IJG

Securities (Pty) Ltd.

Member of the NSX

FNB NAMIBIA HOLDINGS

FY16 Results Review

DECEMBER 2016

FNB Namibia Holdings

FY16 Results Review

Target Price (c)	4980
Current Price (c)	4790

Year End 30 June	2015	2016	F2017	F2018	F2019
Net interest income (N$m)	1,453	1,654	1,905	2,148	2,447
Non-interest income (N$m)	1,260	1,507	1,612	1,849	2,123
Profit (N$m)	999	1,218	1,330	1,503	1,724
HEPS (c)	378	436	503	568	652
DPS (c)	183	213	221	273	313
DY (%)	3.8	4.4	4.6	5.7	6.5
P/E (x)	12.7	11.0	9.5	8.4	7.4
P/BV (x)	3.7	3.1	2.6	2.2	1.9

Source: FNB, IJG

Recommendation	
NSX Code	FNB
Market Cap (N$m)	12,817
Shares in Issue (m)	267.6
Free float (%)	40
52 week high (c)	4850
52 week low (c)	4350
Expected total return	8.6%

FNB Namibia released its results for year ending 30 June 2016. The company saw good growth given the current macroeconomic climate, with profit up 21.9% for the year, beating our expectations by 3.4%. Profit was, however, bolstered by the a once-off property sale to the value of N$67.3 million. As a result, headline earnings grew at a lower rate of 15.7%. Headline earnings per share just missed our expectations, coming in short by 2.1%. However, as we had not forecast the once of item, earnings per share beat our expectations by 3.2%. The company's income was split 48.4% to 51.6% between non-interest income and net-interest income (after impairments). Overall, net interest income has shrunk as a percent of total income, from 52.7%, while non-interest income has increased from 47.3%. Over the year, net interest income (after impairments) expanded by 14.5%, while non-interest income is up 19.4%.

From a net-interest income perspective, interest income saw healthy growth of 18.9%, while the interest expense increased dramatically, by 26.6%. This increase in interest expense has been seen across much of the sector, driven by the current challenging funding conditions in the country, stretched loan to funding ratios, government crowding out and increased competition for funding. Over the year, the average rate of interest on loans (excluding interbank lending) was 11.81%, while the average funding costs (including the two debt instruments, accounted for as tier two liabilities, but excluding interbank borrowing) was 4.70%. This compares to an average lending rate of 11.27% and an average funding rate of 4.15% in the previous year. The value of loans outstanding increased by 12.9% over the year, driving overall asset growth of 14.8%. Deposits expanded by 16.0%. As such, the overall tightening of the net interest margin was driven by increased cost and volumes of deposits vis-à-vis advances. Surprisingly, given the current environment, impairment losses contracted when compared to last year, falling by 4.1%, from N$49.9 million to N$47.9 million. This was notably better than our forecast of N$78.7 million.

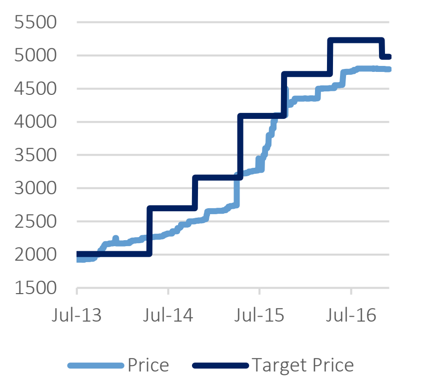
Non-interest income growth was driven by a number of factors. The largest growth in non-interest income came from "other non-interest income" under which the aforementioned sale of property was classified. However, on a weighted basis, the strongest growth was seen in net fee and commission income, which expanded by 13,5%, or by some N$144.8 million. According to the bank this was due to increased transaction volumes and accounts, particularly through electronic channels.

The groups operating expenses increased, but by a lesser amount than revenue, resulting in continued compression in the cost to income ratio, which now stands at 43.7%, from 43.9% in FY15. The bulk of the 16.0% increase was driven by staff costs (up 15.0%), as well as a major increase in depreciation thanks to the new head office in Windhoek.

FNB remains well capitalized with a total capital adequacy of 17.8% (tier 1 capital of 15.1%)., up from 17.4% in FY15, and well above the regulatory requirement of 10%.

For the purpose of valuing the company, we establish a **cost of equity, of 12.20%,** down from 14.12% in FY15, largely on account of a major deterioration in the growth environment in the country, and thus the equity risk premium. Based on this cost of equity, a highly conservative **long-term growth rate for the company of 7.75%,** and a **dividend pay-out ratio of 44%**, we believe a **PE of 9.9x can be justified** on this share. Given **expected earnings growth of 9.2% in FY16**, taking **total earnings to c503/share**, we derive **a target price of N$c4980/share, down from our earlier price target of N$c5230**. Coupled with an **expected dividend of 221cps**, we expect a **total return of 8.6% in FY17**. We thus **revise our previous BUY** recommendation to a **HOLD** recommendation for FNB Namibia.

Share Price (c)



Analyst

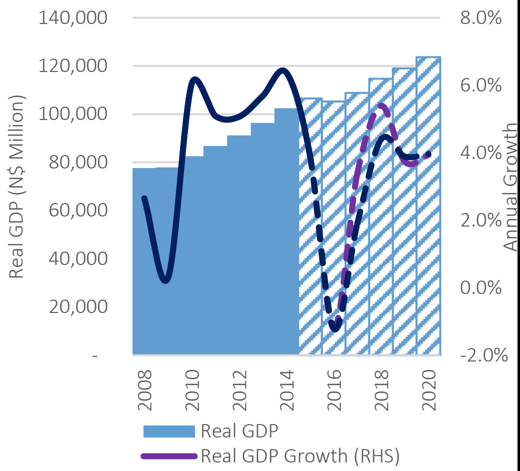
Rowland Brown
+264 61 383 513
rowland@ijg.net.

Dividends

Dividend (final): 122c/share
Declaration date: 5 August 2016
Ex-date: 19 September 2016
Record date: 23 September 2016.
Payment date: 7 October 2016.

Disclaimer

Namibia Real GDP (N$ Million)



Source: Namibia Statistics Agency

Macro backdrop

Growth environment:

The Namibian economy performed admirably over the five years from 2010 to 2014. Over this period, growth averaged over 5.6%, compared to average growth since independence of 4.3%. This abnormally strong growth was driven by three key factors. Firstly, Namibia has been through a prolonged period of historically low interest rates which drove unprecedented uptake of credit by the private sector; secondly, 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, with the economy rebasing from a N$83 billion dollar economy to a close to N$160 billion dollar economy in a period of six years.

However, subsequently, the macroeconomic environment in Namibia has started to deteriorate, as a combination of factors have come together to dampen growth and drive imbalances within the local economy. The unwinding of historically low interest rates, less foreign investment into the economy, a weaker external environment – particularly in Angola and South Africa, weakening commodity prices, regional drought and a high base all had a negative impact on the economy directly, as well as reducing government revenues and thus forcing a relatively abrupt slowdown in government expenditure.

Given the high base created over the past half-decade, and the rate of growth experienced over this period, this abrupt deterioration in macroeconomic conditions comes as a shock, which if not carefully handled is likely to drive a host of negative repercussions to the country.

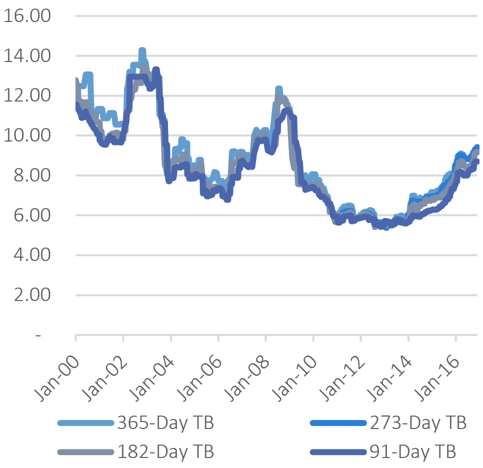
Inflation

As expected, inflation has seen a sizable upswing in 2016 when compared to 2015. While 2015 saw average inflation of 3.4%, the first 10 months of 2016 saw a more normal 6.6%.

