IJG

Securities (Pty) Ltd.

Member of the NSX

FNB NAMIBIA HOLDINGS

1H15 Results Review

APRIL 2015

FNB Namibia Holdings

1H15 Results Review

Target Price (c)	4090
Current Price (c)	3221

Year End 30 June	2013A	2014A	F2015	F2016
Net interest income (N$m)	985	1,138	1,340	1,478
Non-interest income (N$m)	869	1,087	1,272	1,463
Profit (N$m)	608	785	964	1,103
HEPS (c)	229	295	366	419
DPS (c)	100	109	132	151
DY (%)	3.7	3.4	4.1	4.7
P/E (x)	11.6	10.9	8.8	7.7
P/BV (x)	3.1	3.0	2.5	2.1

Source: FNB, IJG

Recommendation	BUY
NSX Code	FNB
Market Cap (N$m)	8,619
Shares in Issue (m)	267.6
Free float (%)	40
52 week high (c)	3221
52 week low (c)	2261
Expected Total Return (%)	32.1

1H15 Initial Impression

FNB Namibia released its results for first half of the year ended 31 December 2014. The firm posted excellent results, with profit for the period up by 29.4% to N$495.6million, and earnings per share up by 28.5% to 187.2c. Headline earnings per share saw similar growth of 28.6%. As such, headline earnings for the six months ended 31 December 2014 also stands at 187.2 cps. On account of these strong results, FNB Namibia announced an interim dividend of 71cps for the 6 month period, up 29.1% from the 55cps dividend declared for the same period of 2013.

Over the period, return on average equity improved to 35.0% from 32.9% in 2013 while return on average assets was 3.7%, up from 3.4% in 2013 and cost to income ratio improved to 43.8% from 47.3%.

Net interest income (after impairments) grew by 23.4% on an annual basis, to N$675m, while non-interest income expanded by a sizable 21.2%, to N$643m. The growth in interest income is partially due to extremely strong growth in private sector credit extension, off an ever increasing base, as well as favorable margins due to interest rate movements and expectations through 2014. Advances increased from N$18.8bn to N$21.6bn over the 12 month period, representing growth of 14.9%. Total PSCE growth over this period totaled 16.5%, suggesting a slight loss in market share for FNB Namibia, however from a high base. Nevertheless, FNB Namibia's advances represent 31.2% of total advances registered with the bank of Namibia, well above the natural market share of the company given the number of established commercial banks in the country.

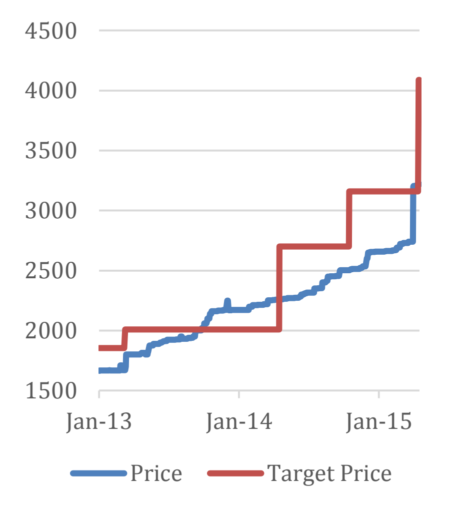
On the other hand, the increase in non-interest income was driven by increased volumes and values of transactions, leading to greater income from fees and commissions. Over the six month period to December 2014, an 11% increase in the number of accounts was witnessed, coupled with an 11% increase in transaction volumes. This drove a 23.1% increase in fee and commission income. The company noted that "mobile banking transactions have increased at double the rate of traditional branch volumes. Although this erodes revenue to a certain extent, we are pleased to pass on the benefits of our strategy to encourage innovative electronic banking."

Total operating expenses are up 14.9% to N$602 million year on year, driven by staffing costs, which increased 18.2% as the staff contingent increased 8%, an 8% wage increase was agreed upon with the union and a training levy was imposed on Namibian businesses.

The overall credit quality of FNB Namibia advances remains extremely sound, with the ratio of non-performing loans to average gross advances improving over the year to 0.67%, from 0.96% in December 2013. Non-performing loans decreased by 18% to N$139.7 million, from N$170.9 million a year ago. This is particularly impressive given the fact that Namibia hiked interest rates by 50 basis points through the 2014 calendar year, which would usually result in a slight uptick in non-performing loans.

Based on a justified PE multiple of 11.2x , and our FY15 and FY16 earnings per share forecasts of 365.7cps and 418.8cps, respectively, we get a target price of 4090cps. Based on forecasted dividend of 132cps in FY15, a dividend yield of 4.1%, we foresee a total return of 31.1% from the share for the next 12 months, making it our **most preferred** locally listed stock, and thus **recommend a BUY** on FNB Namibia.

Share Price (c)



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Macroeconomic Backdrop

The macroeconomic environment in Namibia remains positive, while a number of developments have been seen over the past six months that provide for continued growth opportunities for the local commercial banks.

A notable decoupling of the Namibian and South African economies has been witnessed since 2009. Following the global recession, the Namibian economy rapidly rebounded, posting some of the highest growth figures seen since independence in the subsequent half decade. However, South Africa's economy continued to languish, growing at below trend rates for an extended period of time, up until the present. The structural nature of this low-and-slow growth, means that South Africa is unlikely to rebound dramatically in the short term, and may well remain on a low growth trajectory for much of the next decade. The same cannot be said of Namibia. While partially attributable to fiscal and monetary policy, current growth in Namibia is largely driven by construction activity, creating jobs, increasing disposable income, and expanding the productive capacity of the country, and thus propelling it onto a higher growth path and development level in the future.

This strong growth, however, is not without risks. The speed and vigour of the expansion in the economy has led to a number of macroeconomic imbalances, which if left unchecked may destabilise the future growth prospects of the country to some degree. While numerable in nature, the key issues at present are: i. increasing demand side inflation; ii. increased government debt; iii. declining international reserve levels; and iv. rapidly increasing household debt.

