21 October 2014

FNB Namibia Holdings

Leader of the pack

Target Price (c)	3163
Current Price (c)	2504

Year End 30 June	2013A	2014A	F2015	F2016	F2017
Net interest income (N$m)	985	1,138	1,284	1,451	1,615
Non-interest income (N$m)	869	1,087	1,250	1,438	1,654
Profit (N$m)	608	785	919	1,075	1,243
HEPS (c)	229	295	349	408	472
DPS (c)	100	109	122	143	165
DY (%)*	4.0	4.4	4.9	5.7	6.6
P/E (x)*	10.9	8.5	7.2	6.1	5.3
P/BV (x)*	2.9	2.4	2.0	1.6	1.4

Source: BWH, IJG
**Ratio to current price*

Recommendation	BUY
NSX Code	FNB
Market Cap (N$m)	6 701
Shares in Issue (m)	267.6
Free float (%)	40
52 week high (c)	2504
52 week low (c)	2141
Expected Total Return (%)	31.2

Solid earnings growth, broadly in line with expectations

FNB released solid results for the year ended 30 June 2014, with headline earnings per share beating IJG forecasts by 3.4%, an increase on 2013 HEPS of 28.2%. Basic earnings per share are up 29.3% to 297.7c. The company continues to look relatively cheap from a price-to-earnings ratio perspective, with this ratio now standing at 8.3x. Moreover, a full year dividend of 122cps, up 22% on the dividend distribution in 2013, puts the company on an attractive dividend yield of 4.9%.

Income from operations increased by 20.4%, to N$2.262 billion, driven by large increases in both non-interest and interest income. Net interest income increased by 15.5% (or N$153m) on the back of strong growth in average advances, of 18%. The net interest margin deteriorated slightly over the period, partially due to the tightening of the spread between the Namibian and South African interest rates, but also due to the increased duration of FNB's funding base, thus putting the company in a strong position to benefit from future rate increases. Non-interest income expanded by 25.1% (or N$218m) on account of expansion in the use of electronic banking, predominantly.

Impairment losses remain low, currently at N$18.4 million, down from N$23.4 million in 2013. Non-performing loans decreased further, to N$141 million, just 0.9% of gross advances. This low level of non-performing loans, and thus impairment losses, is on account of the current low interest rate environment in the country, as well as prudent lending by the bank.

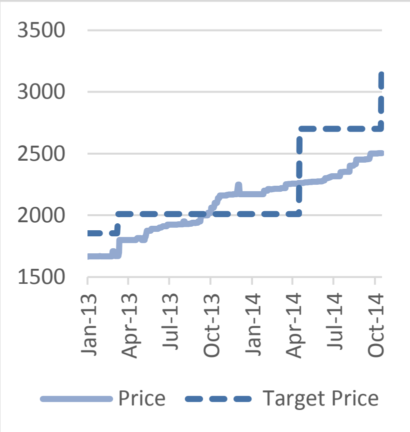
Cost control

Once again, FNB has shown notable increases in income while managing to contain costs with the result being a double-whammy effect on the company's bottom line. Cost increases of 13.3% were seen during 2014, compared to the increase in income of 20.4%. As such, profit before tax increased by 27.7%, to surpass the N$1 billion mark for the first time. As such, profit before tax now stands at N$1.171 billion, while profit after tax stands at N$785 million.

Valuation and Recommendation

Based on a justified PE multiple of 9.3x[1], and our FY15 and FY16 earnings per share forecasts of 348.6cps and 408.1cps, respectively, we get a warranted price of 3250cps. In support of this valuation, a residual income calculation, based on the same cost of equity and long term growth rate, suggests a warranted price of 3072cps. Equally weighting the two valuation methods, **we derive a target price for FNB Namibia of 3163cps.** Based on forecasted **dividend of 122cps in FY15**, a **dividend yield of 4.9%**, we foresee a **total return of 31.2%** for the company, making it our **most preferred locally listed stock**, and thus recommend a **BUY on FNB Namibia.**

FNB closing price vs target price



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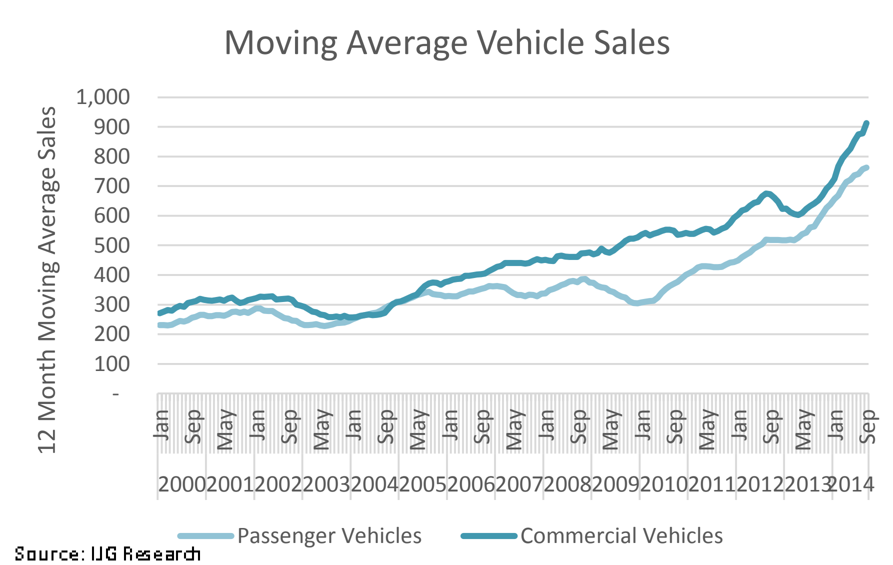
[1] Based on a cost of equity of 12.25%, a long term growth rate of 8.5% and a dividend payout ratio of 35%.