For the year so far, Namibian inflation has outstripped that of South Africa. However, inflation expectations remain high in both countries. South African inflation is expected to average 6.4% in 2016 and 5.8% in 2017, as per figures from the South African Reserve Bank. These expectations are largely driven by currency weakness and the pass through effect of higher Import prices. The effect of higher food inflation due to the drought also has a negative effect. Earlier this year the Bank of Namibia released a study which demonstrated that South African food inflation tends to have significant effects on the inflation in Namibia.

Our expectations of Namibian inflation for 2016 is for an average of 6.6% before slowing slightly to 6.4% in 2017. The main reason for this relatively high level being the continual increases seen in administered prices, sustained increases in rentals and housing, and the continuing pass-through effect of high food import prices.

TB Effective Yields (%)

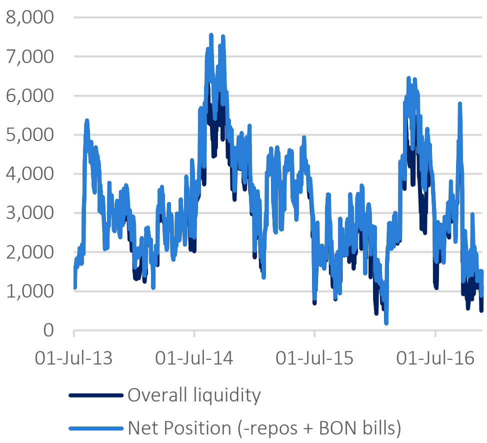


Source: IJG Securities

Generic 10 year yield (%)

Source: IJG Securities

Commercial Bank Liquidity (N$ Million)



Source: Bank of Namibia

Funding

Over the past two years, Namibia's public debt stock has doubled, with the domestic debt stock increasing approximately 80%. Over the same period, the assets that conventionally purchase this debt have not increased by the same magnitude, with pension fund and life insurance assets growing by approximately 27% over the two year period. Additionally, the credit worthiness of Government has deteriorated, as illustrated by the recent rating outlook downgrade by Fitch and the increase in the debt-to-GDP ratio from 23% two years ago, to over 40% at present. At the same time, the South African yield curve, off which Namibian government securities are benchmarked, has weakened. These factors have caused a notable repricing in both Government securities, but also all corporate securities. The IJG Generic 10-year yield has seen an increase from 9.73 to 10.76% in the year from 23 November 2015, while the effective yield on the one year treasury bill has increased from 8.13% in November 2015, to 9.43% in November 2016 (up from 7.01% in November 2014).

The effect of the major debt issuance, and indirectly, monetary policy tightening, has been to crowd out private sector credit issuance, as most of the private sector entities benchmark off government debt, or compete for the same funding.

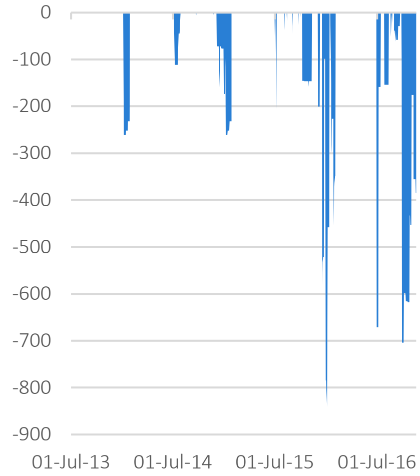
Liquidity

Given the major increases in Government debt (mopping up system liquidity), as well as the prolonged period of low interest rates (incentivizing borrowing and disincentivising savings), banking sector liquidity has come under increased pressure of late. Despite notable growth in commercial bank liabilities, the nominal liquidity position has been recording some of its lowest ever levels in recent months, and the central banks reverse repo facility has seen repeated use.

Government finances too have come under strain over the past 18 months, and as a result, a major source of conventional deposits for commercial banks has dried up. While the Bank of Namibia and Ministry of Finance do not use tax and loan accounts as the South African Reserve Bank does, in order to provide funding and liquidity to the commercial banks, payments from the central government to state owned enterprises and regional government have a tendency to find their way into the banking system. Since 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, as well as payments to service providers have become more cautious and slowly made, resulting in less money finding its way into the banking system.

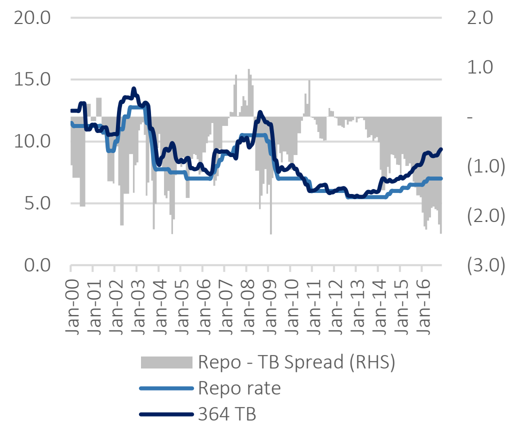
In addition, anecdotal evidence suggests that there have been a number of withdrawals from the banking system as a result of proposed policy changes, with money being taken off-shore as a precautionary measure. Given the nature of a fractional banking system, these withdrawals have a multiplied effect on bank funding, and may be contributing to the current funding and liquidity challenges.

Repo Facility Usage (N$ Million)



Source: Bank of Namibia

Administered vs. market rates/yields (%)



Source: Bank of Namibia, IJG Securities

Spread

The spread between the administered interest rate (repo) and the market determined interest rate (one year treasury bills) is now as wide as it's been since 2000, and has been widening consistently, in a manner not before seen, since early 2013. The spread is now approximately 250 basis points, and as the banks tend to borrow at a margin above the government rates, the marginal cost of funding for the commercial banks, particularly through debt securities, is now close to the administered rate at which loans can be made to the public. Thus, the marginal net interest margin is extremely low at present, and in most instances is not sufficient to justify the credit and duration risk on loans, particularly given the current economic climate and the resultant heightened credit risk.

This situation creates a peculiar and counter-intuitive phenomenon whereby higher interest rates are likely to be required to drive an increase in credit extension, as the current constraint to further credit extension is funding more than credit demand. Higher rates would justify commercial banks borrowing to make further loans, as well as attract deposit funding from the public.

Competitors

Added to the general increase in competition for funding at present is the increased banking sector competition for funding. Not only are a number of large banks now competing for funding more aggressively than they did historically, but there have also been a large number of new entrants into the banking space over the past three years. Given the low liquidity and constrained funding space, the large number of players competing for available funds has driven the cost of funding for the commercial banks up notably.

Licensed Banks

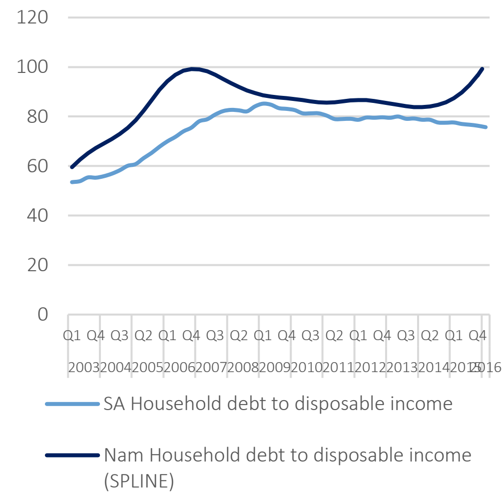
	Full License	Branch License	Fully operational (as a bank)
EBank Limited	✓		✓
First National Bank Namibia Limited	✓		✓
Nedbank Namibia Limited	✓		✓
Standard Bank Namibia Limited	✓		✓
SME Bank Limited	✓		✓
Trustco Bank Limited	✓		
Banco Atlantico		✓	
Bank BIC Namibia Limited	✓		✓
Letshego Bank Namibia Limited	✓		

Source: IJG Securities

Basel III

The implementation of Basel III has heightened demand for longer duration funding in the domestic market, as the commercial banks look to improve their duration matching of long term loan books (largely made up of mortgage loans) with their current relatively short funding books. As such, most of the large commercial banks have issued debt securities with medium to long term duration, have been paying handsomely for one-year plus NCDs and have all-but stopped paying interest on short term or call deposits.