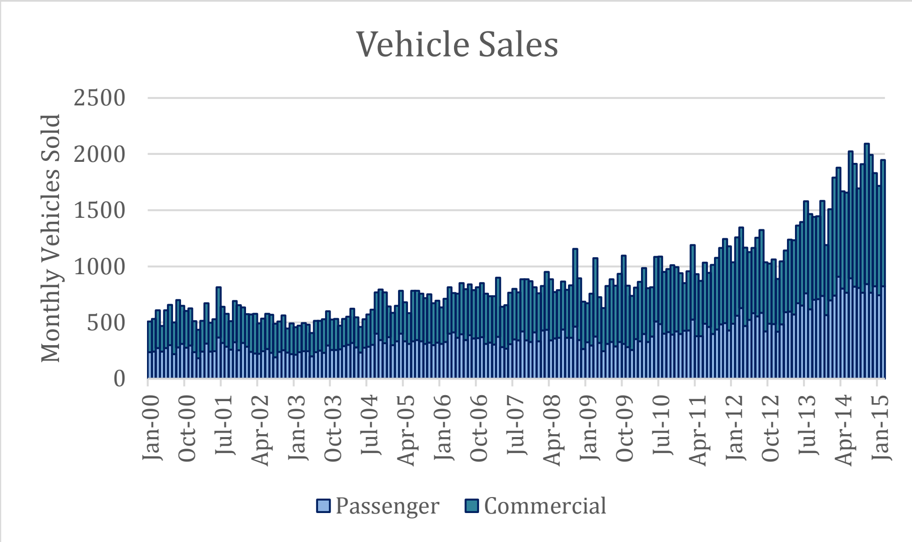
Amongst these issues, most pertinent to the banking system is the increase in household debt, followed by government debt and demand side inflation. The risk from increasing household debt is obvious, as household debt levels can be expected to have an inverse relationship with asset quality, particularly once they surpass a threshold level. In Namibia, this threshold level is unknown, however given that household debt to disposable income is at close to record highs and continuing to grow at a double-digit rates, it is believed that households will be becoming increasingly sensitive to interest rate and income shocks. From the Government debt perspective, total government debt increased by 125% between the start of the 2011/12 financial year, and the end of the 2014/15 financial year. This major increase was driven by the counter-cyclical budget pursued over this period. The increased supply of Government securities may well negatively impact upon the rates at which banks can borrow in the market, through textbook "crowding out". Finally, demand side inflation has been seen in the local economy, largely for services. However, due to high demand and slow supply of housing, house price inflation and by extension, rental inflation, have also been dramatic. House prices double every 4 to 5 years, while anecdotal evidence suggests that rental inflation is upward of 10% per year. The inflation in house prices seen over the past decade have been hugely positive for home owners and the banking sector, however, should prices exceed fair value, a risk of overvaluation of banking and household sector asset values may be seen, which may cause financial sector instability.

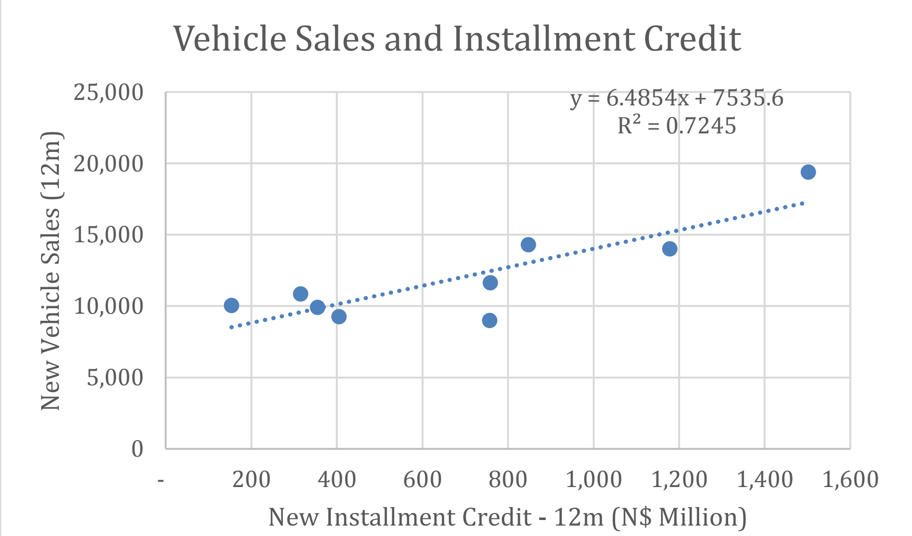
In most economies, these imbalances would be addressed through the tightening of monetary (and at times, fiscal) policy, however in this regard, Namibia is somewhat hampered by the fixed exchange rate regime it shares with South Africa, Lesotho and Swaziland. Due to this, Namibia is unable to implement completely independent monetary policy, and is required to remain fairly close to the rates seen in the common monetary area in order to ensure that unstable capital flows between the countries do not occur. As such, despite the clear need for tighter monetary policy in the country, interest rate increases have been fairly slow. Nevertheless, the Bank of Namibia is in an interest rate hiking cycle, having increased rates by 75 basis points, in the form of three 25 basis point hikes, over the past 12 months.

Nevertheless, this expansive policy and strong growth in the economy have led to a dramatic increase in disposable income, as increased government expenditure coupled with lower tax rates, higher employment, increased wages and cheap money supply have injected funds back into the pockets of the populous. This in turn has resulted in major increases in consumer activity in the country, due to the low marginal propensity to save witnessed in Namibian consumers. Additionally, the increase in disposable income has been utilized to increase leverage at a household level, particularly for consumptive goods, notably vehicles.

Vehicle Sales

As a result of fiscal and monetary stimulus as well as general wealth effects, consumer demand for vehicles has seen a dramatic increase over the past 18 months, with record sales having been seen and then broken in almost every consecutive month of 2014. In the first three quarters of 2014, sales approximately equalled full year sales seen in 2013. For the first nine months of the year, 15,881 new vehicles were sold, many of which will have been funded through instalment credit, given the relationship between vehicle sales and instalment credit extension. As can be seen from the below chart, a fairly strong relationship suggests that the purchase of, for example, 10,000 new cars in Namibia, results in the uptake of approximately N$400 million worth of instalment credit.





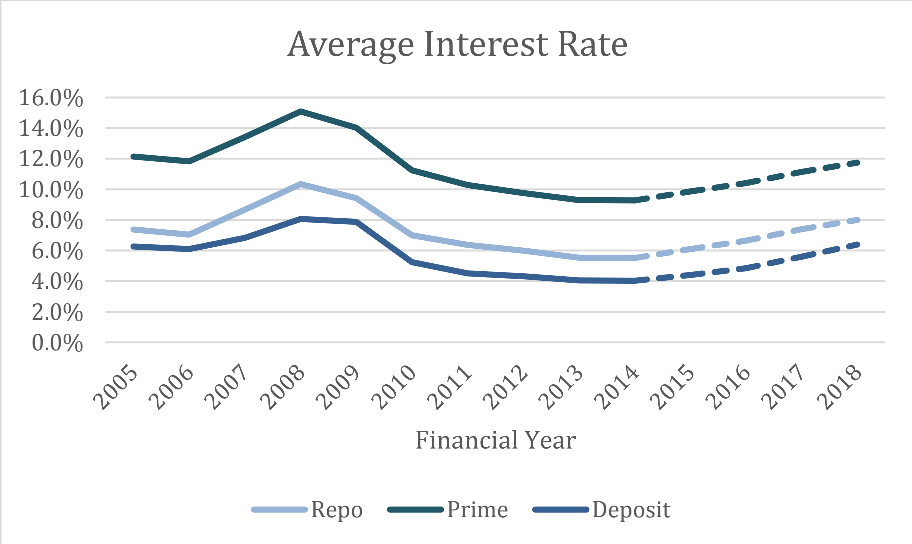
Source: IJG Research

Going forward, we expect to see continued strong demand for vehicles, both in terms of passenger and commercial sales. As Namibian's become more wealthy, more households can be expected to own vehicles, while strong economic growth, particularly in the mining sector, coupled with Government purchases, will drive commercial vehicle sales going forward.

