

17 April 2014

FNB Namibia Holdings	Target Price (c)	2700
Leader of the pack	Current Price (c)	2261

Year End 30 June	2012A	2013A	F2014	F2015	F2016	Recommendation	BUY
Net interest income (N\$m)	890	985	1,089	1,285	1,417	NSX Code	FNB
Non-interest income (N\$m)	787	917	1,079	1,166	1,247	Market Cap (N\$m)	6 050
Profit (N\$m)	539	610	748	868	933	Shares in Issue (m)	267.6
HEPS (c)	203.1	231.2	285.0	330.5	355.5	Free float (%)	40
P/E (x)	11.1	9.8	7.9	6.8	6.4	52 week high (c)	2261
DPS (c)	82	100	110	122	145	52 week low (c)	1801
DY (%)	3.6	4.4	4.8	5.4	6.4	Expected Total Return (%)	24.6
P/B (x)	2.5	2.6	2.2	1.9	1.6		

Source: BWH, IJG

1H14 results

FNB Namibia released its results for first half of the year ended 31 December 2013. The firm posted reasonable results, with profits up 20% when compared to the first half results of last year, and declared an interim dividend of 55c, up from the dividend of 46c at this time last year. As such, headline earnings per share also increased by 20% y/y to 145.7cps.

Net interest income

In our view the latest decrease in FNB's net interest margin is more a function of a lower yield on advances (on the back of competitive pricing) as opposed to an increase in the cost of funding. Going forward we continue to see FNB being competitive in pricing of new business, while increasing deposit rates in anticipation of an interest rate hike, which means that we will see continuing compression in FNB's net interest margin in the immediate future. We do however expect to see a rebound in the net interest margin in FY15 when assets re-price faster than liabilities once the Bank of Namibia commences its interest rate hiking cycle.

Non-interest income

FNB's non-interest income continued to show significant growth, increasing 22.9% on top of an already high base, underpinned by elevated volume of transactions, increases in the value of transactions and further expansion of the banking network. The strong growth has led to the increased significance of non-interest income within FNB, making it one of the bank's strongest attributes. In FY13 non-interest income and insurance income jointly contributed 48.8% to total revenue, the most significant contribution yet.

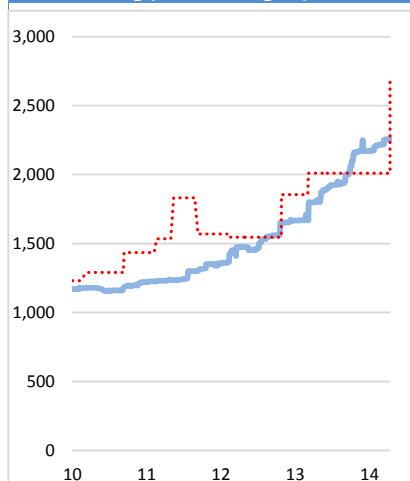
Earnings forecast and outlook

We revised our earnings forecasts upward on the back of stronger than previously anticipated macro backdrop, leading to increased demand for and thus faster growth in, PSCE. This coupled with the bank's dominance in the sector leads to a rosy outlook. We forecast earnings of 285cps in FY14, and 331cps in FY15, implying strong momentum in earnings.

Target price and recommendation

Based on a justified PE multiple of 8.79x, relative to the current rating of 8.9x and our FY14 and FY15 earnings per share forecasts of 285cps and 331cps respectively, we derive a **target price of 2700cps**. Based on our expected **12 month total return of 24.6%**, we recommend a **BUY** on FNB.

FNB closing price vs target price



Analyst

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Interest income and the asset base