Household Debt to Disposable Income (%)



Source: Bank of Namibia, IJG Securities, SARB

Regulation 28

On the positive side, as far as the banks are concerned, impending changes to the local asset requirements in Regulation 28 (both reduction in dual listed equity as a percent of total assets and a gradual increase of the local asset requirement to 50% of total assets, over a period of three years) will force a percentage of Namibia's contractual saving pool back into the country from its current home abroad. Given the magnitude of the expected inflow, and the major shortages of available local assets, both the banking system and central government will likely see a recovery in both demand and pricing for their debt instruments. In addition, the banking system will likely see an improvement in the availability of conventional deposits as some of the funds find their way into the system directly or indirectly as a result of government and real sector activity. While this is beneficial to the banking sector, it could be to the detriment of the owners of the capital (primarily pensioners and long term insurance policy holders), as it forces concentration of investments into a handful of entities in a single jurisdiction, likely for an artificially low return.

Credit demand and supply

As we move through an interest rate hiking cycle, private sector credit extension, one of the key drivers of growth in the Namibian economy over recent years, has come under pressure. Strong growth in credit extension through the trough of the cycle has left many consumers highly indebted, and many corporates with heavily leveraged balance sheets. IJG estimates now put household debt to disposable income at over 100% for the first time.

As a result of increasing interest rates, falling or stagnating household incomes and highly indebted households, credit demand has declined somewhat over the second half of 2016. However, more importantly, credit supply has become increasingly constrained by the funding position of most of the banks and the constrained liquidity environment. In this regard, the loan to funding ratios in the sector have increased from the low 80%'s five years ago, to the high 90%'s at present. This is to say that in order to extend further loans, the majority of the local banks would need to acquire back-to-back funding, which is increasingly difficult and expensive to come by.

In addition to this, Government, previously a key provider of funding to the banking sector has been under financial pressure since the back end of 2015, and thus does not have the funds that they used to have to deposit with the commercial banks (often via local authorities or state owned enterprises). As well as this, government has become relatively slow when it comes to paying contractors, particularly for civil works, which meant fewer deposits from such individuals and entities into commercial banks. Private sector credit extension growth has thus slowed notably through 2016, and is expected to register 10.00% growth for the year. This is expected to increase marginally in 2017, but only to 10.10%, before increasing to 13.95% in 2018, when funding starts to recover.

Interest Rates

The rate of interest rate increases slowed through the second half of 2016, following increases in the first half of the year after the rand weakness caused by the Minister of Finance rotation in South Africa at the back end of 2015. The repo rate now stands at 7.00% in both Namibia and South Africa. Going forward, the repo rate in South Africa is highly exposed to binary events, most notably the question of whether the country will maintain its investment grade rating, and whether there is a leadership change in the ANC.

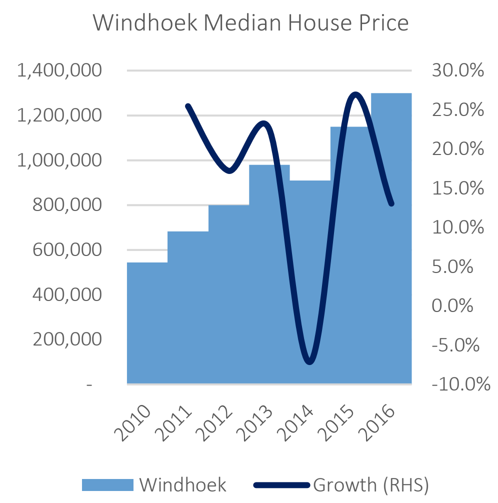
In the event that South Africa is downgraded to junk status, our expectation is that rates will be increased in South Africa and that Namibia will be forced to follow. However, should this be averted, it appears likely that rates will be kept on hold to support growth in the South African economy, provided inflation remains within the SARB target band over the medium term. Despite the dovish leaning of the SARB in recent meetings, it appears unlikely that rates will be cut in South Africa any time soon, particularly given the expectation of higher interest rates in the US towards the end of 2016 and into 2017.

In Namibia, interest rates are expected to broadly follow South Africa going forward, as despite the clear need for higher rates in Namibia, the low and slow growth environment means the central bank is likely to try and keep rates as supportive as possible for as long as possible.

Windhoek Property Market

The Windhoek property market has come under deep scrutiny for the past half-decade, as prices have risen dramatically, away from fair value, according to some. This market represents the single jurisdiction and loan type to which the commercial banks are most exposed. Mortgage loans make up approximately 51% of total loans extended to the private sector, of which 75.8% are loans to households. It is estimated that approximately 65% of the outstanding mortgage loans are against properties in Windhoek.

Windhoek Median House Prices (N$)



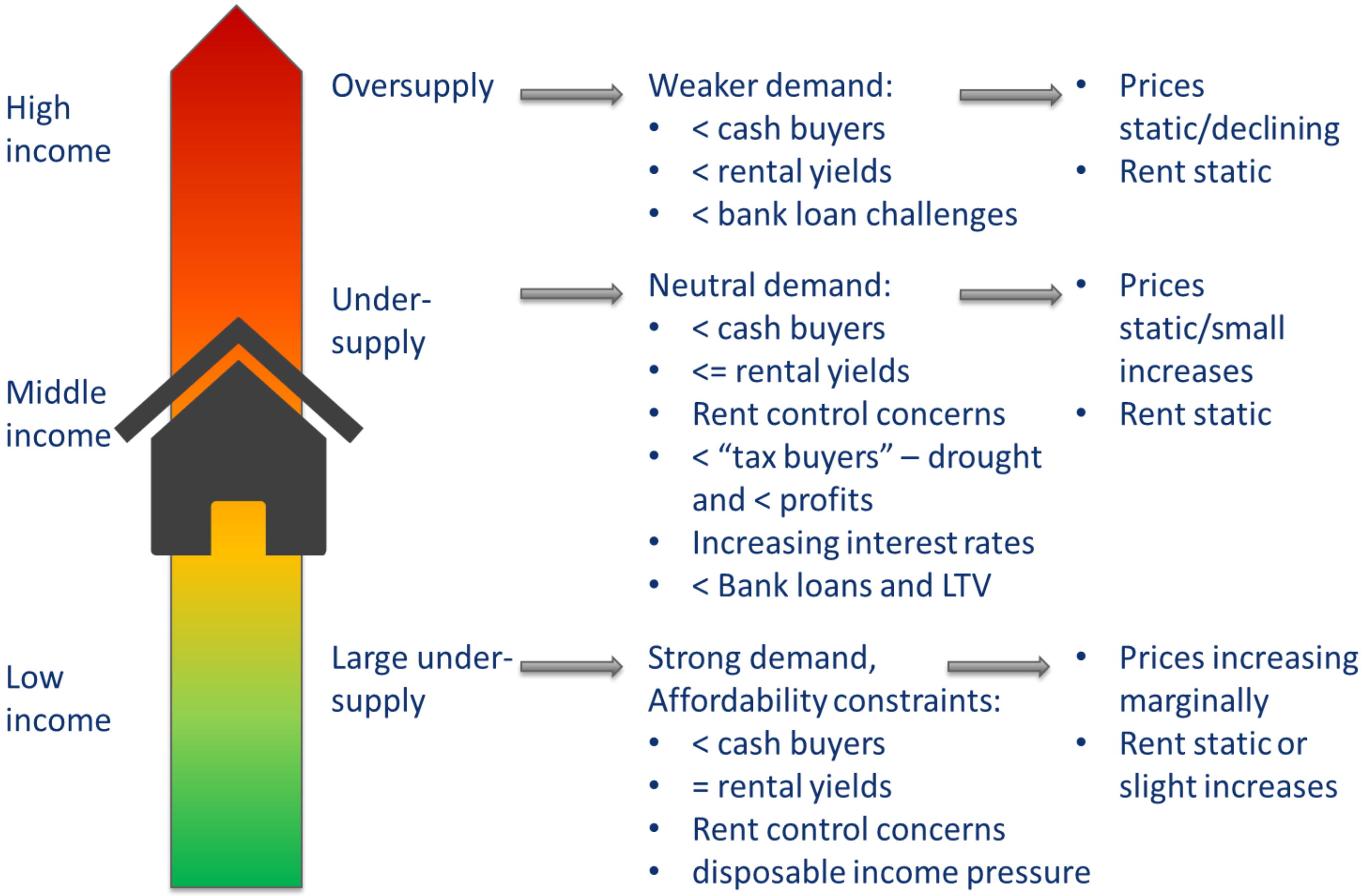
Source: FNB Namibia

The only recognized measure of property prices in the country is the FNB Housing Index, based on the median price of bonds registered for natural persons at the Deeds Office. This measure is not without fault for many reasons, including the fact that the median house price in the index is likely to be incomparable to the median house on the banks' balance sheet and the low volume of transactions through the deeds office. As such, the index should be taken with a pinch of salt, but remains a reasonable indicator of general trends in the market.

