Namibian Banking Sector Review

- **Capricorn Group**
- **FirstRand Namibia**
- **SBN Holdings**

December 2020

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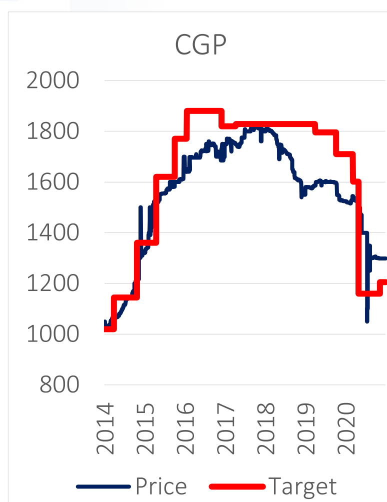
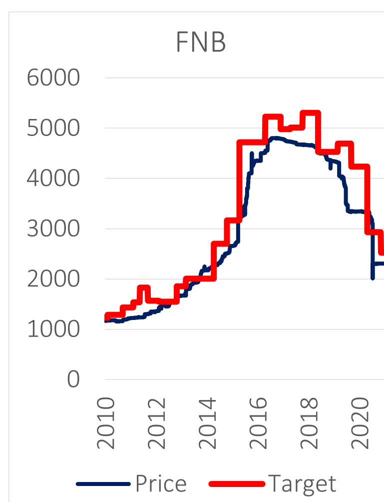
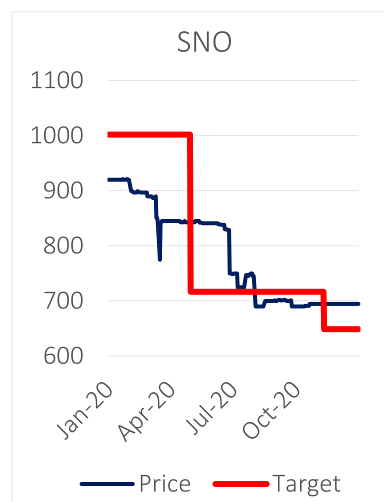






Capricorn Group

					Target Price (c)	***1205***
					Current Price (c)	1299
Year-End 30 June	**FY20A**	**FY21E**	**FY22E**	**FY23E**	Recommendation	**SELL**
Net interest income (N$m)	2,081	2,073	2,295	2,484	NSX Code	CGP
Non-interest income (N$m)	1,425	1,513	1,605	1,701	Market Cap (N$m)	6,744
Profit (N$m)	1,012	989	1,179	1,331	Shares in Issue (m)	519
HEPS (c)	195	191	227	256	Free float (%)	26.1
DPS (c)	50	59	63	75	52 week high	1600
DY (%)	3.8	4.5	4.8	5.8	52 week low	1050
P/E (x)	6.7	6.8	5.7	5.1	Expected Total Return (%)	-2.7
P/BV (x)	1.0	0.9	0.8	0.9		

FirstRand Namibia Holdings

					Target Price (c)	***2520***
					Current Price (c)	2308
Year-End 30 June	**FY20A**	**FY21E**	**FY22E**	**FY23E**	Recommendation	**HOLD**
Net interest income (N$m)	2,013	2,019	2,186	2,360	NSX Code	FNB
Non-interest income (N$m)	1,905	2,007	2,119	2,232	Market Cap (N$m)	6,179
Profit (N$m)	833	975	1,069	1,165	Shares in Issue (m)	268
HEPS (c)	311	364	399	435	Free float (%)	24.0
DPS (c)	154	153	200	218	52 week high	3349
DY (%)	6.7	6.6	8.6	9.4	52 week low	2015
P/E (x)	7.4	6.3	5.8	5.3	Expected Total Return (%)	15.8
P/BV (x)	1.2	1.1	1.0	1.0		

Standard Bank Namibia Holdings

					Target Price (c)	***649***
					Current Price (c)	695
Year-End 30 June	**FY19A**	**FY20E**	**FY21E**	**FY22E**	Recommendation	**SELL**
Net interest income (N$m)	1,333	1,358	1,483	1,584	NSX Code	SNO
Non-interest income (N$m)	1,263	1,302	1,359	1,426	Market Cap (N$m)	3,631
Profit (N$m)	613	482	617	667	Shares in Issue (m)	522
HEPS (c)	117	92	118	128	Free float (%)	15.0
DPS (c)	27	39	50	54	52 week high	921
DY (%)	3.9	5.6	7.1	7.7	52 week low	690
P/E (x)	5.9	7.5	5.9	5.4	Expected Total Return (%)	-1.0
P/BV (x)	0.9	0.9	0.8	0.7		