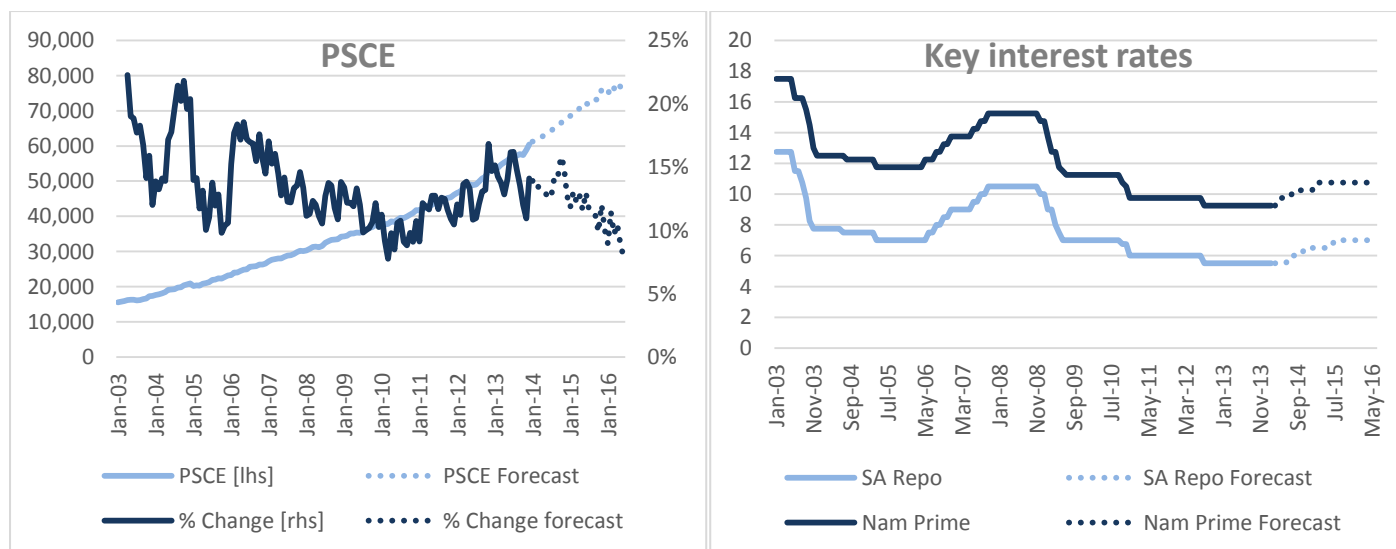
Macro backdrop for PSCE and interest rates

Growth in PSCE bottomed out in March 2010 and has since been on a fairly strong upward trend, driven by strong growth in disposable income and declining interest rates to record lows. In the space of 48 months credit extended to the private sector increased N\$22.6bn or 64%. Stated in terms of a compounded annual growth rates, growth was 13.3% compared to nominal growth in GDP over the period of 10.6%.

From June 2010 to December 2013, FNB managed to grow its loans and advance to customers by a CAGR of 15.9%, higher than the PSCE growth rate, and as such increasing its market share, once again clearly showing off the bank's dominance in the Namibian economy. Market share in terms of total advances outstanding increased from 28.7% as at June 2010 to 31.6% as at December 2013.

IJG's view is that growth in PSCE is likely topping out after almost four years of trending higher. This view is justified below:

- ✓ The marginal benefit of lower rates and cheaper money has been diminishing as is evident in credit demand slowing from low twenties to sub fifteen percent;
- ✓ The economy is at the start of an interest rate hiking cycle, with borrowers expected to be cautious going forward in light of this; and
- ✓ Increased focus by BoN on PSCE and the likely introduction of non-interest measures to curb credit growth.
- ✗ The main risk to our view however is the latest expansionary budget announced by Government, with a 25% increase in the wage bill likely to underpin credit demand in the immediate future.