Macroeconomic Backdrop

The macroeconomic backdrop for the Namibian commercial banks remains largely positive. The economy continues to perform admirably, despite frosty headwinds emanating from Europe and China, and the resultant price-drag on Namibian exports, particularly in local currency terms. The local economy has grown at over 5.0 percent for the past three years, which strong growth is expected to continue in 2014 and 2015. This growth is largely driven by a construction boom, as well as unprecedented fiscal and monetary stimulus in the country.

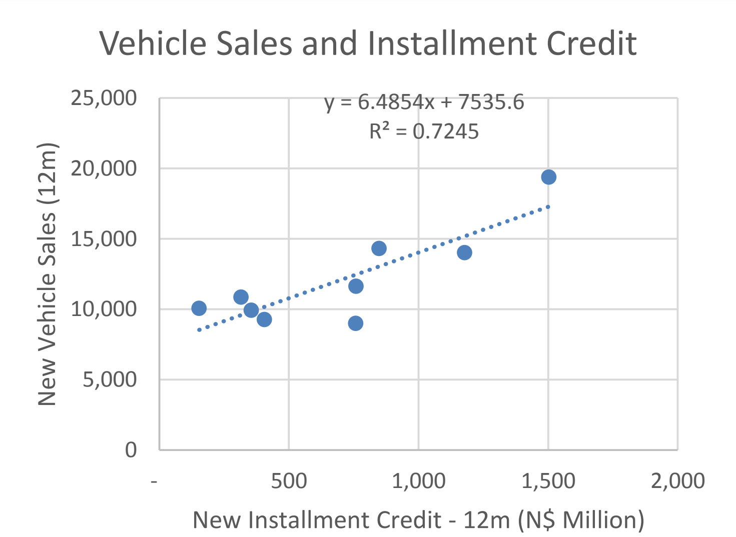
As a result of the aforementioned, a major increase in in disposable income in the country has been witnessed, as increased government expenditure coupled with lower tax rates, higher employment, increased wages and cheap money supply have put funds back into the pockets of the populous. This in turn has resulted in major increases in consumer activity in the country, due to the low marginal propensity to save witnessed in Namibian consumers. Additionally, increases in disposable income are often utilized to increase leverage at a household level, and thus salary and wages growth results in increased uptake of credit by the private sector.



Source: IJG Research

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 year, 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 strong 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.

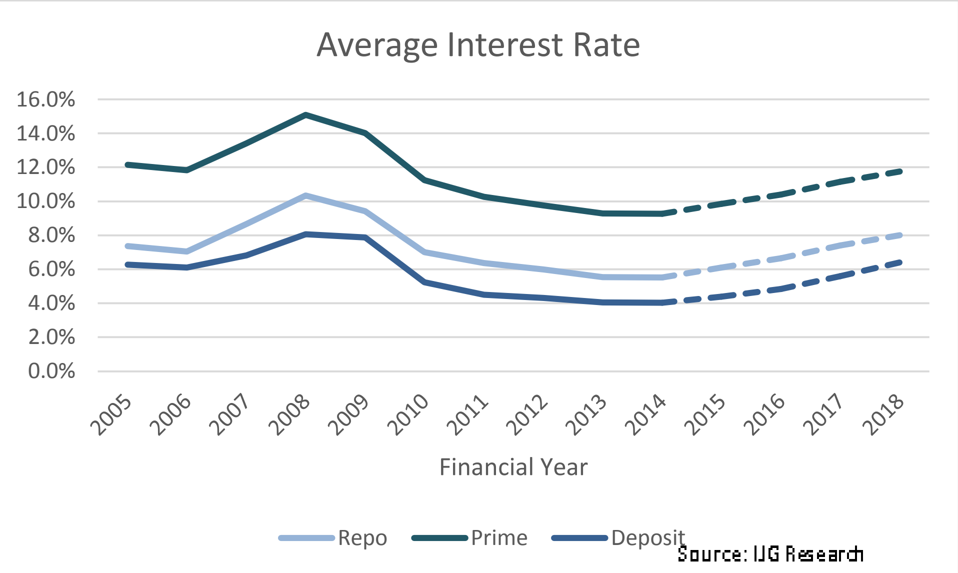


Source: IJG Research

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, 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.