Source: CGP, FNB, SNO, IJG, Bloomberg

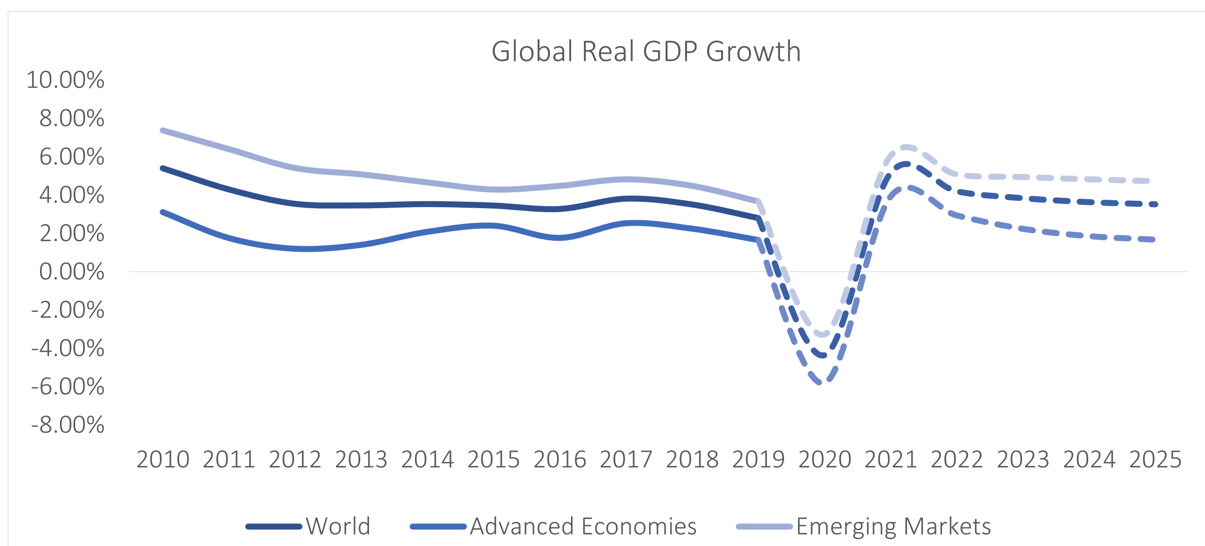
Banking Macro

Growth Environment

2020 will in all likelihood be looked back on as the world's *Annus Horribilis*. The global pandemic has wreaked havoc on both lives and livelihoods, with the global fatalities attributed to the COVID-19 exceeding 1.3 million. Although the virus has inflicted a high human cost, efforts to curtail its spread including closing borders and limiting business activity, have had a devastating effect on the world's economy, which is expected to decline by roughly 4.4% according to World Bank and IMF estimates. Measures put in place to curb the spread of COVID-19 have had a continued effect on global travel and tourism, putting the livelihoods of millions under serious pressure.

Most countries are expected to dive into recession in 2020, as estimates point to the developed world posting contractions of 5.8% while emerging markets are expected to contract by 3.3%. The extent of economic contractions has been mitigated, to some extent, by an extremely strong fiscal and monetary response. The goal of fiscal policy actions is to buffer the short-term impact of the shock. And include a wide array of measures to support individuals and firms. The United States injected an estimated US$2.9 trillion (around 13.6% of GDP) into the economy, through government spending, tax relief and credit enhancements, to provide support for individuals and corporates.

Although the US was by far the largest fiscal response in terms of government spending, the rest of the developed world also provided strong fiscal support, especially the Euro Area and Japan. However, emerging markets had much less fiscal firepower to combat the shock. Budgetary measures in advanced economies have reached 8.3% of GDP, 6.6% higher than in the aftermath of the 2008 global financial crises, while for emerging economies they represent just 2.0% of GDP, even less than in 2008. Undoubtedly, advanced economies will be better equipped to rebound after the crisis, due to stronger fiscal positions, better healthcare, and lower borrowing costs. These are concerns for emerging markets, as the poor state of healthcare and high debt levels pose a serious risk for a quick recovery.