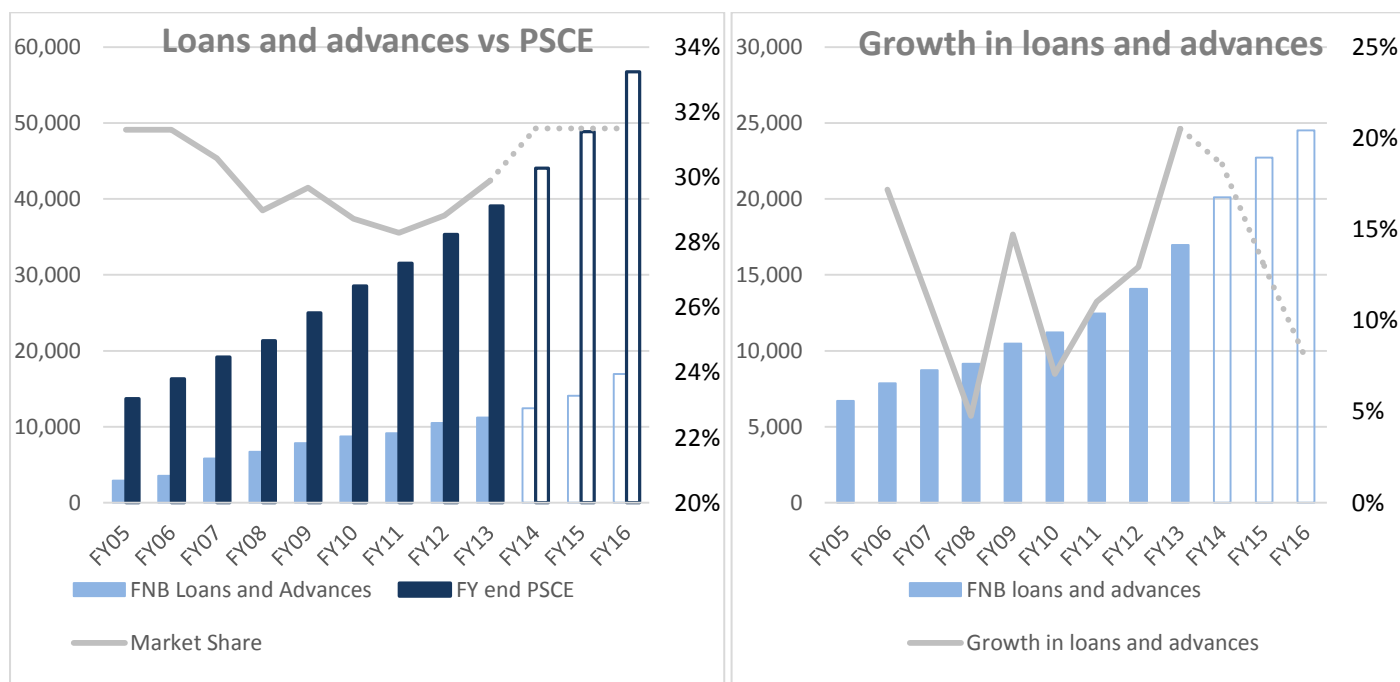
Source: Bank of Namibia; IJG Research

Asset growth

Over the past 8 years, FNB has witnessed relative volatility in its market share as measured by the ratio of loans and advances to PSCE. The graph below shows FNB market share following a general downward trend from FY05 to FY11, decreasing from 31.5% to 28.3%. FNB's market share has however rebounded since, to 31.2% as at end December 2013. In our forecast we assume that FNB will build on its recent strength and further grow market share in FY14 after which it will stabilize at approximately 31.5%.

The loans and advances forecasts are a function of IJG's projections of PSCE over the next 3 years and our market share assumptions. Based on this we foresee that FNB loans and advances will increase to N\$20.1bn in FY14, N\$22.7bn in FY15 and N\$24.5bn in FY16.

This implies that growth in advances will slow to 18.6% in FY14 (after registering growth of 20.5% in FY13), and continue to moderate to 13.0% and 7.9% in FY15 and FY16, respectively. The "slowdown" must be viewed in the context of the high base which has been established over the past couple of years, thus although there exists a downward trend in growth, absolute change in loans and advances will amount to N\$3.1bn, N\$2.6bn and N\$1.8bn for FY14, FY15 and FY16, respectively.



Source: FNB annual reports; IJG Research

Yield on earning assets and interest income

During FY13 the average yield on FNB loans and advances was an estimated 10.5%, which translates to a 120bps spread over the average prime rate during the same period. What is, however, of particular interest is the decline in the spread over the prime rate over recent years, which has been on the decline ever since its peak at 290bps in FY09. We foresee continuation of this trend in FY14, and are forecasting the spread to decrease further to 90bps after which it is expected to mean revert in the latter year of the forecast period.