Property Market

The Namibian property market, led by Windhoek, remains broadly challenging from a macroeconomic perspective, defined by strong and growing demand for property, coupled with a major undersupply thereof. Large growth in the country's urban population over the past decade has not been met with a comparable increase in the supply of housing, which has led to major increases in house prices, particularly over the past five years. As such, property prices have been doubling every four to five years -increases well above inflation. However, the fundamental nature of this dynamic is such that we do not foresee any major changes to the status quo going forward. Given various estimates as to a housing backlog totalling some 80,000-100,000 houses in the country, it is unlikely that a major glut of supply will be seen adequate to critically reduce demand and bring about a major price correction, at least in the near-term. As an interest rate hiking cycle starts, non-performing loans can be expected to increase, however despite elevated house prices, we do not expect to see a major increase in this regard, due to the inelasticity of demand for necessities such as housing. Thus, with a growing and ever-more-wealthy urban population, strong demand and undersupply of serviced land is likely to maintain property prices at high, and increasing levels in the foreseeable future.

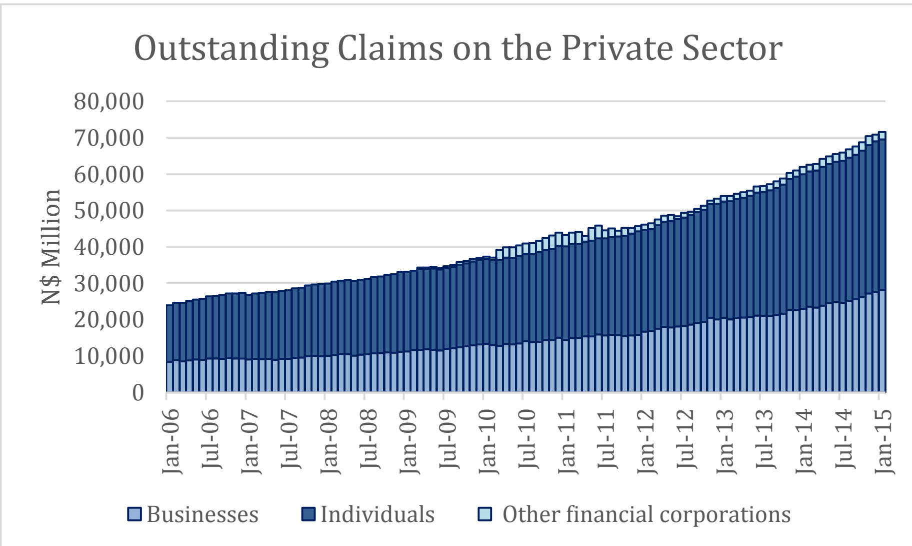
Interest Rates



Following an extended period of historically low interest rates, in January 2014, the South African Reserve Bank (SARB) hiked interest rates by 50 basis points, with the Bank of Namibia (BON) following five months later with a 25 point hike. Thereafter, both the SARB and BON hiked a further 25 points, signalling that a hiking cycle has begun within the common monetary area. However, subsequent weakness in the South African economy and abating headline inflation, due to falling oil prices, kept South Africa's interest rates on hold, while Namibia pushed ahead with a further 25 basis point hike in February of 2015.

It is our view that interest rates in South Africa will remain on hold for much of the rest of 2015, while we believe that the Bank of Namibia will continue to increase rates, albeit slowly, in order to protect the currency peg and attempt to reduce demand for consumptive credit. These slow and steady increases are likely to minimise household duress through the hiking cycle. In addition, the divergent expectations should bode positively for the net-interest margin of the banks, as loans are priced off Namibian rates, and deposits largely off South African rates.

Private Sector Credit Extension



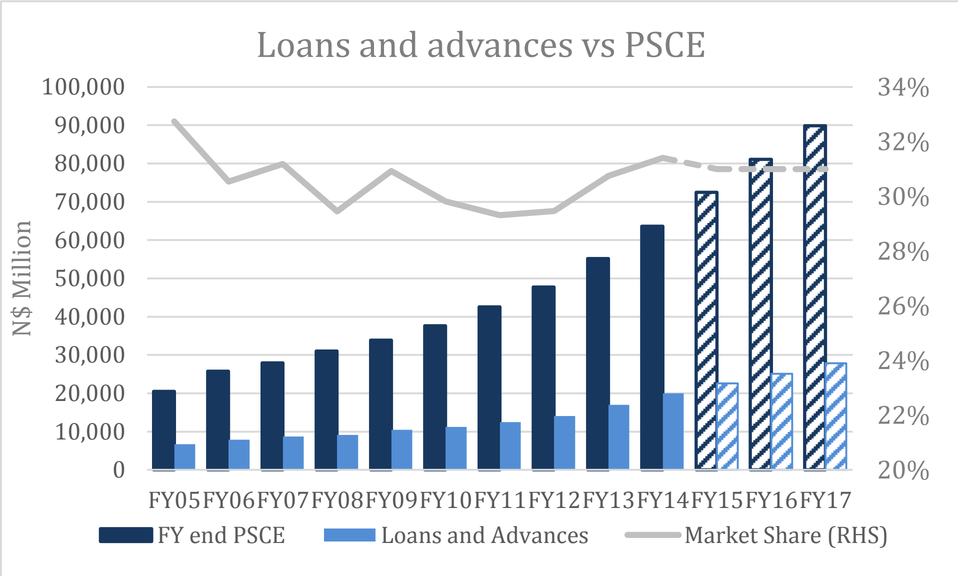
As a result of historically low interest rates for a sustained period, coupled with increasing incomes and wealth on which to leverage, outstanding credit extension to the private sector has increased to unprecedented levels within Namibia over the past 12 months. As of December 2013, outstanding credit to the private sector stood at N$59.6 billion, with N$36.6 billion (62%) and N$22.7 billion (38%) outstanding to households and corporates, respectively. In the following 12 month net issuance surpassed N$9.8 billion, on account of credit extension to both corporates and households. Over this period, both categories expanded by N$4.9 billion. However, due to the relative bases of the two categories, this increase reflected a significantly larger growth rate for corporate debt (of 21.4%) than households (13.3%). Thus, corporate debt is starting to make up an ever larger percent of total debt outstanding.