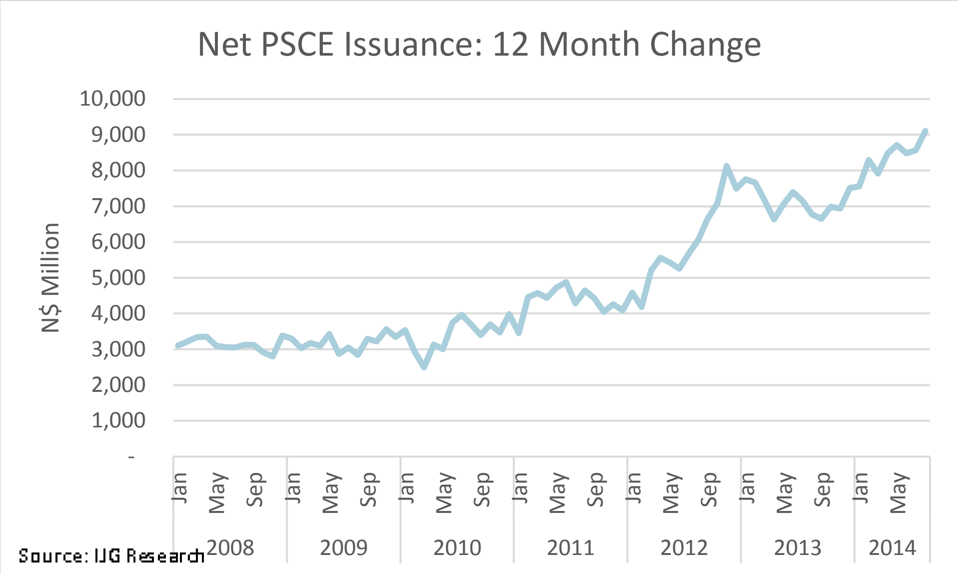


Interest Rates

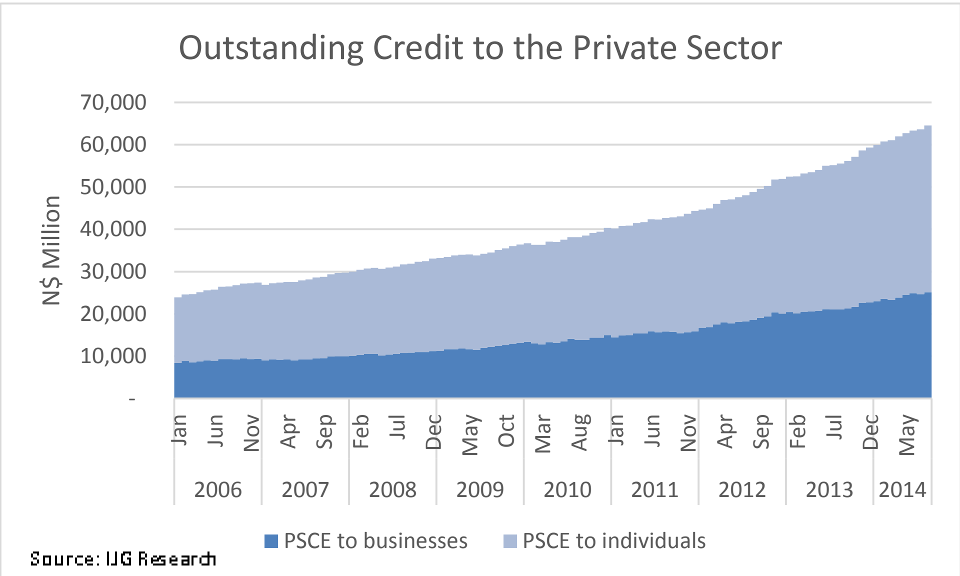
Following an extended period of historically low interest rates, in January 2014, the South African Reserve Bank (SARB) hiked interest rates by 50 basis points, with the Bank of Namibia (BON) following five months later with a 25 point hike. Thereafter, both the SARB and BON hiked a further 25 points, signalling that a hiking cycle has begun within the common monetary area. Given the positive state of the Namibian economy, a weakening balance of payments, rampant credit extension growth and increasing demand-side inflation, this increase was overdue in our view, and we expect a number of further increases over the next 18 to 24 months.

However, anaemic growth in South Africa, coupled with high unemployment and abating inflation suggests to us that the SARB will hike as slowly as possible going forward in attempt to support the economy. BON is likely to take its leads from the SARB, and welcome the opportunity to phase in higher interest rates over an extended period of time, in order to allow households warning and time to deleverage from current high debt levels over an extended period of time, thus reducing the risk of duress.

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 year. As of August 2014, outstanding credit to the private sector stood at N$64.87 billion, with N$39.43 billion (61%) and N$25.14 billion (39%) outstanding to households and corporates, respectively. The 12 month net issuance surpassed the N$9.0 billion mark for the first time in August, on account of major uptake of credit by households, particularly, in the form of mortgage loans and instalment sales, and businesses, primarily in the form of overdrafts.

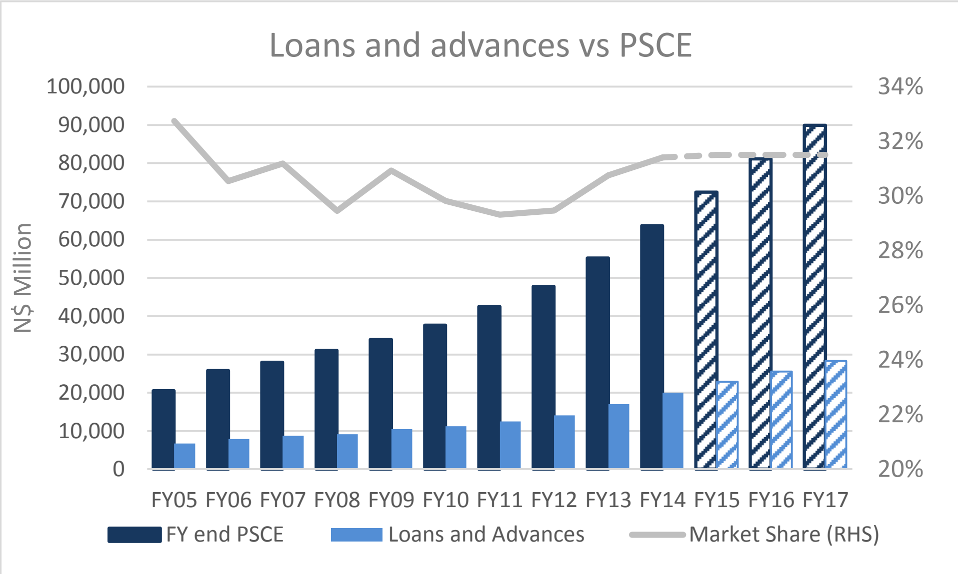


Going forward, we expect credit demand to remain rampant, particularly from private households, while we expect to see slowing growth in PSCE to corporates. On the supply side, however, we expect to see increased caution when it comes to lending as commercial banks go to pains to ensure that non-performing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