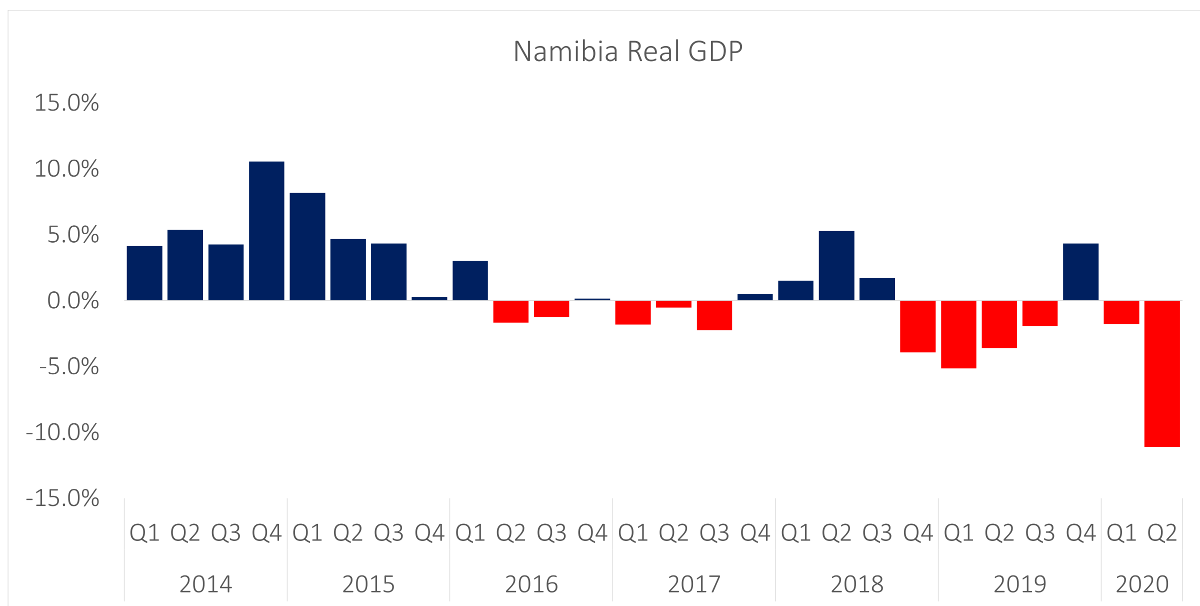


Source: IMF

Recovery is expected to materialise in 2021 albeit at a gradual pace. It is now a matter of which countries have best positioned themselves for whatever comes next. The global outlook is clouded by

a large amount of uncertainty as to the path of the virus, and its impacts remain unknown. The possibility of a vaccine looks promising as there are more than 165 vaccines in development, 36 of which are already in clinical human trials. Pfizer and Moderna have both released good clinical results and seem to be leading the race, with Pfizer having indicated that they will only be able to deliver 50 million doses by the end of the year. Most of the other competitors have indicated that they will likely only have a usable vaccine available from March 2021.

Local economic conditions have been hard hit by the COVID-19 outbreak. Namibia has been facing several structural constraints to growth as economic activity has been weak since the start of 2016. As opposed to the relatively low impact of the 2008 global financial crisis, the Namibian economy will not come off unscathed from the pandemic. Q2 data released by the Namibian Statistics Agency indicated that real GDP growth was 11.1% lower than the corresponding quarter in 2019, with hotels & restaurants, manufacturing and transport posting the largest declines. Furthermore, livestock marketing activity slowed as farmers restocked their herds in light of the drought-induced excess marketing activity in the previous year.



Source: NSA

According to the bank of Namibia, the domestic economy is expected to contract by 7.8% in 2020, before recovering to the growth of 2.1% and 2.7% in 2021 and 2022. This effectively means the economy will still be 3.3% smaller in 2022 than it was in 2019, and per capita incomes are likely to fall. Additionally, unemployment is expected to increase substantially, especially in the hardest-hit sectors like tourism, manufacturing and construction.