Going forward, we expect credit demand to remain rampant, particularly from private households, while we expect to see slowing growth in PSCE to corporates. On the supply side, however, we expect to see increased caution when it comes to lending as commercial banks go to pains to ensure that asset quality remains good, and that non-performing loans and impairments do not skyrocket as interest rates increase.

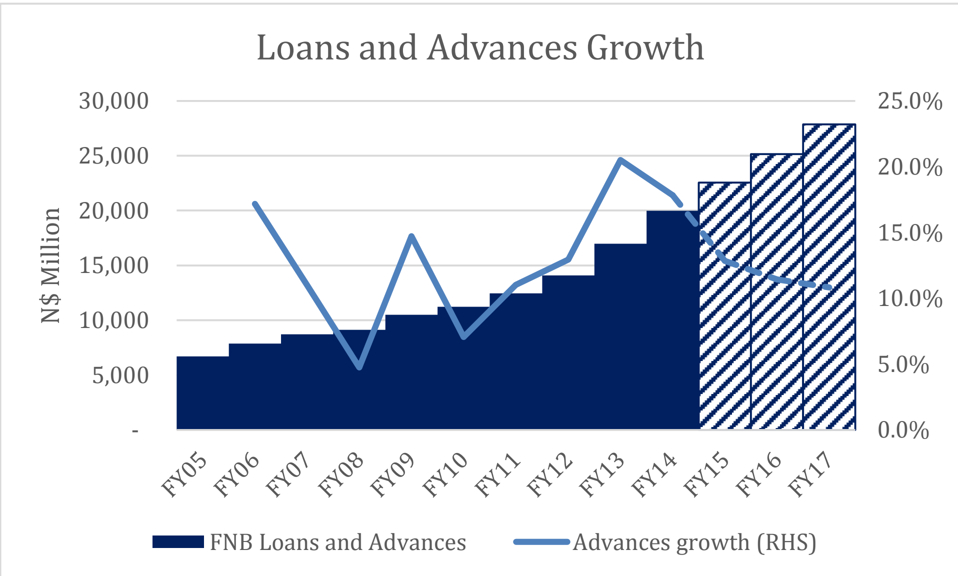
Interest income and the asset base

Asset growth

Over the past eight years, FNB has witnessed relative volatility in its market share as measured by the ratio of loans and advances to PSCE. The adjacent graph shows FNB market share following a general downward trend from FY05 to FY11, decreasing from 32.7% to 29.4%. FNB's market share has since, however, rebounded. As of the end of FY14, the bank's market share stood at 31.4%, declining to 31.2% in 1H15. Going forward, we have conservatively, assumed that FNB's market share will stabilize at 31.0%.



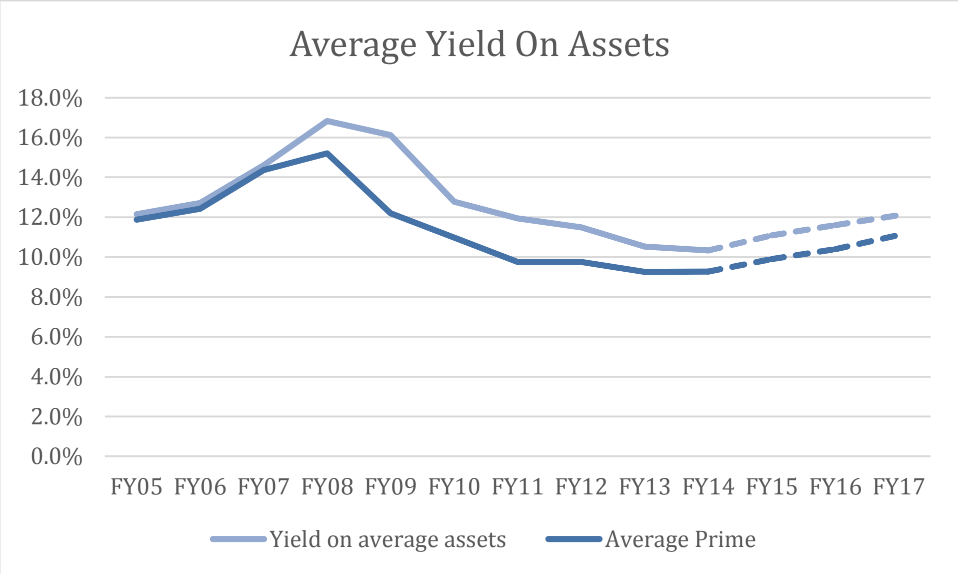
Growth in loans and advances are expected to slow going forward, however this is to be system wide, rather than FNB specific. The loans and advances forecasts are a function of IJG's projections of PSCE over the next 3 years and our market share assumptions. Based on this we foresee that FNB loans and advances will increase to N$22.6bn in FY15, N$25.1bn in FY16, and N$27.9bn in FY17.



Growth in advances slowed to 17.8% for FY14, slightly below our forecast of 18.6%. In the 12 months to end December 2014, growth in advances slowed further, to 14.8%. We forecast growth in advances continuing to moderate to 12.8%, 11.4% and 10.8% in FY15, FY16 and FY17 respectively. The "slowdown" must be viewed in the context of the high base which has been established through the trough of the interest rate cycle, as historically low interest rates have increased demand for credit dramatically. Thus, although there exists a downward trend in growth, absolute change in loans and advances will amount to N$2.6bn, N$2.6bn and N$2.7bn for FY15, FY16 and FY17, respectively.