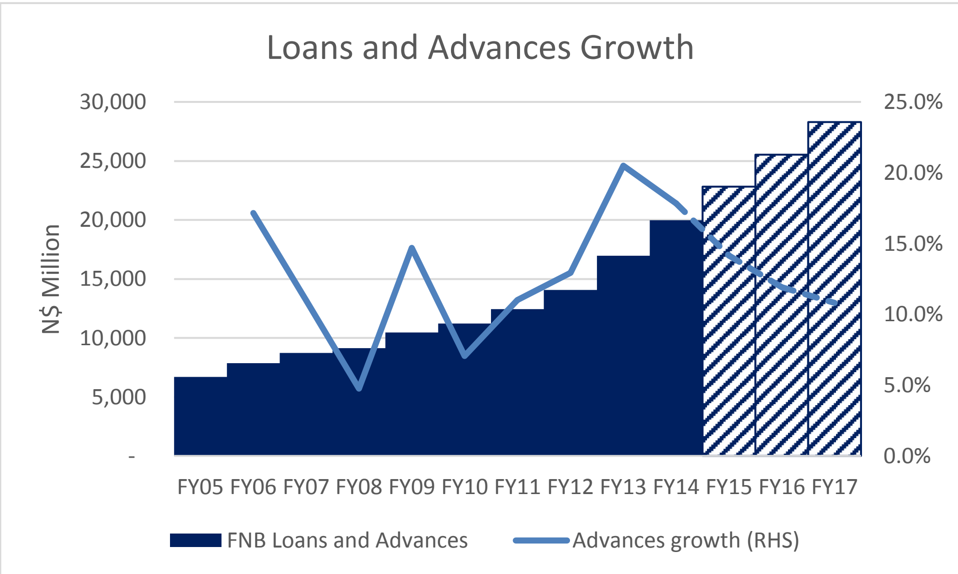
Interest income and the asset base

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 adjacent graph shows FNB's market share following a general downward trend from FY05 to FY11, decreasing from 32.7% to 29.4%. FNB's market share has however rebounded since, to 31.4% as at FY14. In our forecast we assume that FNB's market share will stabilize at 31.5% going forward.



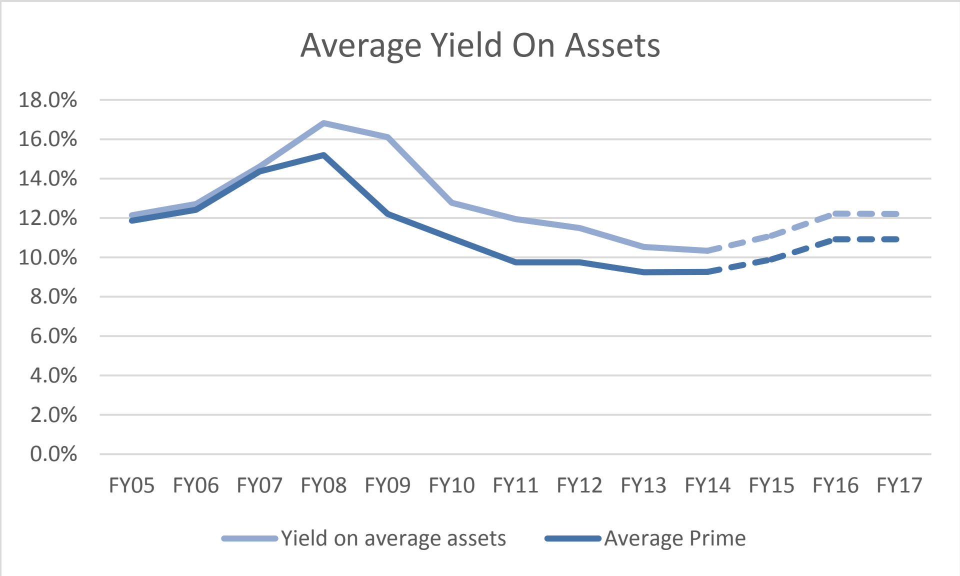
The loans and advances forecasts are a function of IJG's projections of PSCE over the next 3 years and our market share assumptions. Based on this we foresee that FNB loans and advances will increase to N$22.8bn in FY15, N$25.5bn in FY16, and N$28.3bn in FY17.



Growth in advances has slowed to 17.8% for FY14, slightly below our forecast of 18.6%. We forecast growth in advances continuing to moderate to 14.2%, 11.9% 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$2.8bn, N$2.7bn and N$2.8bn for FY15, FY16 and FY17, respectively.

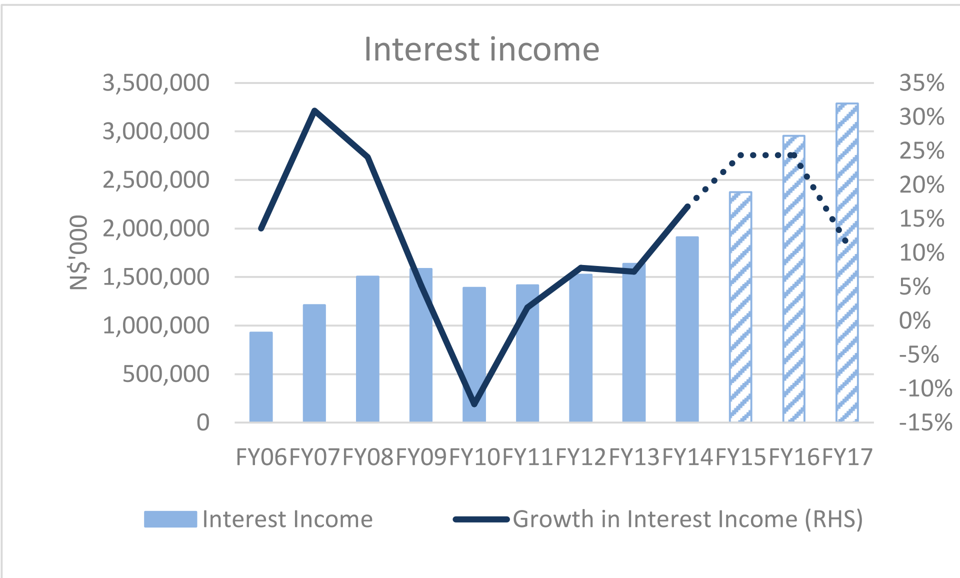
Yield on earning assets and interest income

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.

