		24.3%	24.5%	24.8%	25.0%	25.3%	25.5%	25.8%
Growth	7.5%	4,159	4,222	4,284	4,346	4,408	4,470	4,532
	8.0%	4,335	4,402	4,468	4,535	4,602	4,668	4,735
	8.5%	4,538	4,610	4,682	4,754	4,826	4,899	4,971
	9.0%	4,777	4,856	4,934	**5,012**	5,091	5,169	5,247
	9.5%	5,062	5,148	5,234	5,319	5,405	5,491	5,577
	10.0%	5,407	5,502	5,596	5,691	5,786	5,881	5,976
	10.5%	5,833	5,939	6,045	6,151	6,257	6,363	6,469

Expected Return		ROE						
		24.3%	24.5%	24.8%	25.0%	25.3%	25.5%	25.8%
Growth	7.5%	-9.5%	-8.2%	-6.9%	-5.6%	-4.3%	-3.0%	-1.7%
	8.0%	-5.8%	-4.4%	-3.0%	-1.6%	-0.2%	1.2%	2.6%
	8.5%	-1.5%	0.0%	1.5%	3.1%	4.6%	6.1%	7.6%
	9.0%	3.5%	5.2%	6.8%	**8.5%**	10.2%	11.8%	13.5%
	9.5%	9.6%	11.4%	13.2%	15.0%	16.8%	18.6%	20.4%
	10.0%	16.8%	18.8%	20.9%	22.9%	24.9%	26.9%	28.9%
	10.5%	25.9%	28.1%	30.3%	32.6%	34.8%	37.1%	39.3%

Price to Book		ROE						
		24.3%	24.5%	24.8%	25.0%	25.3%	25.5%	25.8%
Growth	7.5%	2.31	2.35	2.38	2.42	2.45	2.49	2.52
	8.0%	2.41	2.45	2.49	2.52	2.56	2.60	2.64
	8.5%	2.53	2.57	2.61	2.65	2.69	2.73	2.77
	9.0%	2.66	2.70	2.75	**2.79**	2.83	2.88	2.92
	9.5%	2.82	2.86	2.91	2.96	3.01	3.06	3.10
	10.0%	3.01	3.06	3.11	3.17	3.22	3.27	3.33
	10.5%	3.25	3.31	3.36	3.42	3.48	3.54	3.60

Income Statement

Year End June (N$ 000)	FY15	FY16	FY17	FY18	FY19
Interest and similar income	2,413,043	2,869,473	3,102,796	3,451,344	3,658,425
Interest expense and similar charges	(960,176)	(1,215,842)	(1,422,384)	(1,634,904)	(1,813,619)
Net interest income before impairment of advances	1,452,867	1,653,631	1,680,412	1,816,440	1,844,806
% Growth	*27.7%*	*13.8%*	*1.6%*	*8.1%*	*1.6%*
Impairment of advances	(49,882)	(47,852)	(82,741)	(117,493)	(155,678)
Net interest income after impairment of advances	1,402,985	1,605,779	1,597,671	1,698,948	1,689,128
Non-interest revenue	1,260,061	1,506,656	1,612,122	1,741,092	1,897,790
Net insurance premium income	153,944	189,253	218,288	261,422	311,987
Net claims and benefits paid	(82,310)	(102,777)	(109,144)	(130,711)	(155,994)
Income from operations	2,734,680	3,198,911	3,318,937	3,570,750	3,742,912
% Growth	*20.9%*	*17.0%*	*3.8%*	*7.6%*	*4.8%*
Operating expenses	(1,221,986)	(1,417,647)	(1,518,148)	(1,624,418)	(1,738,127)
Net income from operations	1,512,694	1,781,264	1,800,789	1,946,332	2,004,785
Share of profit from associate after tax	558	1,328	1,328	1,328	1,328
Income before tax	1,513,252	1,782,592	1,802,117	1,947,660	2,006,113
Indirect tax	(26,611)	(31,974)	(35,171)	(39,392)	(44,119)
Profit before tax	1,486,641	1,750,618	1,766,946	1,908,268	1,961,994
Direct tax	(487,979)	(532,985)	(561,005)	(591,563)	(622,933)
Profit for the period	998,662	1,217,633	1,205,941	1,316,705	1,339,061
% Growth	*27.3%*	*21.9%*	*-1.0%*	*9.2%*	*1.7%*

Balance Sheet

N$ 000	FY15	FY16	FY17	FY18	FY19
Cash and cash equivalents	795,225	2,119,861	2,381,708	2,875,835	3,486,821
Due from banks and other financial institutions	1,585,029	1,772,267	1,914,048	2,067,172	2,232,546
Derivative financial instruments	158,644	209,497	209,497	209,497	209,497
Advances	22,833,693	25,776,087	27,580,413	29,373,140	31,135,528
Investment securities	3,365,927	3,236,883	3,560,571	3,916,628	4,308,291
Accounts receivable	185,614	136,592	161,103	161,103	152,933
Investments in associate	3,726	5,054	5,054	5,054	5,054
Property and equipment	849,171	924,997	1,017,497	1,139,596	1,276,348
Intangible assets	2,534	104	104	104	104
Deferred income tax asset	3,897	2,868	3,293	3,353	3,171
Reinsurance assets	191	598	454	414	489
Tax asset	664	695	567	642	635
Total assets	**29,784,315**	**34,185,503**	**36,834,309**	**39,752,539**	**42,811,416**
Deposits	23,951,813	27,793,798	29,739,364	31,821,119	34,048,598
Due to banks and other financial institutions	1,020,016	800,973	857,041	917,034	981,226
Derivative financial instruments	158,644	209,497	209,497	209,497	209,497
Short trading positions	26,693	36,927	36,927	36,927	36,927
Creditors and accruals	431,781	396,958	374,368	401,036	390,787
Tax liability	49,774	54,920	54,063	52,919	53,967
Employee liabilities	167,830	191,350	191,350	191,350	191,350
Deferred income tax liability	110,904	190,209	190,209	190,209	190,209
Policyholders liabilities under insurance contracts	69,770	67,778	74,556	82,011	90,213
Finance lease obligation	2,060	-	-	-	-
Tier two liabilities	392,635	392,654	390,000	390,000	390,000
Total liabilities	**26,395,464**	**30,145,022**	**32,145,635**	**34,339,677**	**36,662,071**
Capital and reserves attributable to ordinary equity holders of parent	3,348,673	3,989,699	4,628,169	5,341,494	6,066,930
Non-controlling interests	40,178	50,782	60,505	71,368	82,415
Total equity	**3,388,851**	**4,040,481**	**4,688,674**	**5,412,862**	**6,149,345**
Total equity and liabilities	**29,784,315**	**34,185,503**	**36,834,309**	**39,752,539**	**42,811,416**

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