Yield on earning assets and interest income

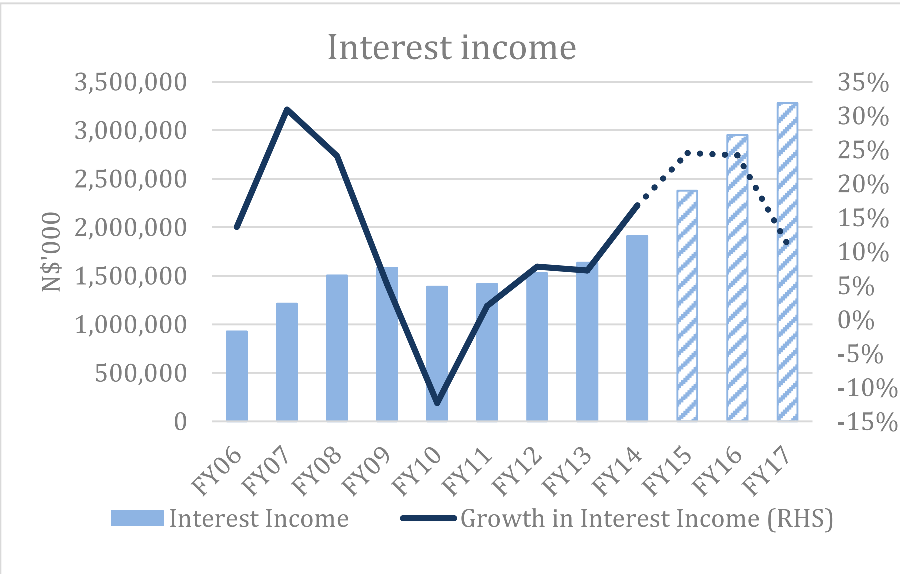
During FY14 the average yield on FNB loans and advances was an estimated 10.3%, down from 10.5% in FY13. This confirms our forecast of a decline in the spread between this yield and the average prime rate. This spread has dropped to 110bps from our 1H14 estimate of 120bps. This spread has declined since a peak of 290 bps in FY09. We foresee a stabilization of this spread in FY15 at close to the current level after which it is expected to mean revert slightly in the latter years of the forecast period. An increase in the average yield on loans and advances is projected due to an expected interest rate hiking cycle.



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, albeit marginally and temporarily, as the hiking cycle commences. 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.

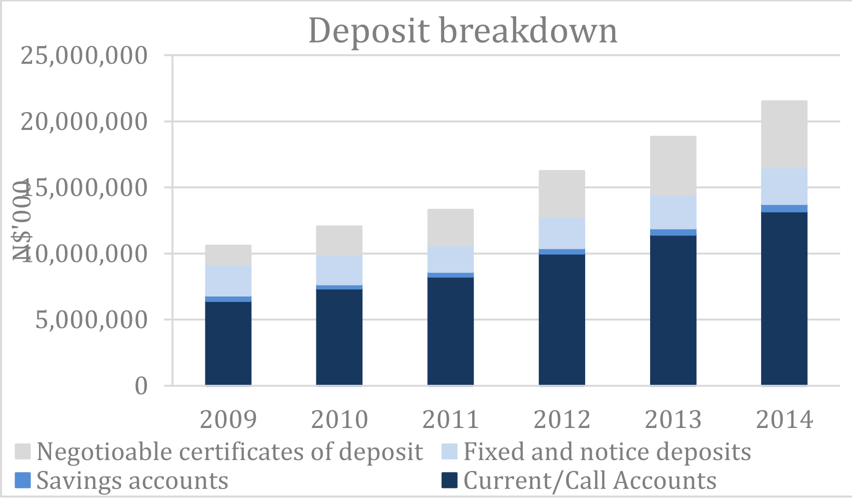
On the back of strong growth in the asset base over recent years (as illustrated on the previous page) and the initiation of an interest rate hiking cycle, the macro environment bodes well for interest income. Interest income growth has accelerated from 7.2% in FY13 to 16.8% in FY14. Following extremely strong growth in interest income, of 26.0%, in the 12 months to December 2015, we have revised up our forecast full year growth, by 0.1%, to 24.5% for FY15.

This equates to N$2.4bn in (gross) interest income in FY15. Based on continued strong growth in income in FY16, of 24.2%, we forecast (gross) interest income at N$3.0bn and as growth slows, to 11.1% in FY17, (gross) interest income will climb to N$3.3bn. In FY15 and 16, higher interest rates will result in improved interest income, despite slowing growth in loans and advances as interest rates increase faster than loans and advances growth declines. However, in FY17, the reverse is true, and slowing interest rate increases are overtaken by slowing loans and advances growth, resulting in slowing growth in interest income.

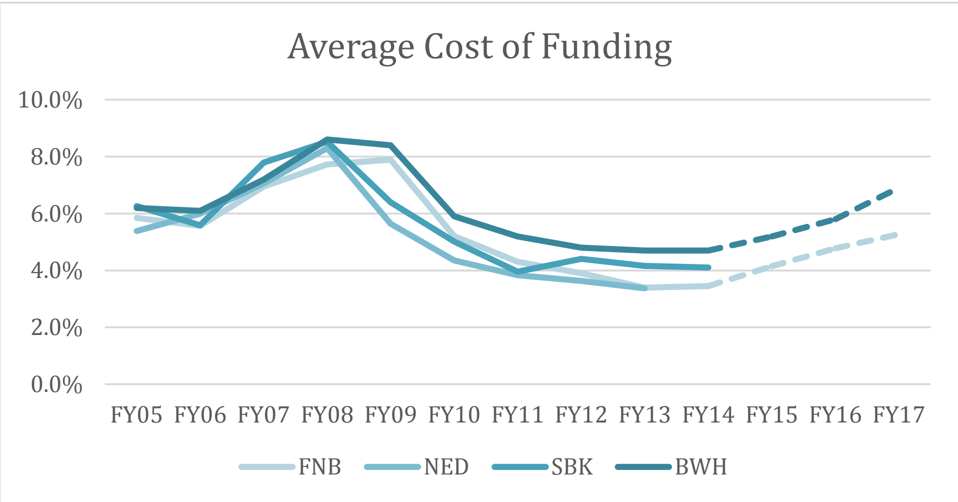


Funding the FNB asset base

Funding mix

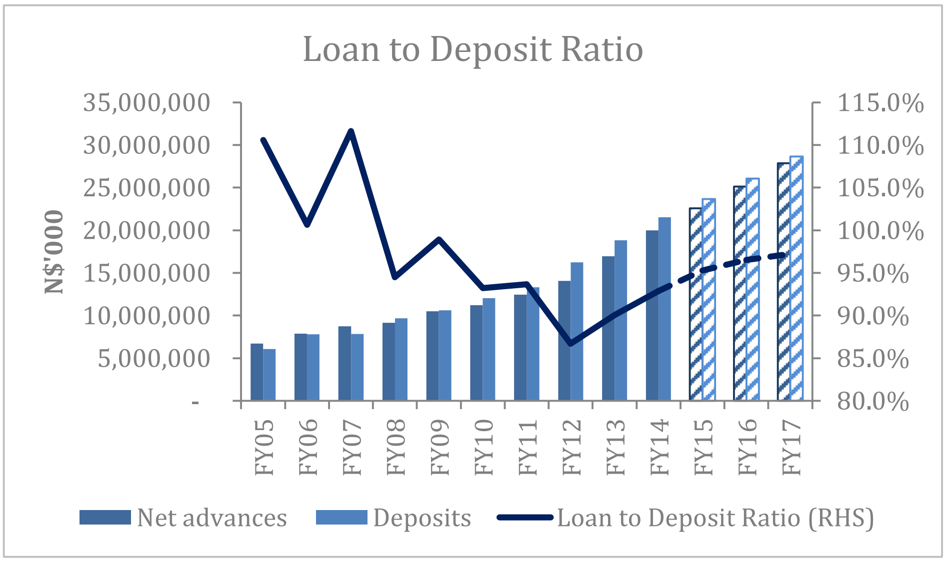


FNB's deposit base has been growing at a CAGR of 15.2% from FY09 to FY14, which is more than sufficient to support growth of 13.8% (CAGR) in loans and advances growth over the same comparable period. However, this spread has declined since last year. The narrowing spread is indicative of FNB's loan to deposit ratio increasing slightly over the past year, although it remains low by historic standards.