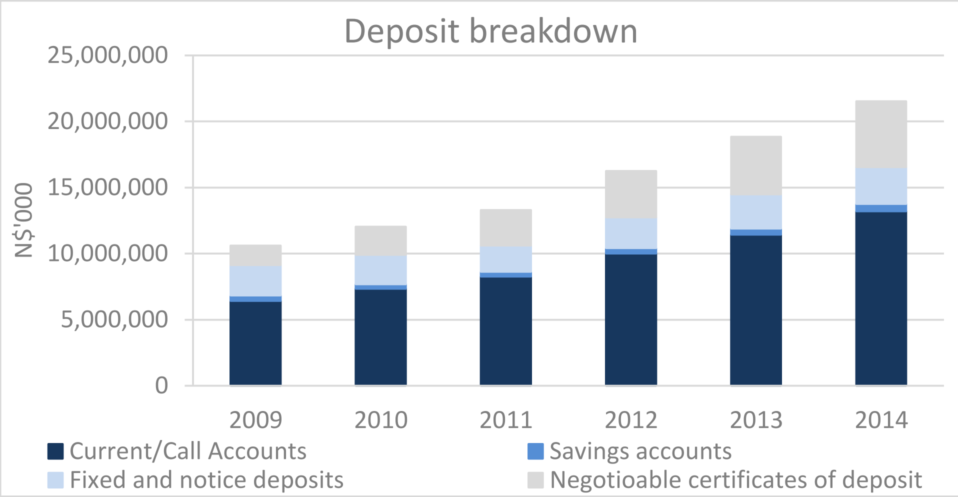


The reason for the small spread over the prime rate is twofold, firstly this is typical at the bottom of an interest rate cycle and is expected to widen, albeit marginally and temporarily, as the hiking cycle commences. Secondly, this could also be a reflection of FNB's competitiveness, as the bank is, 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 (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. We forecast interest income at N$2.4bn in FY15, N$3.0bn in FY16 and N$3.3bn in FY17. This implies that growth will accelerate from 16.8% in FY14 to 24.4% in FY15 and 24.4% in FY16 after which it is expected to slow to 11.3% in FY17. 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.

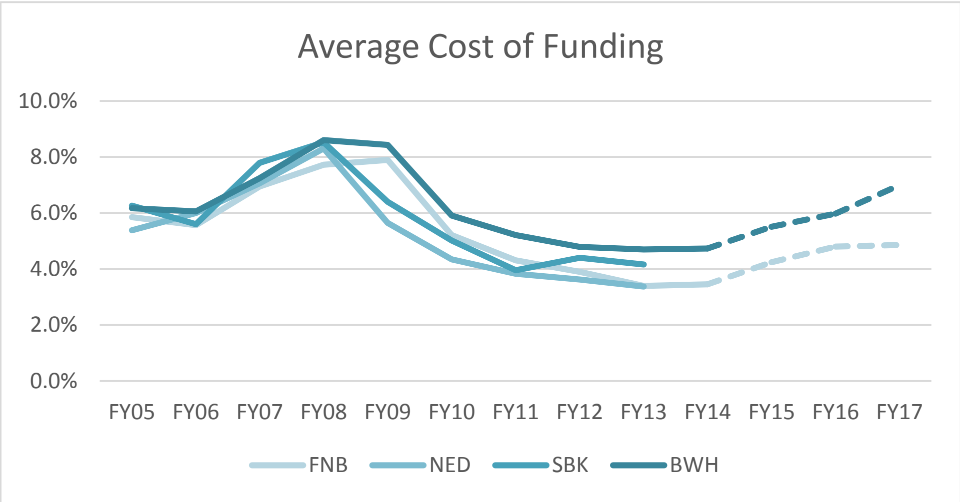


Funding the FNB asset base



Funding mix

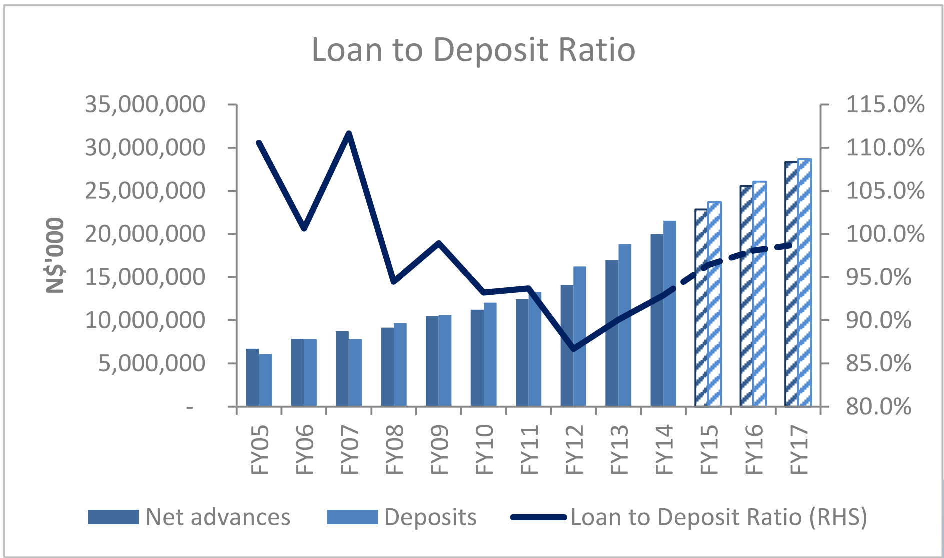
FNB's deposit base has been growing at a CAGR of 15.2% from FY09 to FY14, which is more than sufficient to support growth of 13.8% (CAGR) in loans and advances growth over the same comparable period. However, this spread has declined since last year. The narrowing spread is indicative of FNB's loan to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