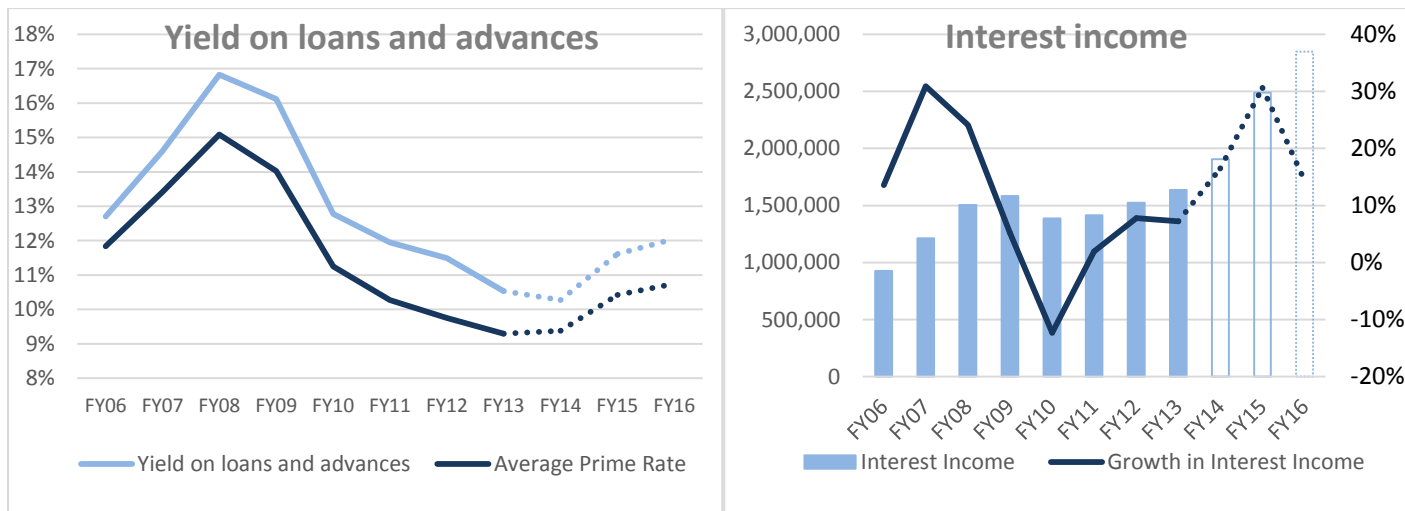
The reason for the small spread over the prime rate is twofold, firstly this is typical at the bottom of an interest rate cycle and is expected to widen as the hiking cycle commence. Secondly, this could also be a reflection of FNB's competitiveness, as the bank is, perhaps moving away from the traditional prime plus loans. This approach is contrary to that seen in our analysis of Bank Windhoek, which shows that BWH is primarily focused on increasing its spread in light of the bank's increased cost of funding.

On the back of strong growth in the asset base (as illustrated on the previous page) and the initiation of an interest rate hiking cycle, the macro environment bodes well for interest income. We forecast interest income at N\$1.9bn in FY14, N\$2.5bn in FY15 and N\$2.8bn in FY16. This implies that growth will accelerate from 7.2% in FY13 to 16.5% in FY14 and 30.6% in FY15 after which it is expected to slow to 14.4%.

96% of our forecasted increase in FY14 interest income is attributed to asset growth, while the remainder is explained by an increase in average yield. This however does change going forward as a result of the hiking cycle. 60% of our projected FY15 increase is explained by asset growth, while in FY16 the significance of asset growth increases to 70%.

Risks to our forecast of interest income are both to the up- and down side.

- ✓ Our forecast is based on 150bps hiking cycle over the next 12 months, thus the upside risk is that of a more aggressive cycle.
- ✗ Increased intervention by the Bank of Namibia and an outside probability to align the mortgage lending rate with prime.



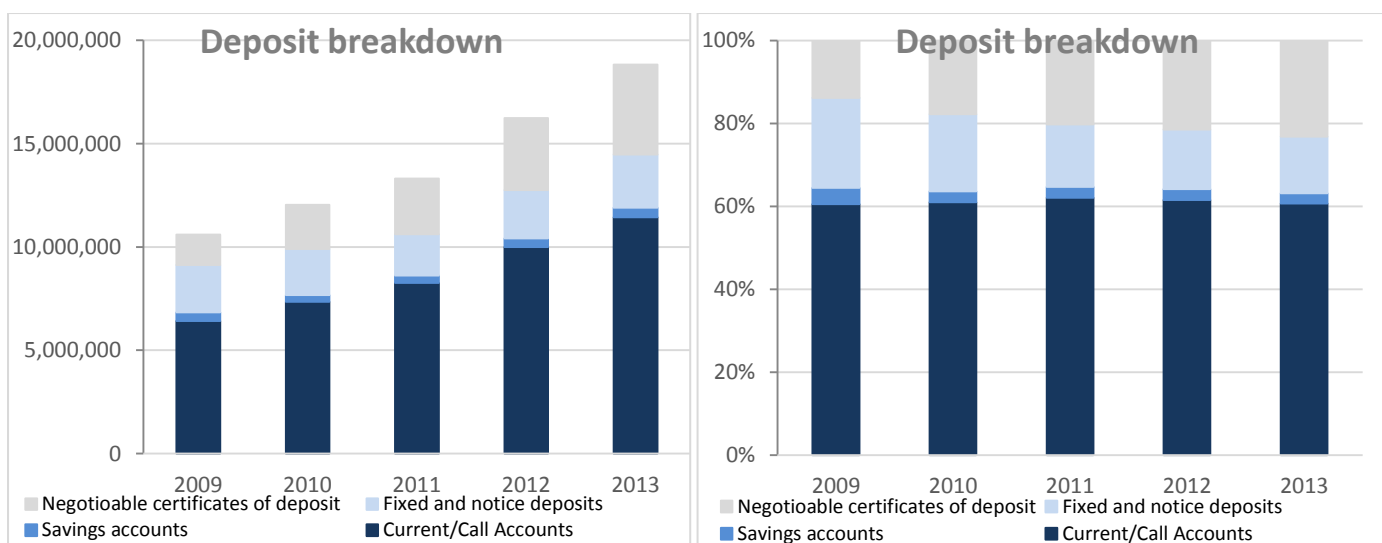
Source: FNB annual reports; IJG Research