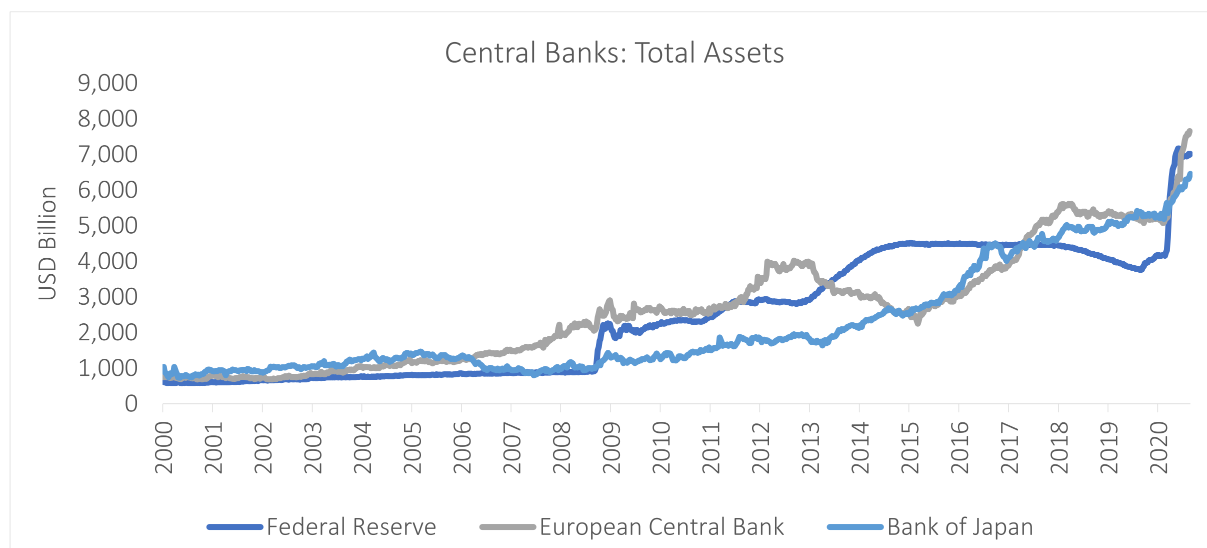
Namibia also increased government spending to help save lives and to support livelihoods through the provision of social grants and the procurement of various health materials and equipment. However, lower economic activity has resulted in lower government revenues. This coupled with the increased Government expenditure to cushion the effect to the COVID-19 pandemic on economic activity has led to rapidly widening budget deficits. According to the mid-year budget review, Namibia's FY2020/21 budget deficit will reach 9.8% or N$17.6 billion, the highest level registered since independence. Total debt to GDP stood at 58.7% at the end of June 2020, up from the 51.2% recorded one year earlier and

IJG expects debt to GDP to increase to over 63% by 2021. The large increase in government debt will largely be funded domestically, and the provisional borrowing plan sees Bank of Namibia raising roughly N$10.1 billion worth of government securities in this financial year, N$3.0 billion of which is to come from treasury bill issuance. Although the Namibian liquidity position has been quite healthy over the last year, the increased issuance of short term government securities will likely continue for the next three years and poses a crowing-out risk for bank deposits, and may raise the cost of wholesale funding to banks.

Although some recovery is expected in the short term, we should be cognizant of the fact that business and consumer behaviour will adapt to a new normal, as incomes fall and confidence remains weak. Businesses will aim to repay debt where possible and will be reluctant to take up new credit without viable projects to apply funding to. Individuals have already cut back on spending and are saving cash where possible, as the future remains uncertain. Consumers will likely continue to shift consumption patterns to value and essential goods, in favour of luxuries as well as a shift to digital platforms. This is coupled with a marked decrease in brand loyalty, as consumers search for cheaper substitutes for goods and services.