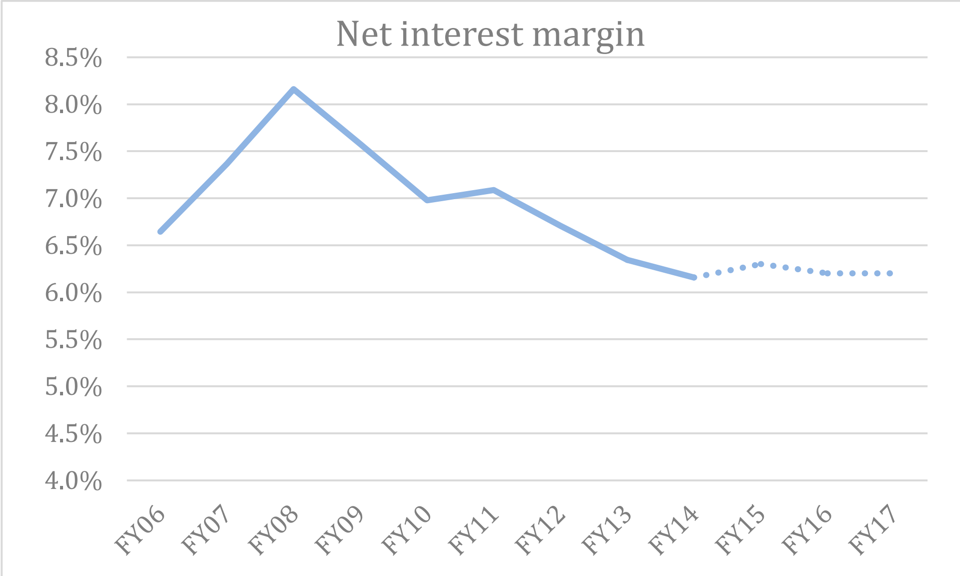


As at FY14 FNB was sitting on a deposit base of N$21.5bn, up N$2.7bn for the year. In the subsequent 6 months, the bank added another N$1.4 billion to its deposit base. Thus, in the 12 months to December 2014, the bank grew its deposit base by 12.4%. FNB has managed to consistently keep current/call accounts at or above 60% of the deposit base. NCDs as percentage of total deposits have increased steadily from 14% in FY09 to 23% in FY14 with this increase being mainly at the cost of saving accounts and fixed/notice deposits. The relatively low prevalence of NCDs and listed-debt funding means that the average cost of FNB's funding is highly competitive, regularly below that of the rest of the market, and the main competitors – Standard Bank and Bank Windhoek.

The favorable loans-to-deposit ratio also allows the bank to extend substantially more credit going forward, without having to seek and compete for additional deposits or more costly funding. Going forward, we see the loan-to-deposit ratio tightening from 92.9% in FY14, to 97.2% in FY17. This closure of the gap between loans and deposits will also compress the company's cost of funding, as liabilities are matched with higher income bearing assets.