Funding the FNB asset base

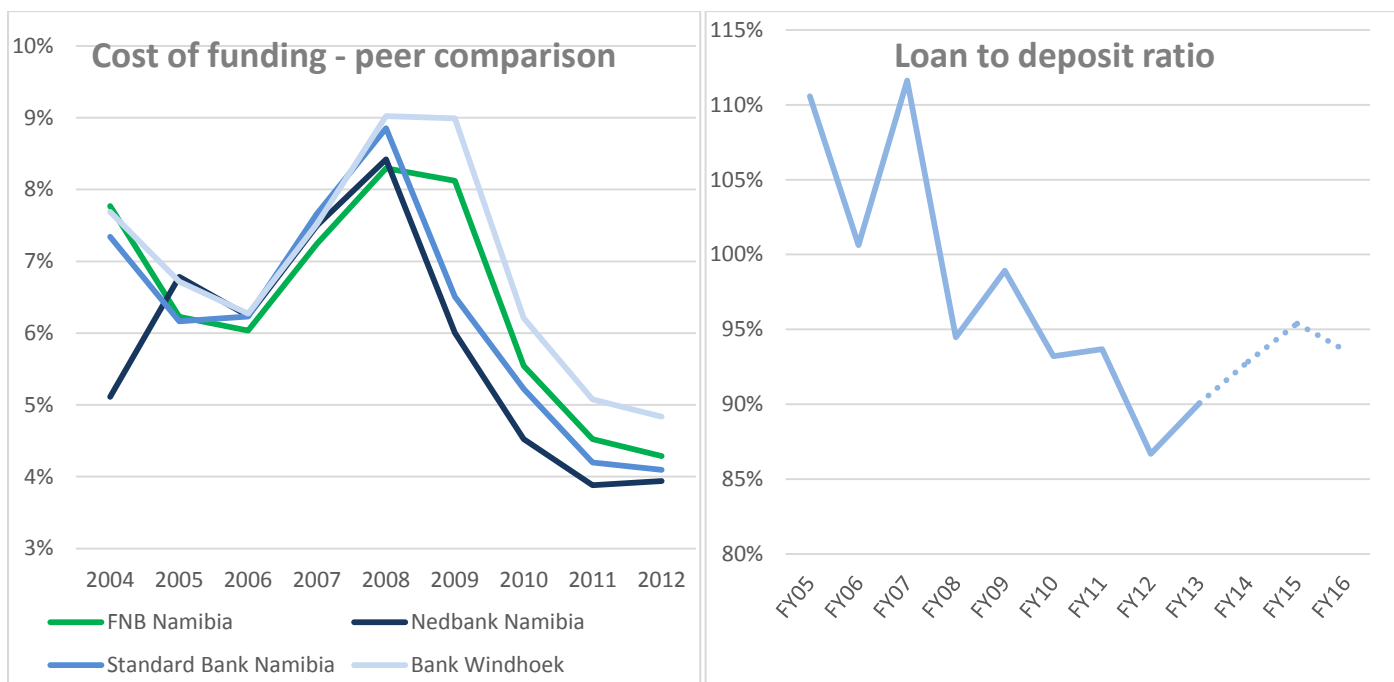
Funding mix

FNB's deposit base has been growing at a CAGR of 15.5% from FY09 to FY13, which is more than sufficient to support growth of 12.8% (CAGR) in advances over the same comparable period. The faster growth in deposits relative to advances is evident in FNB's loan to deposit ratio which has been on a declining trend over the past six years.