The FNB index for Windhoek illustrates a CAGR in the median house price of 15.6% per year over the past six years, implying that house prices have been doubling every five years on average. The underlying cause of this property price growth is the growing shortfall between demand for housing and the supply thereof. The national shortfall of housing is now estimated at approximately 135,000 units, growing at a rate of approximately 5,000 units per year. The shortfall has meant that property prices have been bid to a point where only the most wealthy own or inhabit the available stock. However, fuel has been added to this fire of late as household incomes across the board have risen, driven by accommodative fiscal and monetary policy and the construction boom, particularly. As such, more money has been chasing a largely unchanged stock of assets, and thus prices have risen.

While not yet visible in the FNB Index data, extensive anecdotal evidence from various different market players suggests that property prices have started to correct as growth in income and thus the money chasing the stock of assets, has slowed and even started to reverse. At the same time, supply and the expectations of supply have increased, largely due to mass housing initiatives. It is at present unclear as to the extent to which prices will correct, however it is apparent that house price increases have stalled, particularly in the higher income end of the market. Nevertheless, it is estimated that there is significant equity (around 30% to 35%) in the average property, thus limiting the commercial banks exposures to relatively minor market corrections. Moreover, because of the basic supply/demand imbalance, it appears unlikely that any price corrections will be dramatic, however this will also be determined by the extent of the current economic slowdown and its impact on incomes, particularly for highly indebted consumers.

Housing market: Windhoek



Source: IJG Securities

Basel III

In 2010, Namibia was the third country in Africa to fully implement a Basel II framework commensurate with the broad principles of the global framework. Now, six years later, the country is once again amongst the continent's forefront of implementation of the new Basel accord, namely Basel III.

The Basel III Framework was developed in response to the deficiencies found in financial regulation during, and resulting from, the world financial crisis. The aim of the new accord is to develop a global regulatory framework for more resilient banks and banking systems.
The latest package of reforms from the Basel Committee on Banking Supervision (BCBS) in December 2010 focuses on strengthening the global quality of capital and liquidity rules, following the peak of the global financial crisis with the aim of promoting a more resilient banking and financial sector. The main objectives of Basel III reforms are:

1. To improve the banking sector's ability to absorb shocks arising from the financial and economic sector.
2. To improve risk management and governance practices within banking institutions.
3. To strengthen transparency and disclosure of capital and liquidity within banking institutions.

In Namibia, the decision to adopt Basel III was taken in 2015, and the new framework will be implemented with five key tenants.

1. Revisions to risk weighted capital adequacy requirements.
2. Revisions to the minimum leverage ratio.
3. Introduction of new liquidity ratios.
4. Revisions to the calculation or risk weighting of assets.
5. Inclusion of off balance sheet items for calculation of capital ratios.

The table below presents the phase-in arrangement for the implementation of the Basel III Capital Framework. This Capital Adequacy Framework is expected to become effect by 2021, two years behind the recommended date envisaged by the Basel Committee, but many years ahead of many of the regional countries. In terms of the Basel Committee timelines banking intuitions are expected to comply with the new capital and liquidity rules by 2019, while they will have to comply with new capital and liquidity requirements for Namibia only by 2021. However, for some of the local banking institutions, parent companies in South Africa have already ensured that local subsidiaries are on the path to becoming Basel III compliant.

	Current		Phased-in Arrangement				
	2015	2016	2017	2018	2019	2020	2021
Minimum Common Equity Capital Ratio	7.00%	7.00%	5.50%	5.50%	5.50%		
Additional Tier 1 Capital (maximum)			1.50%	1.50%	1.50%		
Common Equity Tier 1 Capital	7.00%	7.00%	7.00%	7.00%	7.00%		
Capital Conservation Buffer			1.00%	2.00%	2.50%		
Total Minimum Tier 1 Capital Ratio	**7.00%**	**7.00%**	**8.00%**	**9.00%**	**9.50%**		
Maximum Tier 2 Capital	3.00%	3.00%	3.00%	3.00%	3.00%		
Total Risk-weighted Capital ratio	**10%**	**10%**	**11%**	**12%**	**12.50%**		
Leverage Ratio	6%	6%	3.00%	4.00%	5.00%		
Liquidity Coverage Ratio				60%	75%	90%	100%
Net Stable Funding Ratio				60%	75%	90%	100%

Outlook

the second half of 2015 and 2016 have proved challenging for Namibia, due to the aforementioned “perfect storm” of factors converging on the country simultaneously. The coming year is likely to remain challenging, however should a handful of the 2015/2016 negative factors start to improve, some growth can be expected. This could come about as a result of improved rainfall, commodity price recovery and/or improvement in the Angolan balance of payments. However, the slowdown in Government expenditure seen between 2015 and 2017 will likely keep the economy under immense pressure in 2016/17, and 2017/18, before some respite is seen in 2018/19.

Asset base

Asset growth

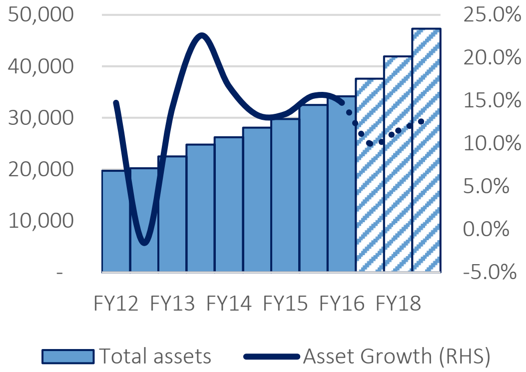
FNB's asset base has seen exceptional growth over the last decade, driven by major expansion in their loan book, particularly. Total assets have grown at a rate exceeding 10% per annum (CAGR) for much of the last decade. In FY16, assets expanded by 14.8%, driven by strong loan book and cash reserve growth.

The loan book makes up 75.4% of total assets of FNB Namibia. Other primary assets include cash (6.2%), advances to banks and other financial institutions (5.2%), investment securities and other investments (9.5%) and property plant and equipment –PPE- (2.7%). With regards to property plant and equipment, the asset value on the bank's balance sheet has more than doubled over the past two years, largely on account of the construction of the FNB Freedom Plaza in central Windhoek, estimated to cost some N$425m.

The bank currently sits on a sizable cash position of N$2.12 billion, some of which is likely to be used in FY17 to purchase PointBreak and EBank, as detailed in the box article on page 17.

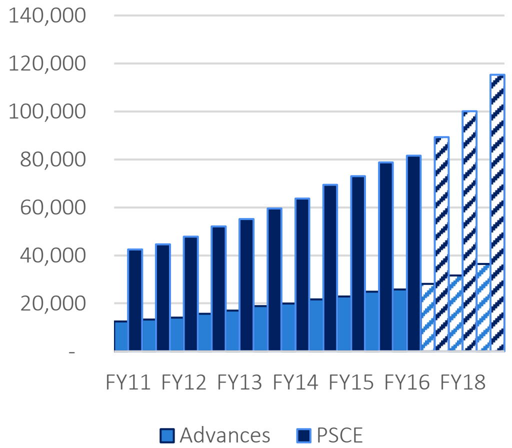
With the exception of the pointbreak transaction, and following the completion of a number of notable investments made by FNB Namibia over the past few years, we believe there will be some consolidation in spending towards PPE and intangibles, notably buildings and technology.