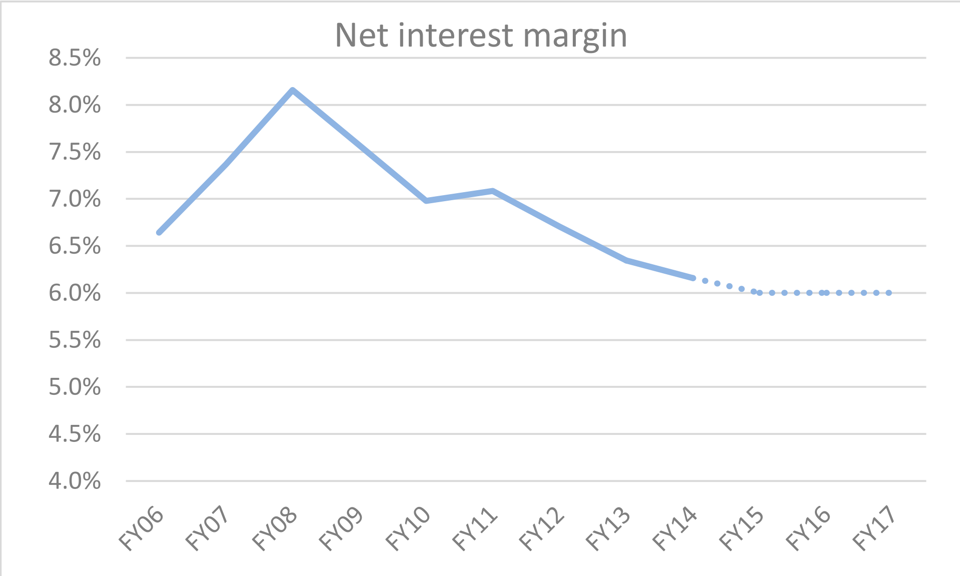
The favorable loans-to-deposit ratio also allows the bank to extend substantially more credit going forward, without having to seek and compete for additional deposits or more costly funding. Going forward, we see the loan-to-deposit ratio tightening from 92.9% in FY14, to 98.8% in FY17. This closure of the gap between loans and deposits will



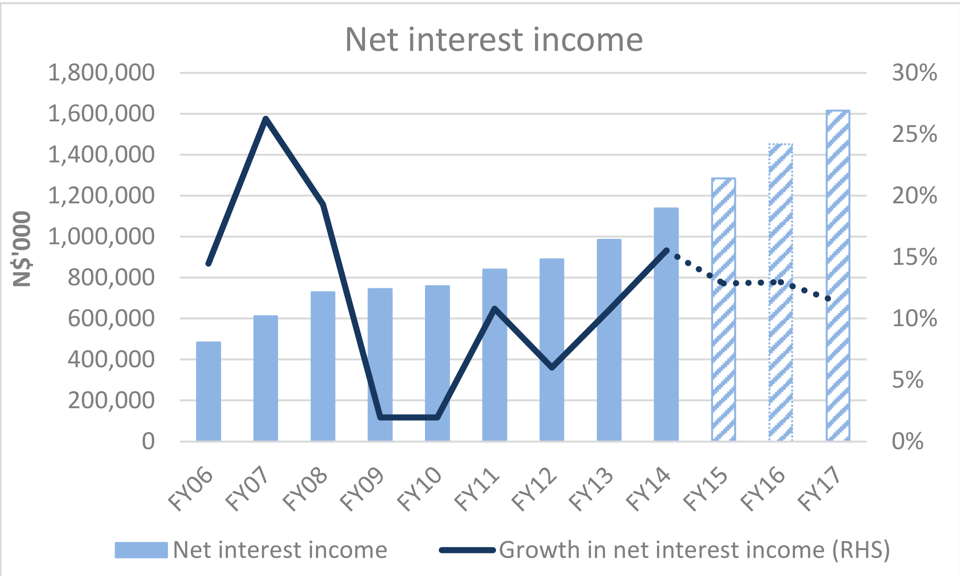
also compress the company's cost of funding, as liabilities are matched with higher income bearing assets.