As at 1H14 FNB was sitting on a deposit base of N\$20.4bn, up N\$1.6bn during the six month period. FNB has managed to consistently keep current/call accounts at 60% of the deposit base. On the other hand NCDs as percentage of total deposits has increased from 13.8% in FY09 to 23.2% in FY13 with this increase being mainly at the cost of saving accounts and fixed/notice deposits.



Source: FNB annual reports; Bank Windhoek Treasury; IJG Research

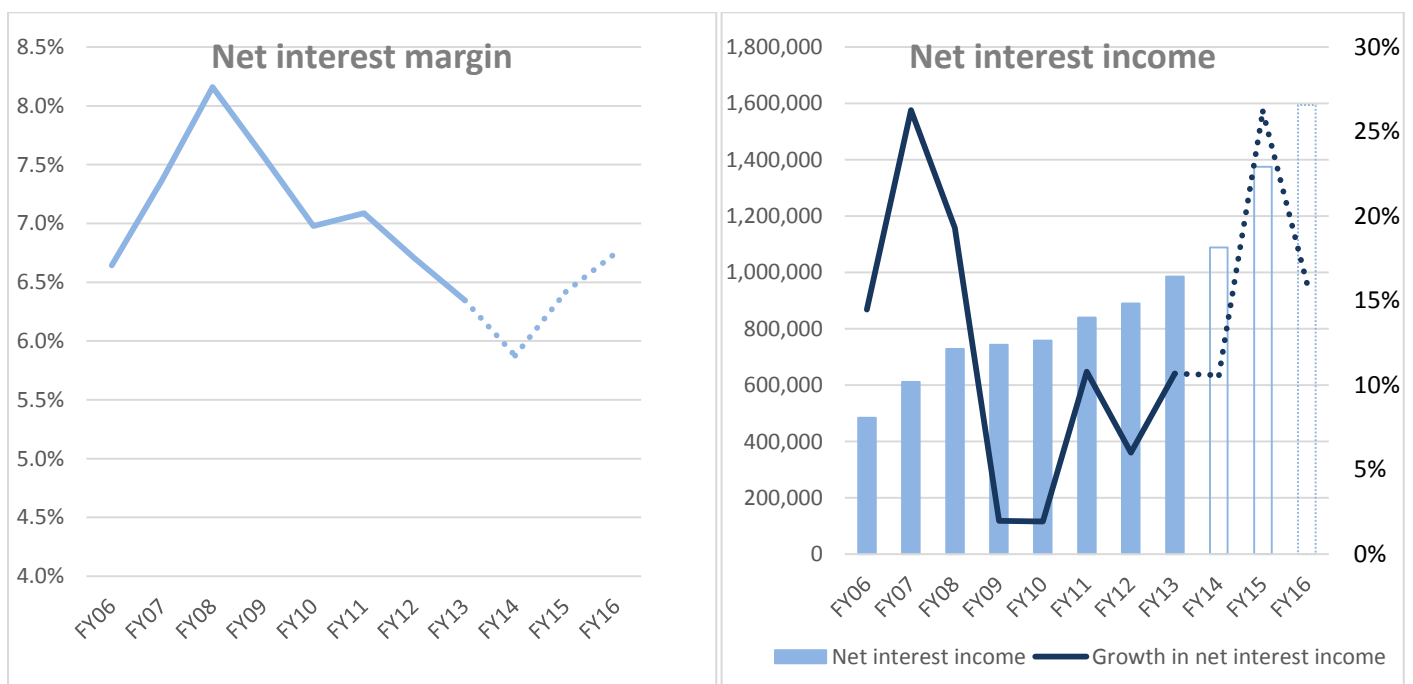


Source: FNB annual reports; IJG Research

Net interest margin

In our view the latest decrease in FNB's net interest margin is more a function of lower yield on advances than an increase in the cost of funding.

Going forward we continue to see FNB being competitive in pricing of new business while increasing deposit rates in anticipation of an interest rate hiking cycle, and thus we will see continuing compression in FNB's net interest margin in the immediate future. We do however expect to see a rebound in the net interest margin in FY15 when assets re-price faster than liabilities, once the Bank of Namibia commences its interest rate hiking cycle.