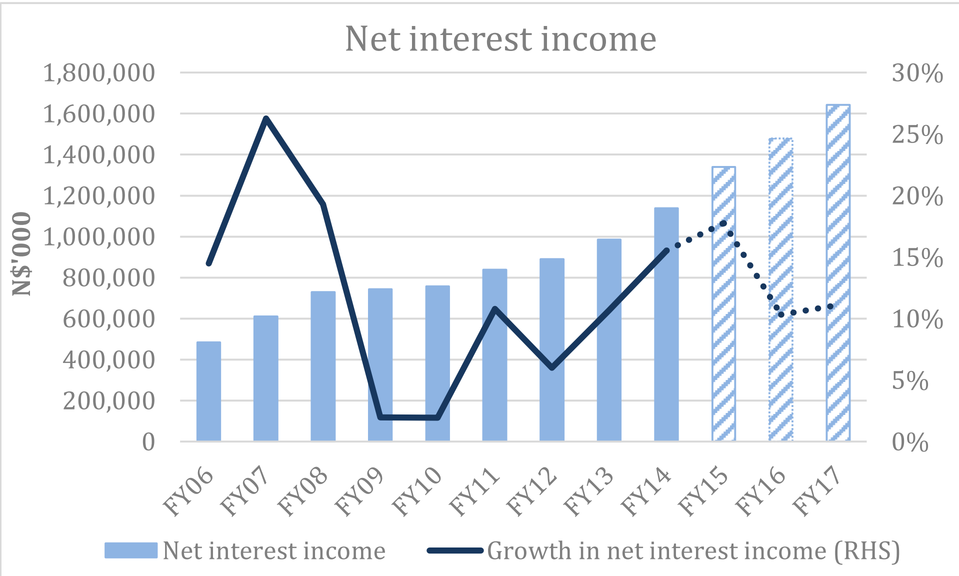


Net interest margin

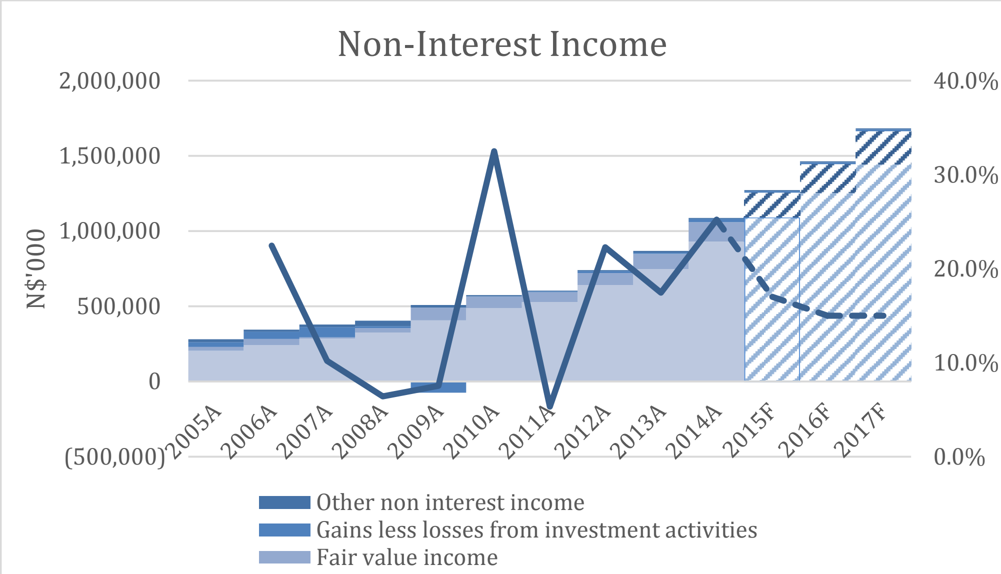


Since FY08, FNB's net interest margin has seen notable compression, from 8.2% in FY08, to 6.2% in FY14. Going forward, we expect this increase to 6.3% in FY15, and then stabilize at 6.2% in FY16 and FY17. In our view, this decrease in FNB's net interest margin as much a function of lower yield on advances as 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.



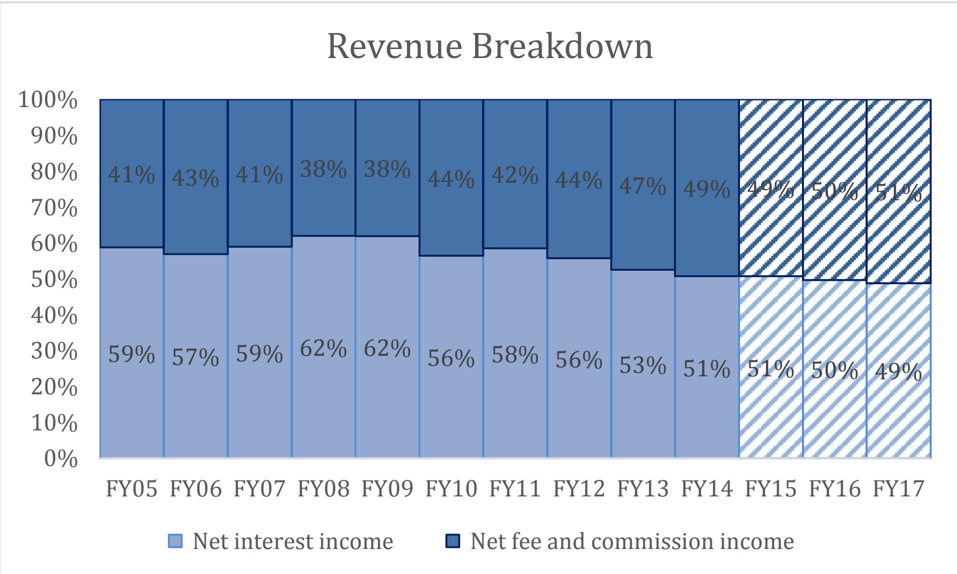
Non-interest income



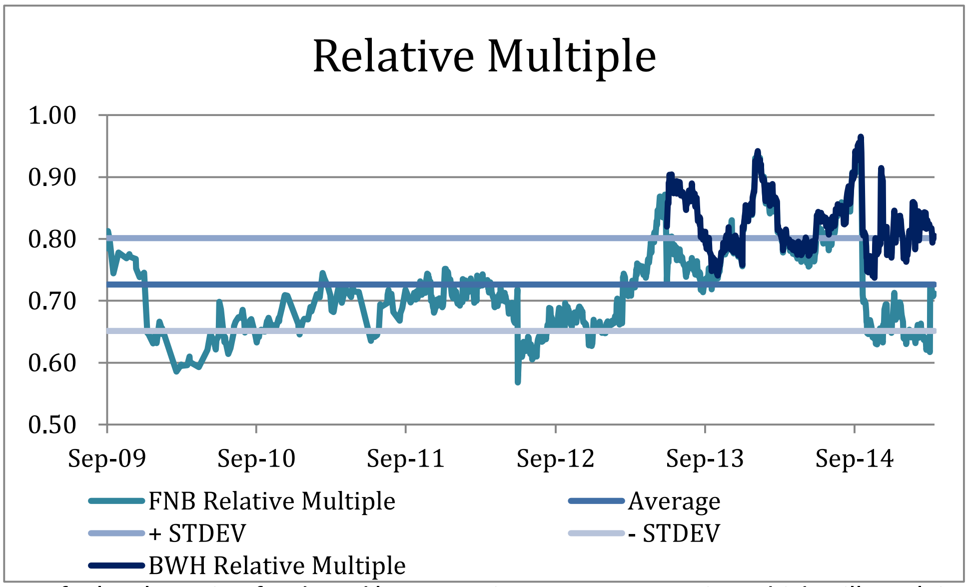
FNB's non-interest income has shown stellar growth, increasing 25.2% in FY14 to N$1.09 billion, continuing the strong trend witnessed the past nine years (9 year CAGR = 16.2%; 5 year CAGR = 20.2%). The strong growth has led to the increased significance of non-interest income within FNB's earnings, making it one of the bank's strongest attributes. In 1H15, no exception was seen or expected. Twelve month growth of 21.2% was seen in the period to December 2014, and thus the year is on track to reach or surpass our full year growth forecast of 17.5%.

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 saw the addition of two new branches, 38 additional ATM's installed and the introduction of various new products aimed at making banking easier over the six month period to 1H15.