Net interest margin

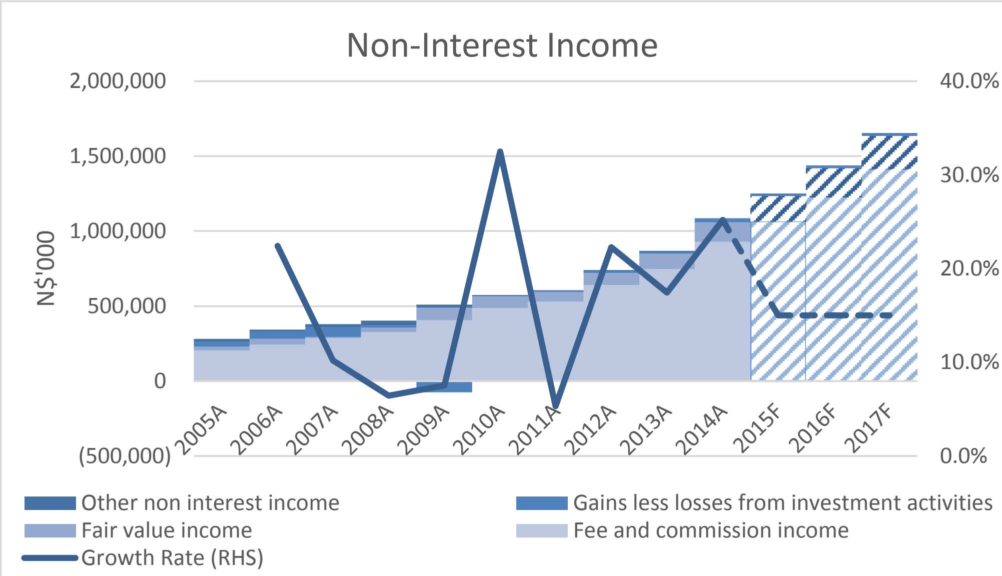
Since FY08, FNB's net interest margin has seen notable compression, from 8.2% in FY08, to 6.2% in FY14. Going forward, we expect this to continue to 6.0% in FY15, and then stabilize at that level to FY17. In our view, this decrease in FNB's net interest margin is more a function of lower yield on advances 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 expect net interest income growth to taper off for the next three periods towards 12% in FY17.



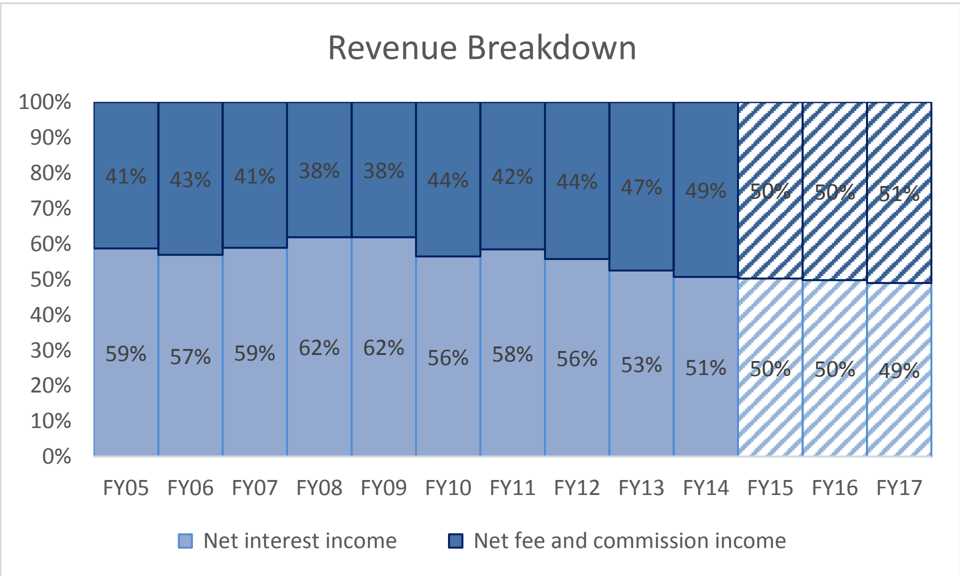
Non-interest income



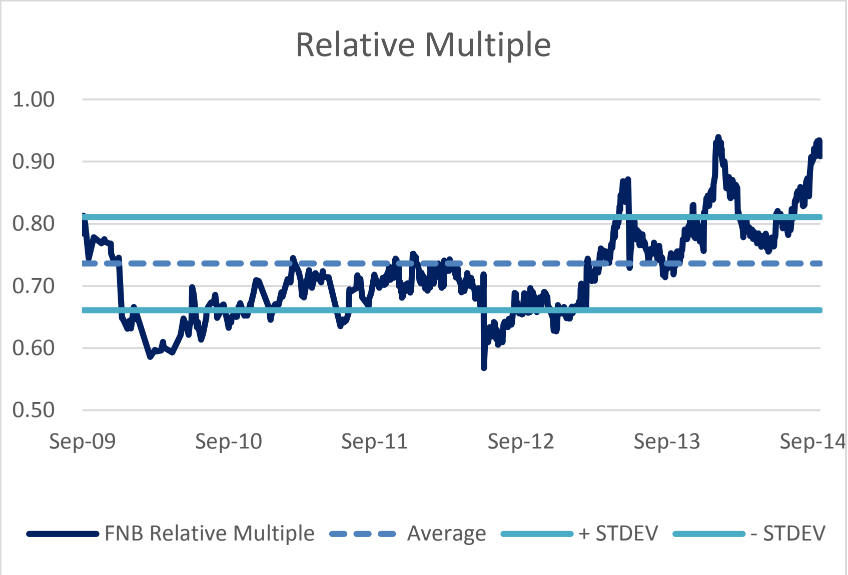
FNB's non-interest income has shown stellar growth, increasing 25.2% in FY14 to N$1.09 billion, continuing the strong trend witnessed the past nine years (9 year CAGR = 16.2%; 5 year CAGR = 20.2%). The strong growth has led to the increased significance of non-interest income within FNB's earnings, making it one of the bank's strongest attributes. In FY14 non-interest income and insurance income jointly contributed 49% to total revenue, up from 47% as recently as FY13.

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 3 new branches, 25 ATM's and 341 POS devices over the last year.