FNB Total Assets (N$ Million)



Source: FNB Namibia, IJG Securities

FNB Loans and Advances (N$ Million)



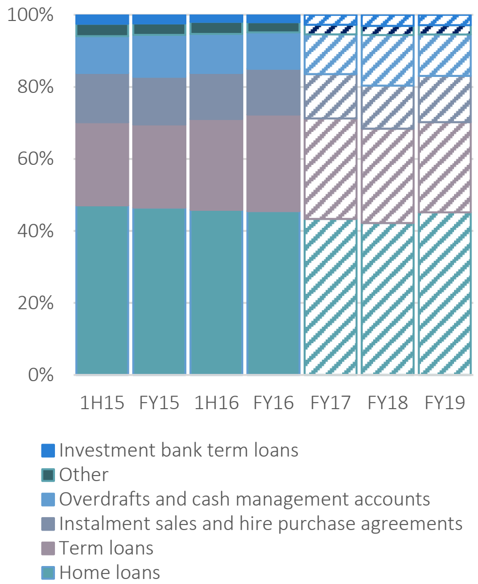
Source: FNB Namibia, IJG Securities

Advances breakdown

FNB's advances remain highly concentrated in property financing, with 45.5% of gross advances falling into this category. However, a notable effort to reduce the weighting of mortgages as a percentage of the total book has been seen over the past few years. Just five years ago, this category of loans made up more than 50% of the total loan book. In order to reduce the concentration of homeloans relative to the total loan book, growth in homeloans has been slowed, with this category of loans growing at 10.48%, compared to gross loan growth of 12.88%. 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.

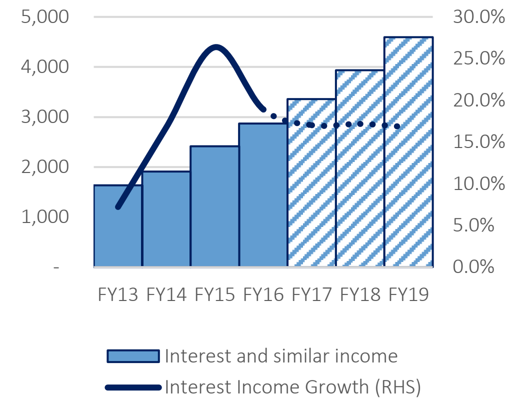
The strongest growth in advances in the FNB loan book, as a percent of total advances, over the past half-decade has been term loans. These loans have grown from N$1.9 billion in value in FY11, to N$7.0 billion in value as of end FY16. As such, these loans now make up the second largest loan category for the bank. Installment loans represent the third largest loan category for the bank, at N$3.3 billion, and have remained fairly constant as a percent of total loans over the last five years.

Advances Breakdown



Source: FNB Namibia, IJG Securities

Interest Income (N$ Million)



Source: FNB Namibia, IJG Securities

Net Interest Income

Interest Income

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. Over the past 24 months, however, much of this interest growth has been driven by increasing interest rates in Namibia and South Africa. In FY16, interest income expanded by 18.9%, while loans and advances expanded by 12.9%. As a result, the faster growth in interest income than loans was down to increasing interest rates. However, given the major growth in loans and advances over the past half decade, the current expansion in interest rates drives major increases in interest income for the country's banks.

While interest income expanded by 18.9% in FY16, interest expenses expanded by 26.6% due to fast increasing funding costs for both deposits and debt securities. As a result, net interest income expanded by 13.8%. At the same time, and contrary to expectations, impairment charges came down slightly, by 4.1%, resulting in net interest income after impairment charges increasing by 14.5%.

Funding mix

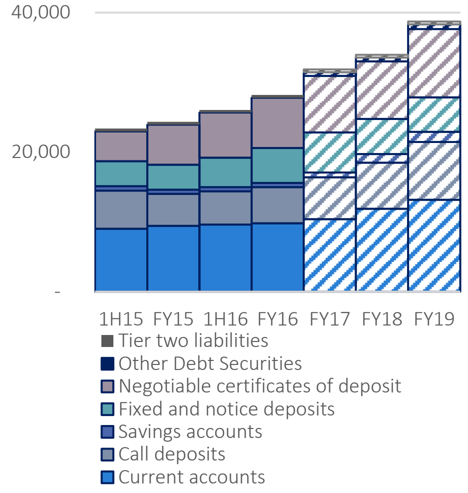
To date, FNB Namibia has funded all of its loans from conventional deposits, carrying virtually no debt securities on its balance sheet. However, following the end of FY16 (in November 2016), the bank issued N$540 million worth of debt securities, which is expected to be used for funding and to manage their currently liquidity challenges.

As a result, FNB Namibia now has six debt securities in issues, namely the X22 and J22 issued in 2012 and maturing in 2022, the J19 and X19 issued in 2016 and maturing in 2019, and the J21 and X21 issued in 2016 and maturing in 2021. In total, the bank now has N$930 million of outstanding debt securities, representing approximately 3.3% of total funding.

	FNBX22	FNBJ22	FNBJ19	FNBX19	FNBJ21	FNBX21
Issue	29-Mar-12	29-Mar-12	1-Nov-16	1-Nov-16	1-Nov-16	1-Nov-16
Maturity	29-Mar-22	29-Mar-22	1-Nov-19	1-Nov-19	1-Nov-21	1-Nov-21
Nominal (N$ '000)	110,000	280,000	206,000	170,000	22,000	142,000
Fixed/ Floating	Fixed	Floating	Floating	Fixed	Floating	Fixed
Rate	8.88%	3M JIBAR + 1.65%	3M JIBAR + 1.80%	10.08%	3M JIBAR + 2.00%	10.50%

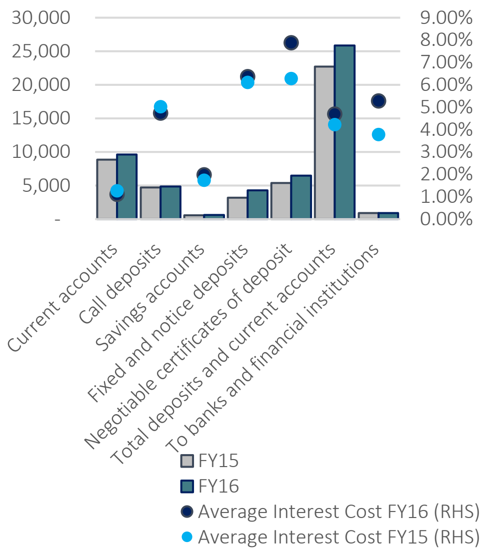
The bank has a good split of debt funding between fixed and floating rate, with 45.4% being fixed and the remainder floating. All floating rate debt is three month JIBAR linked.

Funding Mix (N$ Million)



Source: FNB Namibia, IJG Securities

Interest Bearing Assets and Expense (N$ Million)



Source: FNB Namibia, IJG Securities

FNB's loan-book funding is thus effectively 96.7% deposit based. Of these deposits, current accounts make up the largest portion of total deposits, at N$9.81 billion (35.3%) in FY16, followed by negotiable certificates of deposit (NCDs) at N$7.20 billion (25.9%), and call deposits at N$5.00 billion (18.0%). Over the past 12 months, large increases in longer-term funding have been seen, most notably with regards to fixed and notice deposits (up 40.6%) and NCDs (up 51.9%). This is on account of efforts to extend funding duration as per Basel III, as well as the low liquidity environment seen in the country over this period and new market entrants competing for available funding. As is to be expected, this longer duration funding in a more competitive environment, drives up the cost of funding for the bank.

Interest Expense

On the interest expense side of net interest income, increasing interest rates and the need to fund the strong loan-book growth resulted in a sizable increase in the bank's loan-funding costs over the past 24 months. In FY14, the average cost of funding for the bank was just 3.75%, which increased to 4.15% in FY15 and 4.63% in FY16, and is expected to increase further, to 4.87% in FY17. This is both on account of expectations for a 25 basis point hike in rates through the year, the new debt securities on the bank's books and the competition for longer term funding amongst the commercial banks.

It should be noted that while the average cost of funding is increasing relatively slowly, the marginal cost of funding has increased dramatically. Thus, the marginal interest margin has contracted significantly.