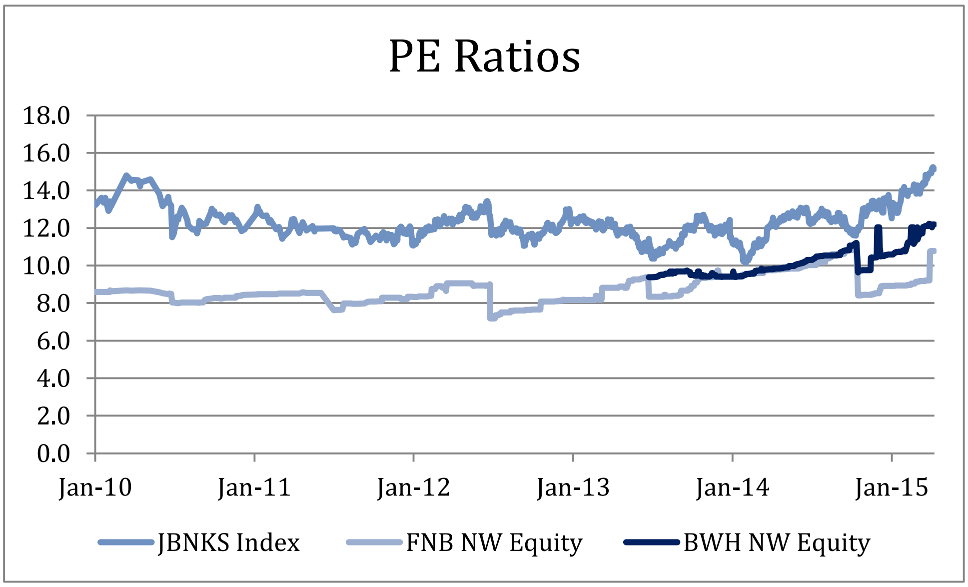
Going forward, we see non-interest income moving past net-interest income as the company's primary source of revenue, despite an expected major decline in interest income growth, from 25% to 17% in FY15. This is on account of the slowing in growth of net interest income as interest rates increase and PSCE growth slows and margins are compressed. As such, we expect non-interest income to represent 49% of total income in FY15, increasing to 51% by FY17.



Valuation and recommendation



FNB's PE relative to the JSE Banks index has been on the rise since early 2010, and until June 2014, was trading at a notable premium to its relative 10-year average. However, it has subsequently de-rated as a result of extremely strong earnings growth in the 2014 financial year. As such, the share is now trading in-line with the 10 year average PE. This re-rating comes despite changes in regulatory requirements for local pension funds and long term insurance companies, which will result in increased demand for the limited available Namibian assets. Thus, we will see a growing demand/supply mismatch over the coming years and as a result may see a continuing re-rating in valuation multiples for Namibian companies. However, the same regulation continues to drive a buy-and-hold mentality amongst local investors, resulting in limited trading of local company shares on the exchange. As such, the share is highly undervalued in our view, but unlikely to increase dramatically in the near term due to a lack of offers and trading.



Based on a justified PE multiple of 11.2x[1], and our FY15 and FY16 earnings per share forecasts of 365.7cps and 418.8cps, respectively, we get a target price of 4090cps. Based on forecasted **dividend of 132cps in FY15**, a **dividend yield of 4.1%**, we foresee a **total return of 31.1%** from the share for the next 12 months, making it our **most preferred locally listed stock**, and thus recommend a **BUY on FNB Namibia.**

[1] Based on a cost of equity of 13.2%, a long term growth rate of 10.0% and a dividend payout ratio of 36%.

INCOME STATEMENT

Year End June	2013A	2014A	2015F	2016F	2017F
Net interest income before impairment of advances	**984,964**	**1,138,002**	**1,340,247**	**1,478,446**	**1,642,654**
Interest and similar income	1,634,997	1,909,521	2,360,501	2,766,125	3,205,824
Interest expenditure and similar charges	(650,033)	(771,519)	(1,020,254)	(1,287,679)	(1,563,170)
Impairment losses of advances	(23,366)	(18,433)	(31,199)	(34,765)	(38,525)
Net interest income	**961,598**	**1,119,569**	**1,309,048**	**1,443,681**	**1,604,129**
Fee and commission income	747,083	928,558	1,091,056	1,254,714	1,442,921
Net fee and commission income	**868,549**	**1,087,351**	**1,272,201**	**1,463,031**	**1,682,485**
Net insurance premium income	99,725	125,795	138,375	149,444	161,400
Operating Income	**1,878,957**	**2,261,636**	**2,641,437**	**2,970,151**	**3,355,128**
Operating expenses	(944,265)	(1,069,398)	(1,197,726)	(1,317,498)	(1,449,248)
Operating Profit before taxation	**936,663**	**1,192,795**	**1,443,711**	**1,652,653**	**1,905,880**
Indirect tax	(19,757)	(21,971)	(26,593)	(30,441)	(35,106)
Profit before tax	**916,906**	**1,170,824**	**1,417,118**	**1,622,211**	**1,870,774**
Direct tax	(309,285)	(386,216)	(453,478)	(519,108)	(598,648)
Profit for the year	**607,621**	**784,608**	**963,640**	**1,103,104**	**1,272,126**

BALANCE SHEET

N$ 000	2013A	2014A	2015F	2016F	2017F
Cash and short-term funds	690,340	867,579	766,434	726,368	810,885
Due from banks and other financial institutions	1,888,968	1,766,327	1,745,487	1,934,000	2,142,872
Derivative financial instruments - trading	94,987	92,031	92,031	92,031	92,031
Advances - at amortized cost	16,964,679	19,990,782	22,556,735	25,135,070	27,853,754
Investment securities and other investments	2,272,753	2,833,146	3,139,126	3,478,151	3,853,792
Accounts receivable	187,764	140,446	155,614	172,420	191,042
Re-insurance assets	221	572	10,445	2,518	2,937
Investment in associate companies	3,994	3,168	3,510	3,889	4,309
Current taxation	-	341	341	341	341
Deferred taxation assets	3,173	3,115	3,115	3,115	3,115
PPE	376,737	551,620	611,195	677,204	750,342
Intangible assets	15,825	6,700	7,424	8,225	9,114
TOTAL ASSETS	**22,499,441**	**26,255,827**	**29,091,456**	**32,233,334**	**35,714,534**
Deposit and current accounts	18,835,676	21,522,377	23,674,615	26,042,076	28,646,284
Due to banks and other financial institutions	319,084	812,964	894,260	938,973	985,922
Derivative financial instruments - trading	128,612	109,281	109,281	109,281	109,281
Creditors and accruals	159,410	294,364	294,364	294,364	294,364
Policyholder liabilities under insurance contracts	50,490	62,993	69,796	77,334	85,686
Current taxation	143,117	57,494	57,494	57,494	57,494
Employee liabilities	122,336	150,098	135,350	152,285	160,688
Deferred taxation liabilities	48,582	70,432	70,432	70,432	70,432
Long term liabilities	392,620	392,622	392,624	392,626	392,628
Other Liabilities	9,806	6,030	-	-	-
TOTAL LIABILITIES	**20,209,733**	**23,478,655**	**25,698,217**	**28,134,866**	**30,802,779**
Ordinary shares	1,297	1,299	1,299	1,299	1,299
Share premium	174,167	161,998	161,998	161,998	161,998
Reserves	2,086,581	2,582,614	3,198,682	3,903,910	4,717,197
Total ordinary shareholder's funds	2,262,045	2,745,911	3,361,979	4,067,207	4,880,494
Non-controlling interest	27,663	31,261	31,261	31,261	31,261
Total equity	**2,289,708**	**2,777,172**	**3,393,240**	**4,098,468**	**4,911,755**

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