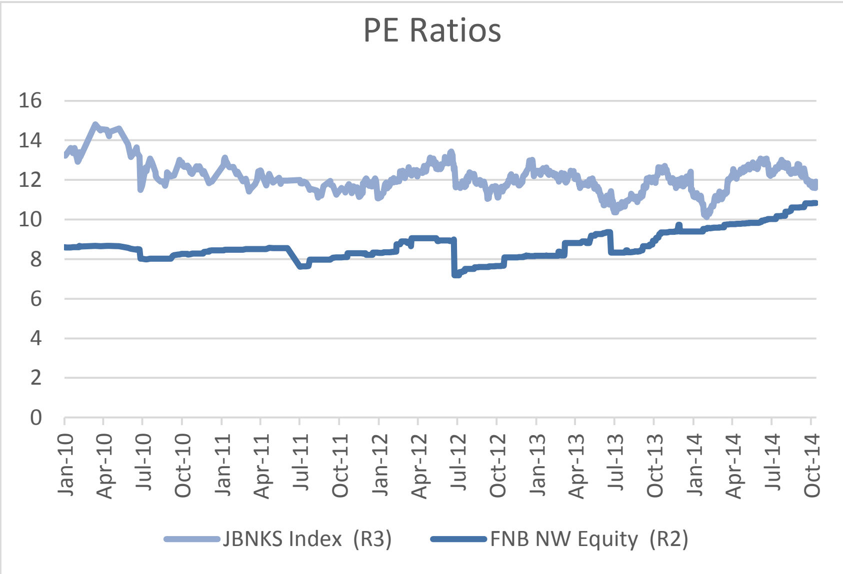
Going forward, we see non-interest income moving past net-interest income as the company's primary source of revenue, despite an expected major decline in interest income growth, from 25% to 15% in FY15. This is on accound of the slowing in growth of net interest income as interest rates increase, and demand for credit slows. As such, we expect non-interest income to represent 50% 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 is currently trading at a notable premium to its relative 10-year average. However, this re-rating is to be expected as changes in regulatory requirements for local pension funds and long term insurance companieswill 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 will see a continuing re-rating in valuation multiples for Namibian companies. Since June 2014, the FNB PE ratio has climbed to 10.8x, well above the long term norm. It has also rerated dramatically against JBANKS, both due to a decline in the PE of the latter, and an increase in the PE of the former.



Based on a justified PE multiple of 9.3x[2], and our FY15 and FY16 earnings per share forecasts of 348.6cps and 408.1cps, respectively, we get a warranted price of 3250cps. In support of this valuation, a residual income calculation, based on the same cost of equity and long term growth rate, suggests a warranted price of 3072cps. Equally weighting the two valuation methods, **we derive a target price for FNB Namibia of 3163cps.** Based on forecasted **dividend of 122cps in FY15**, a **dividend yield of 4.9%**, we foresee a **total return of 31.2%** for the company, making it our **most preferred locally listed stock**, and thus recommend a **BUY on FNB Namibia.**

WEIGHTED AVERAGE VALUATION

Methodology	Weight	Target price	Weighted average price
Residual Income (cps)	50.00%	3072	1536.10
Justified PE (cps)	50.00%	3253	1626.74
Weighted Average Target Price (NADs cps)			**3163**

[2] Based on a cost of equity of 12.25%, a long term growth rate of 8.5% and a dividend payout ratio of 35%.

INCOME STATEMENT

Year End June	2013A	2014A	2015F	2016F	2017F
Net interest income before impairment of advances	**984,964**	**1,138,002**	**1,284,347**	**1,450,837**	**1,615,304**
Interest and similar income	1,634,997	1,909,521	2,375,149	2,954,066	3,288,939
Interest expenditure and similar charges	(650,033)	(771,519)	(1,090,803)	(1,503,229)	(1,673,635)
Impairment losses of advances	(23,366)	(18,433)	(21,042)	(23,550)	(26,097)
Net interest income	**961,598**	**1,119,569**	**1,263,304**	**1,427,287**	**1,589,207**
Fee and commission income	747,083	928,558	1,067,842	1,228,018	1,412,221
Net fee and commission income	**868,549**	**1,087,351**	**1,250,454**	**1,438,022**	**1,653,725**
Net insurance premium income	99,725	125,795	138,375	149,444	161,400
Operating Income	**1,878,957**	**2,261,636**	**2,573,945**	**2,928,748**	**3,311,446**
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**	**1,376,220**	**1,611,249**	**1,862,198**
Indirect tax	(19,757)	(21,971)	(25,350)	(29,679)	(34,301)
Profit before tax	**916,906**	**1,170,824**	**1,350,870**	**1,581,571**	**1,827,896**
Direct tax	(309,285)	(386,216)	(432,278)	(506,103)	(584,927)
Profit for the year	**607,621**	**784,608**	**918,592**	**1,075,468**	**1,242,970**

BALANCE SHEET

N$ 000	2013A	2014A	2015F	2016F	2017F
Cash and short-term funds	690,340	867,579	290,792	86,508	101,854
Due from banks and other financial institutions	1,888,968	1,766,327	1,957,090	2,168,456	2,402,649
Derivative financial instruments - trading	94,987	92,031	92,031	92,031	92,031
Advances - at amortized cost	16,964,679	19,990,782	22,820,774	25,540,474	28,303,008
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	2,071,274	5,277,204	5,804,924
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	-	-	-
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**	**26,739,880**	**32,320,812**	**35,461,094**
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	3,169,881	3,857,442	4,652,088
Total ordinary shareholder's funds	2,262,045	2,745,911	3,333,178	4,020,739	4,815,385
Non-controlling interest	27,663	31,261	31,261	31,261	31,261
Total equity	**2,289,708**	**2,777,172**	**3,364,439**	**4,052,000**	**4,846,646**

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