Source: FNB Annual Reports, IJG Research

Nonperforming loans and impairments

The IJG Housing Affordability Index indicates that the Namibian consumer is in a very strong financial position with mortgage payments being the most affordable that they have been in the last 10 years, despite the growth seen in house prices. The relative affordability is on account of historically low interest rates and significant growth in disposable income (the strongest contributor).

Below we illustrated 3 interest rate scenarios, namely flat interest rates, a moderate 100 bps increase and a more aggressive 200bps interest rate hiking cycle's effect on affordability. What is evident from the analysis is that none of the scenarios come close to resulting in broad based unaffordability of mortgages.

We expect to see continuing strong growth in national disposable income in mind of the fact that the economy is growing above trend levels, and that government (the single biggest employer in the country) is budgeting to increase its wage bill by 25.4% in 2014/15.

The Affordability Index has a very strong correlation with the Namibian banking sector's nonperforming loans, thus given the expectation of "moderate" hiking cycle, we do not foresee a significant (concerning) increase in nonperforming loans.



Source: IJG Research

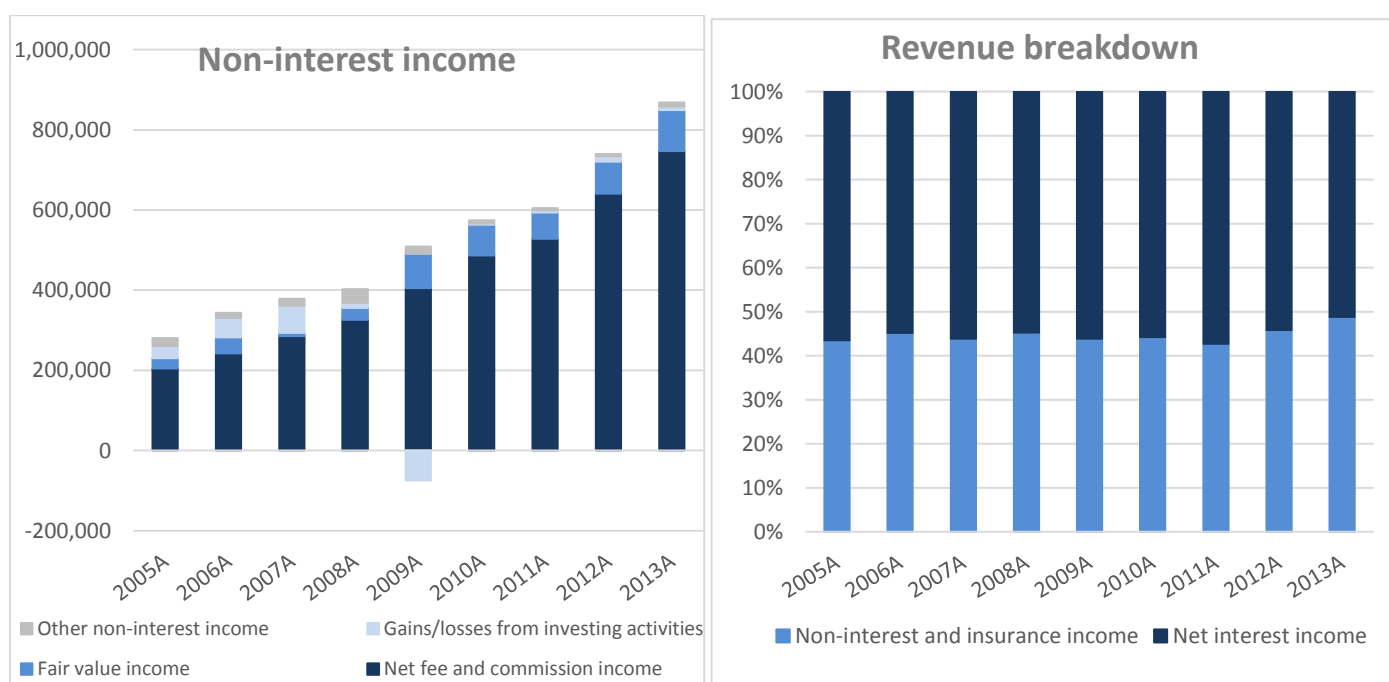
Non-interest income

FNB's non-interest income has shown stellar growth, increasing 22.9% in 1H14 to N\$531m, continuing the strong trend witnessed the past eight years (8 year CAGR = 15.2%; 4 year CAGR = 19.0%). The strong growth has led to the increased significance of non-interest income within FNB's earnings, making it one of the bank's strongest attributes. In FY13 non-interest income and insurance income jointly contributed 48.8% to total revenue, up from 42.7% as recently as FY11.