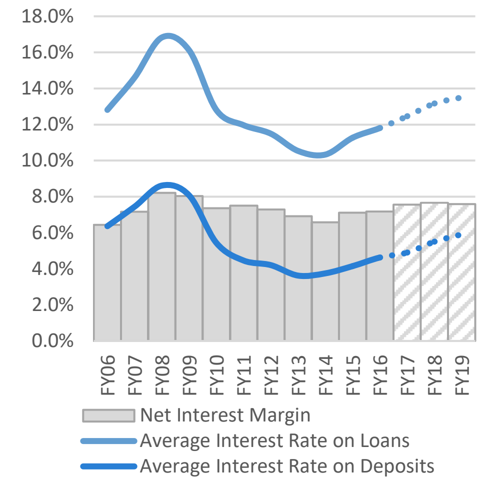
The various types of funding all carry vastly different costs to the bank. The single largest source of funding, namely current accounts, is by far the cheapest, costing the bank an average rate of 1.11%, down from 1.27% in FY15, despite increasing administered interest rates (50bp over the year) and lending rates (up 54bp).

The second largest source of funding is NCDs, which make up 25.9% of total funding at an average cost of 7.88% in FY16, up 159 basis points from the 6.29% seen in FY15. This increase is largely on account of increased competition, as well as general increases in funding costs in the country due to government crowding out. Fixed and notice deposits and call deposits are now approximately the same size, at N$5.00 and N$5.18 billion, respectively. These represent 18.0% and 18.6% of total funding, respectively, and costed an average of 6.37% (up from 6.12% in FY15) and 4.74% (down from 5.03% in FY15) in FY16, respectively.

Going forward, funding costs are expected to continue to increase faster than repo rate increases due to competition and government crowding out.

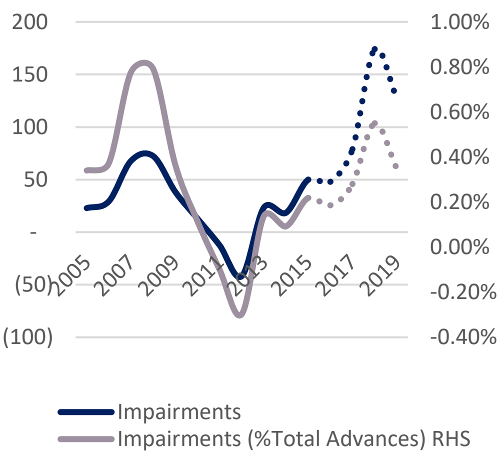
Average Interest Costs	FY14	FY15	FY16	FY17	FY18	FY19
Current accounts	1.19%	1.27%	1.11%	1.44%	2.15%	2.68%
Call deposits	4.37%	5.03%	4.74%	4.97%	5.72%	6.31%
Savings accounts	1.51%	1.74%	1.99%	2.75%	3.20%	3.54%
Fixed and notice deposits	4.17%	6.12%	6.37%	5.55%	6.26%	7.34%
Negotiable certificates of deposit	6.27%	6.29%	7.88%	7.81%	8.27%	8.60%
Total deposits and current accounts	3.82%	4.22%	4.70%	4.63%	5.22%	5.65%

Interest Margin



Source: FNB Namibia, IJG Securities

Impairments (N$ Million)



Source: FNB Namibia, IJG Securities

Interest Margin

The net interest margin of FNB Namibia has been notably above the market average, driven by the two factors earlier mentioned. The banks' funding is relatively cheap when compared to many competitors, as it carries few 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. At 35.3% of total funding, these loans represent just 9.41% of the bank's total funding cost.

On the loan side, FNB Namibia is highly concentrated in long-term mortgage loans, with these loans making up approximately 45.5% of gross advances. On average, mortgage loans attract a higher rate of interest than shorter duration loans. As a result of the relatively low funding cost for FNB Namibia and the relatively high average interest rate charged on loans, the company's interest margin is well above the country average. Over the past decade, this margin has fluctuated between 6.4% and 8.2%. On average, the interest margin achieved by FNB Namibia has been 230 basis points above the market average over the past 10 years.

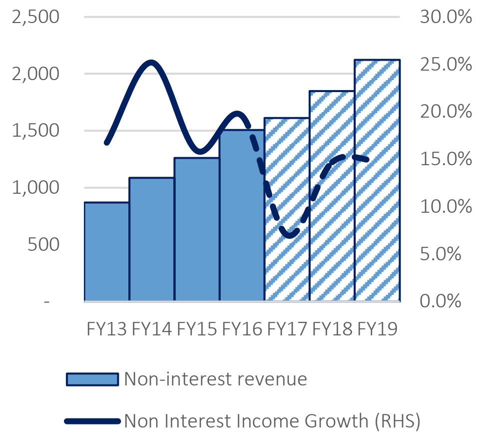
In FY16, the net interest margin was 7.2%. Going forward, we expect to see a slight increase in the net interest margin to 7.6% in FY17 and 7.7% in FY18. This is due to cautious cost containment on the funding side as well as the expectation of a reopening of the gap between the South African base lending rate and the Namibian base lending rate during FY17.

Impairment losses

Impairment losses remain negligible on the FNB Namibia loan book, totaling just 19 basis points in FY16, or N$47.9 million on the N$25.8 billion dollar loan book. Impairment losses have remained well below our expectations over the past 12 months, however we continue to expect a notable increase in these charges going forward. For FY17, we forecast un uptick to 28 basis points, while we expect to see FY18 at 55 basis points. This is due to our expectation of increasing interest rates and slow national growth putting a squeeze on local households and businesses. Nevertheless, while impairments are expected to nearly double in FY17, to N$78.8 million, this remains a negligible amount on the FNB income statement.

The negligible level of impairment losses speaks to the asset quality of the bank, and the caution taken when it comes to granting loans to customers.

Non-interest income (N$ Million)



Source: FNB Namibia, IJG Securities

Non-interest income

FNB's non-interest income has shown stellar growth, increasing 19.6% in FY16 when compared to FY15. The year saw total non-interest revenue of N$1.51 billion, up from N$1.26 billion in FY15. The on-going strong growth in non-interest income has led to the increased significance of this income within FNB's earnings, making it one of the bank's strongest attributes.

The growth seen in non-interest income has been primarily on the back of net fee and commission income. This growth comes from many sources, however of late has been driven by strong expansion in electronic channels, albeit off a large base. In addition to the electronic channels, the bank is constantly adding new branches, ATMs and other infrastructure to increase its market coverage. Over the past year, the company's digital channels have seen enormous growth as illustrated by the table below.

Type of transactions	Volume Growth	Value Growth
Point of Sale	21%	27%
FNB Online	11%	15%
Mobile banking	25%	43%
FNB APP	91%	147%
Overall customer initiated, electronic channel growth	20%	15%

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. The restrictions on cash deposit fees by the Bank of Namibia, however, may result in slowing growth in the FY16 financial year. Nevertheless, the company is well positioned to offset this loss in income through other revenue channels, as was seen in 1H16.

Operating expenses

FNB Namibia's operating expenses increased by 16.0% between FY15 and FY16. As such, operating costs for the year stood at N$1.42 billion, compared to N$1.22 billion in FY15. Once again, the bank has shown excellent cost containment, with operating expenses growing at a lower rate than revenue, meaning that the cost to income ratio for the bank fell from 44.7% in FY15, to 44.3% in FY16.

Staff costs make up the largest cost item for the bank, representing more than 50% of total costs. Further cost reduction strategies are being implemented by the bank not only to reduce staff costs in the long run (without forced redundancies), but also to reduce costs associated with large branches. Notable amongst these is the strategy to introduce automatic deposit machines. The large retail footprint of FNB Namibia means that many customers, particularly in the lower income segment of the market, require cash-handling services from the bank. However, with the introduction of EWallet and automatic deposit machines, the bank believes it can reduce footfall through the branches, thus reducing the need for large numbers of tellers and large areas of floor space.