The growth seen in non-interest income has been primarily on the back of net fee and commission income. Growth is attributed to elevated volumes of transactions, and an increase in the average value of transactions with strong retail domination, contributing 70% to non-interest income.

Non-interest income was further supported by FNB's expanding network, which entailed 25 additional ATMs and two new branches over the last year.

Foreign exchange trading contributed a significant close to 50% of fair value income, which increased from N\$56m in 1H13 to N\$73m in 1H14.

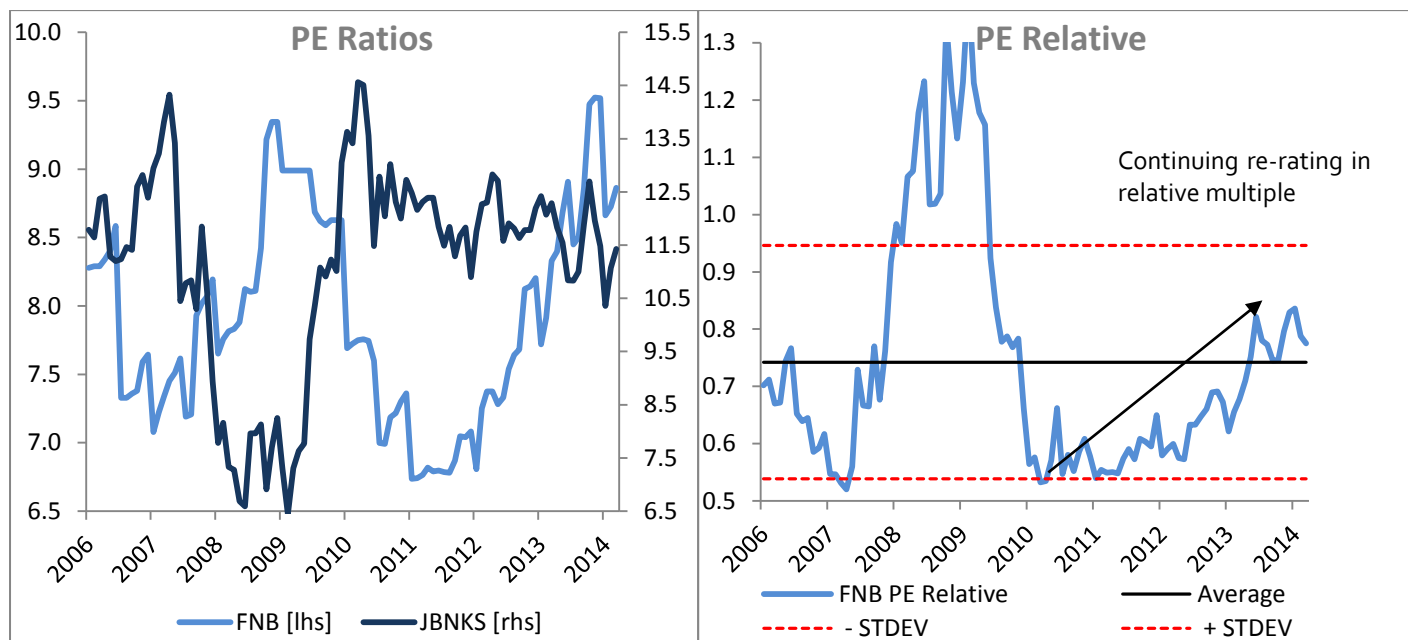


Source: FNB Annual Reports, IIG Research

Valuation and recommendation

FNB's PE relative to the JSE Banks index has been on the rise since early 2010, trading at a slight premium relative to its 10 year average relative PE. The recent changes to regulatory requirements regarding local asset holdings in pension funds and long term insurance companies will see a growing demand/supply mismatch over the coming years and as a result will see a continuing re-rating in valuation multiples for Namibian companies.

Based on a justified PE multiple of 8.79x, relative to the current rating of 8.9x and considering the long term re-rating that is playing out, and our FY14 and FY15 earnings per share forecasts of 285cps and 331cps respectively, we derive a **target price of 2700cps**. Based on our expected 12 month total return of 24.6%, we recommend a **BUY** on FNB.



Source: Bloomberg, IJG Research

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