Pointbreak Deal

On the 18th of October 2016, FNB Namibia released a SENS announcement stating that "FNB Namibia has successfully concluded negotiations to acquire 100% of Pointbreak and Ebank". The details of the deal remain unclear, and the transaction remains pending of approval from the Bank of Namibia, Namfisa, Namibian Competition Commission and the South African Reserve Bank.

Our first impression with regards to this deal is that should the price be right (and we assume it will be, for reasons given below), we believe it could be highly beneficial to FNB Namibia Holdings.

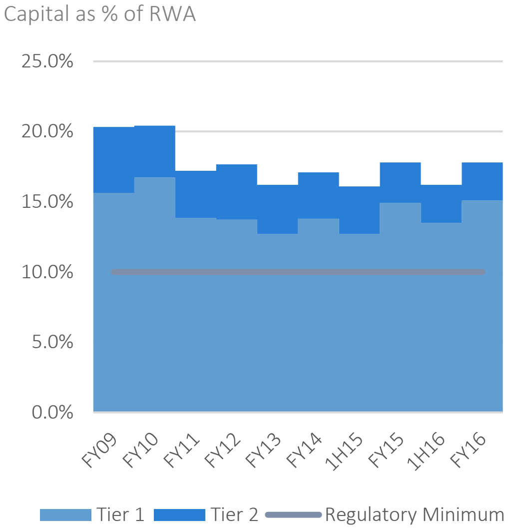
It is our belief that this deal was concluded as a result of two factors. From the buyer (FNB Namibia Holdings) side, the bank has been talking about brining Ashburton to Namibia, thus owning an asset management company under the group umbrella, similar to the CAM and Bank Windhoek Holdings (now Capricorn Group) relationship. As Pointbreak has approximately N$8bn under management, this deal can be expected to expedite the process of building a book for the new asset manager. From the sellers perspective, we believe that the deal was motivated by a will to dispose of EBank, after the company has proven to be highly costly with a deeper J-curve than it appears was expected, and that the best way to achieve this was to dispose of the holding company.

The reason for this is that in the past three years, EBank has posted cumulative losses of nearly N$43 million, and given current macroeconomic conditions in Namibia, these loses appear poised to continue into the future. Because of the highly regulated space in which the bank operates, continued recapitalization of the bank will thus likely be required going forward. The depth of the "J curve" for EBank may well thus have been concerning to the Pointbreak shareholders and thus facilitated the agreement of a sales price agreeable to both parties.

We are very positive about the introduction of Pointbreak into the asset management arm of FNB Namibia Holdings. This will help to get the new Ashburton office off the ground. Once operational, this office will be highly beneficial to the bank, not just allowing a one-stop financial solution to current banking and insurance clients, but also by providing additional funding and liquidity solutions to the bank (obviously on an independent basis). Given the current economic challenges in Namibia, we believe this will provide a source of growth that would otherwise not exist for the bank, and allow the bank more options to manage current funding and liquidity challenges.

Given the approvals still required, this transaction is unlikely to be completed within the next six months in our view.

The bottom line, however, is that the quality of this acquisition, if successful, will be determined by the price paid for Pointbreak and its subsidiaries. Given the limited information available at present, we cannot yet determine whether we believe the deal to be positive for the company or not. Our expectation is that the transaction will total approximately N$250 million, which will be funded from current cash balances.



Source: FNB Namibia, IJG Securities

Capital adequacy

FNB Namibia remains more than adequately capitalized, with Tier two capital of 2.7% of risk weighted assets (RWA) and Tier 1 capital of 15.1% of risk weighted assets, compared to a regulatory minimum of 10%.

Outlook and key risks

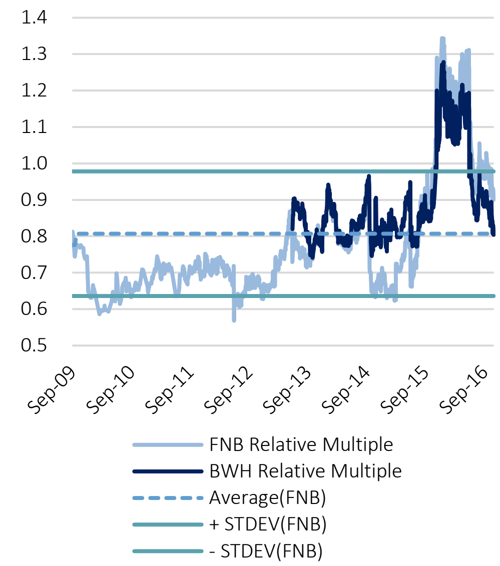
FNB Namibia remains an extremely well run and managed business with an exceptional track record to prove it. However, the company is fairly mature, and unlikely to continue to grow at the pace seen over the past 10 years. This maturity, however, does come with sizable benefits, as the size of the customer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

Nevertheless, there are still sizable components of the business that have significant headroom for growth, most notably the RMB investment banking division, and some of the more premium segments of the retail market. The bank remains focused on pursuing growth in their investment and insurance segments of the business as well, noting the introduction of Ashburton Investments to the local portfolio.

Three key challenges face the business going forward.

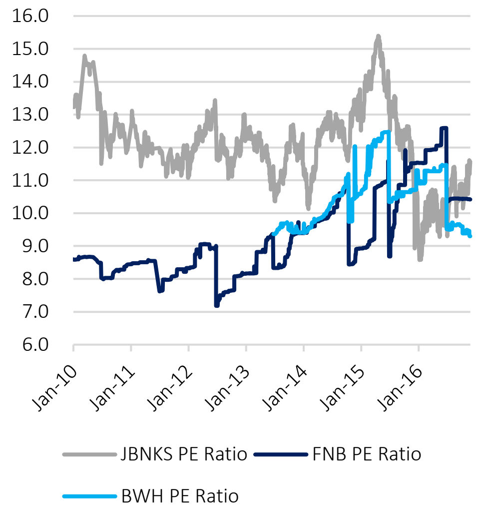
1. The macroeconomic environment in the country has deteriorated notably over the past 18 months. This is expected to continue for another 12 months, before government spending and interest rates stabilize, and local and regional mining entities adapt to current commodity prices. As such, household disposable 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.
2. The introduction of new banking licenses into the Namibian market may see an increase in competition for FNB Namibia, both from a deposit perspective, loan perspective and transactional services perspective. While FNB Namibia is highly entrenched in the market and likely to be able to weather any storm of this nature that comes its way, funding costs, particularly, may come under pressure.
3. Basel III is to be introduced in Namibia over the next three years. As this regulation comes into force, FNB Namibia, like all the domestic banks, is going to have to alter its funding mix, particularly given the long duration of its loan book, which is highly concentrated in mortgage loans. Long duration funding is likely to be expensive when compared to current funding, which may put further pressure on margins.

JBanks Relative Multiple



Source: Bloomberg, IJG Securities

PE Ratios



Source: IJG Securities

Valuation and recommendation

After a number of years of strong growth in the share price of both of the domestically listed banks, share prices have now more or less stabilised for FNB Namibia Holdings. Over the past six months the share price has climbed just 0.84%, while over the past year the price is up 10.1%. This, coupled with the relatively strong growth in bank earnings over the same period has driven a de-rating in the share's multiple. As such, the company is once again trading on a lower multiple than that of the JBanks index of South African listed banks. While this relative multiple remains higher than the long term average, at 0.9x that of JBanks, given the stable performance of the bank and exceptional profitability, we believe this can be easily justified. At present, the FNB Namibia Holdings earnings multiple is 10.4x, while the price to book is a relatively rich 3.1x. At the same time, the dividend yield is 4.4%, largely due to a healthy 48.9% payout ratio. Despite this high payout ratio, the company continues to grow earnings at an impressive rate, averaging 17.8% (GACR) over the past five years. At the same time, 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 time period.

For the purpose of valuing the company, we establish a **cost of equity, of 12.20%,** down from 14.12% in FY15, largely on account of a major deterioration in the growth environment in the country, and thus the equity risk premium. Based on this cost of equity, a highly conservative **long-term growth rate for the company of 7.75%,** and a **dividend pay-out ratio of 44%**, we believe a **PE of 9.9x can be justified** on this share. Given **expected earnings growth of 9.2% in FY16**, taking **total earnings to c503/share**, we derive **a target price of N$c4980/share, down from our earlier price target of N$c5230, primarily because of more cautious earnings forecasts, and highly conservative long term growth forecasts**. Coupled with an **expected dividend of 221cps**, we expect a **total return of 8.6% in FY17**. This price, on forecast financials for FY17, represents a price to book of 2.7x, a price to earnings of 9.9x and a dividend yield of 4.4%. We thus **revise our previous BUY** recommendation to a **HOLD** recommendation for FNB Namibia.

Our residual income valuation, with the same cost of equity and earnings forecasts delivers a slightly lower target price of N$c4731, however we believe the higher multiple can be justified given local market dynamics and the demand-supply imbalance for local equity.

Residual Income (N$' 000)	FY17	FY18	FY19	Cont. value
Beginning book value of equity	4,040,481	4,785,168	5,566,797	
Cost of equity (%)	12.2%	12.2%	12.2%	12.2%
Equity cost	492,618	583,411	678,707	
Net income	1,329,799	1,503,131	1,724,294	
Excess equity return	837,181	919,721	1,045,587	8,575,969
Discount period	1.00	2.00	3.00	3.00
Discount factor @ cost of equity	0.89	0.79	0.71	0.71
Present value of excess equity return	**746,203**	**730,687**	**740,413**	**6,072,910**
Equity invested	4,040,481			
Add: net adjustment to book value	-			
Add: excess equity return	8,290,214			
Equity value	**12,330,695**			
Shares in Issue (000)	260,636,675			
Fair value (NADs cps)	4731			

Income Statement

Year End June (N$ 000)	FY14	FY15	FY16	FY17	FY18	FY19
Interest and similar income	1,909,521	2,413,043	2,869,473	3,357,918	3,934,494	4,594,729
Interest expense and similar charges	(771,519)	(960,176)	(1,215,842)	(1,453,253)	(1,786,372)	(2,147,936)
Net interest income before impairment of advances	1,138,002	1,452,867	1,653,631	1,904,665	2,148,122	2,446,793
Impairment of advances	(18,433)	(49,882)	(47,852)	(78,765)	(173,988)	(127,526)
Net interest income after impairment of advances	1,119,569	1,402,985	1,605,779	1,825,901	1,974,134	2,319,267
Non-interest revenue	1,087,351	1,260,061	1,506,656	1,675,266	1,921,355	2,206,431
Net insurance premium income	125,795	153,944	189,253	218,288	261,422	311,987
Net claims and benefits paid	(71,079)	(82,310)	(102,777)	(116,375)	(126,100)	(166,090)
Income from operations	2,261,636	2,734,680	3,198,911	3,603,080	4,030,811	4,671,596
Operating expenses	(1,069,398)	(1,221,986)	(1,417,647)	(1,540,317)	(1,723,172)	(1,997,107)
Net income from operations	1,192,238	1,512,694	1,781,264	2,062,763	2,307,639	2,674,488
Share of profit from associate after tax	557	558	1,328	1,328	1,328	1,328
Income before tax	1,192,795	1,513,252	1,782,592	2,064,091	2,308,967	2,675,816
Indirect tax	(21,971)	(26,611)	(31,974)	(35,171)	(39,392)	(44,119)
Profit before tax	1,170,824	1,486,641	1,750,618	2,028,920	2,269,575	2,631,697
Direct tax	(386,216)	(487,979)	(532,985)	(644,182)	(703,568)	(835,564)
Profit for the period	784,608	998,662	1,217,633	1,384,738	1,566,007	1,796,134

Balance Sheet

N$ 000	FY14	FY15	FY16	FY17	FY18	FY19
Cash and cash equivalents	867,579	795,225	2,119,861	2,395,743	2,229,357	1,968,910
Due from banks and other financial institutions	1,766,327	1,585,029	1,772,267	1,969,121	2,372,563	2,550,512
Derivative financial instruments	92,031	158,644	209,497	226,747	245,418	265,627
Advances	19,990,782	22,833,693	25,776,087	28,130,294	31,634,167	36,435,887
Investment securities	2,833,146	3,365,927	3,236,883	3,645,856	4,106,501	4,625,347
Accounts receivable	140,446	185,614	136,592	189,950	197,743	200,776
Investments in associate	3,168	3,726	5,054	5,054	5,054	5,054
Property and equipment	551,620	849,171	924,997	1,035,997	1,139,596	1,253,556
Intangible assets	6,700	2,534	104	2,534	2,534	2,534
Deferred income tax asset	3,115	3,897	2,868	3,480	3,480	3,480
Reinsurance assets	572	191	598	645	645	645
Tax asset	341	664	695	664	664	664
Total assets	**26,255,827**	**29,784,315**	**34,185,503**	**37,606,050**	**41,939,601**	**47,327,305**
Deposits	21,522,377	23,951,813	27,793,798	30,017,302	33,019,032	37,641,697
Due to banks and other financial institutions	812,964	1,020,016	800,973	852,580	1,331,959	951,213
Derivative financial instruments	109,281	172,188	219,455	237,758	257,072	288,794
Short trading positions		26,693	36,927	25,000	25,000	25,000
Creditors and accruals	294,364	431,781	396,958	276,785	286,222	295,659
Tax liability	57,494	49,774	54,920	50,000	50,000	50,000
Employee liabilities	150,098	167,830	191,350	191,350	191,350	191,350
Deferred income tax liability	70,432	110,904	190,209	190,209	190,209	190,209
Policyholders liabilities under insurance contracts	62,993	69,770	67,778	74,556	82,011	90,213
Finance lease obligation	6,030	2,060				
Tier two liabilities	392,622	392,635	392,654	390,000	390,000	390,000
Other Debt Securities				540,000	540,000	690,000
Total liabilities	**23,478,655**	**26,395,464**	**30,145,022**	**32,845,539**	**36,362,855**	**40,804,134**
Capital and reserves attributable to ordinary equity holders of parent	2,745,911	3,348,673	3,989,699	4,709,763	5,524,086	6,458,076
Non-controlling interests	31,261	40,178	50,782	50,782	50,782	50,782
Total equity	**2,777,172**	**3,388,851**	**4,040,481**	**4,760,545**	**5,574,868**	**6,508,858**

IJG Securities (Pty) Ltd.
Member of the NSX

TEAM NAMIBIA MEMBER

IJG Holdings

Group Chairman
Mathews Hamutenya
Tel: +264 (61) 256699
mathews@millennium-invest.com

Group Managing Director
Mark Späth
Tel: +264 (61) 383 510
mark@ijg.net

Group Financial Manager
Helena Shikongo
Tel: +264 (61) 383 517
helena@ijg.net

IJG Securities

Managing Director
Romé Mostert
Tel: +264 (61) 383 520
rome@ijg.net

Money Market & Administration
Tashiya Shekutamba
Tel: +264 (61) 383 511
tashiya@ijg.net

Sales and Research
Rowland Brown
Tel: +264 (61) 383 513
rowland@ijg.net

Jan-Hendrik Conradie
Tel: +264 (61) 383 523
janhendrik@ijg.net

Eric van Zyl
Tel: +264 (61) 383 530
eric@ijg.net

Dylan van Wyk
Tel: +264 (61) 383 521
dylan@ijg.net

Equity & Fixed Income Dealing
Lyndon Sauls
Tel: +264 (61) 383 514
lyndon@ijg.net

Leon Maloney
Tel: +264 (61) 383 512
leon@ijg.net

IJG Capital

Managing Director
Herbert Maier
Tel: +264 (61) 383 522
herbert@ijg.net

Portfolio Manager
Jakob de Klerk
Tel: +264 (61) 383 517
jakob@ijg.net

Business Analyst
Mirko Maier
Tel: +264 (61) 383 500
mirko@ijg.net

IJG Advisory

Director
Jolyon Irwin
Tel: +264 (61) 383 500
jolyon@ijg.net

Business Analyst
Jason Hailonga
Tel: +264 (61) 383 529
jason@ijg.net

100 Robert Mugabe Avenue, Heritage Square
P O Box 186, Windhoek, Namibia
Tel: +264 (61) 383 500 Fax: +264 (61) 304 671
www.ijg.net www.ijgdirect.net