Interest Rates

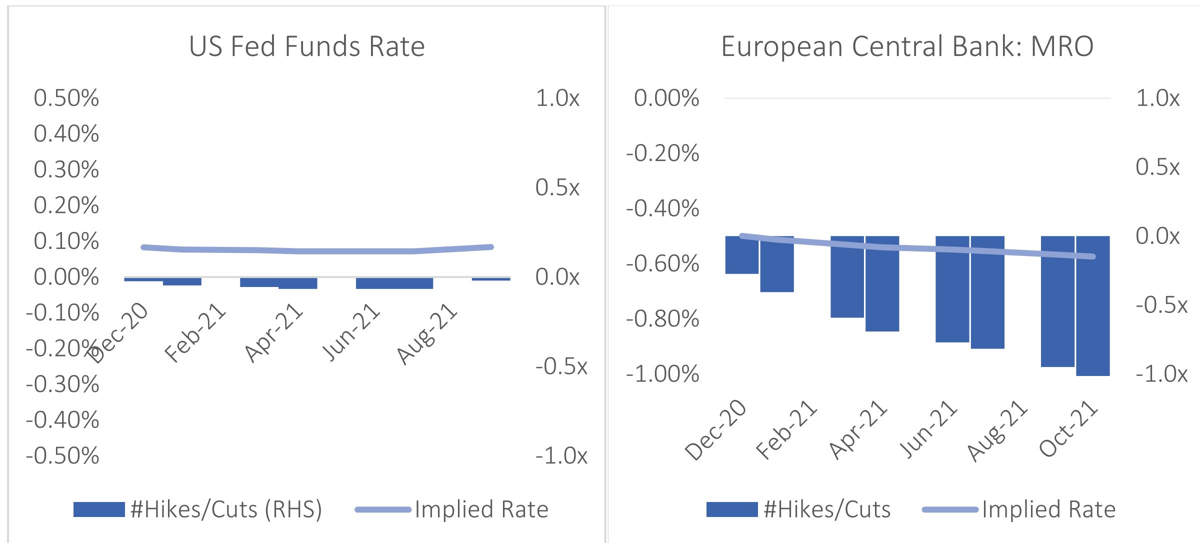
Central banks and financial regulators have complemented fiscal actions with expansionary monetary policies that have eased financial conditions and enabled the continued flow of credit to the real economy to the degree that weak demand necessitated it. The combined policy reaction does not only aim to calm the financial turmoil but also to prevent temporary disruptions from inflicting permanent damage to the economy. Although the fiscal response would have seemed to have been taken straight from the Keynesian playbook, the monetary policy response was of a bit more unconventional nature. US interest rates were slashed to zero, where they are expected to remain for the foreseeable future. However, massive amounts of liquidity have been injected by the US federal reserve, European central and the Bank of Japan, reversing the trend of more modest growth and tapering witnessed from 2018.



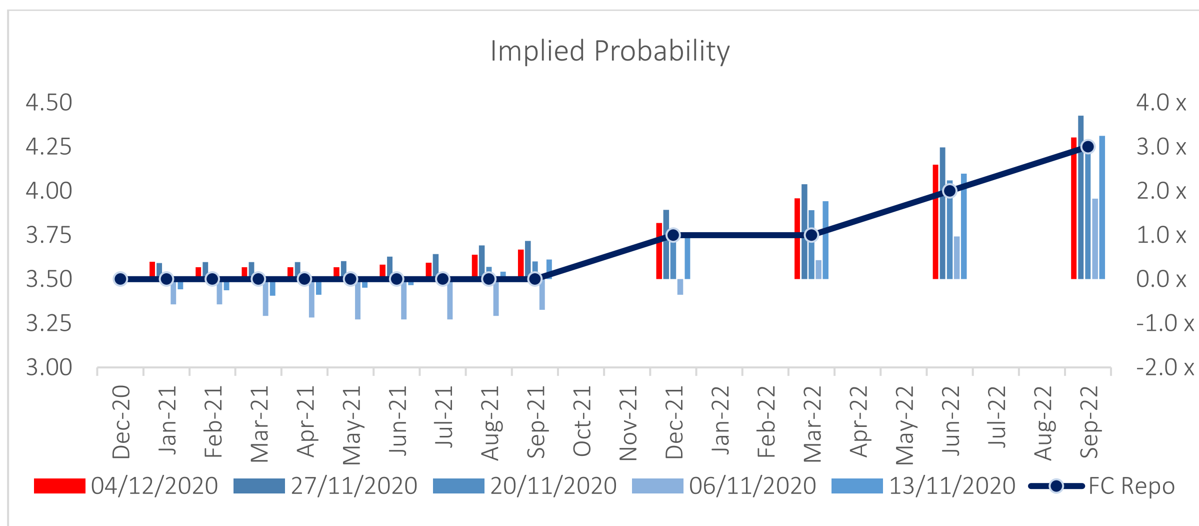
Source: Bloomberg

Global interest rates are also expected to remain low for the foreseeable future. US Fed futures see no change in interest rates over the next twelve months as at this stage negative interest rates are not

being considered in the US. In Europe, interest rates are expected to see one 10bp reduction, taking the rate to -0.6%. Additionally, the bank of England announced that they too will be embarking on quantitative easing programmes and have recently announced another £150 billion stimulus package in November, which means the stock of assets held in the Asset Purchase Facility will total about £895 billion.



We expect to see a similar flat trend in South African interest rates, to which Namibian interest rates are closely tied. The forward rate agreement curve is currently pointing to no change in interest rates over the next twelve months, after which there is an expectation of gradual increases to more normalised levels.

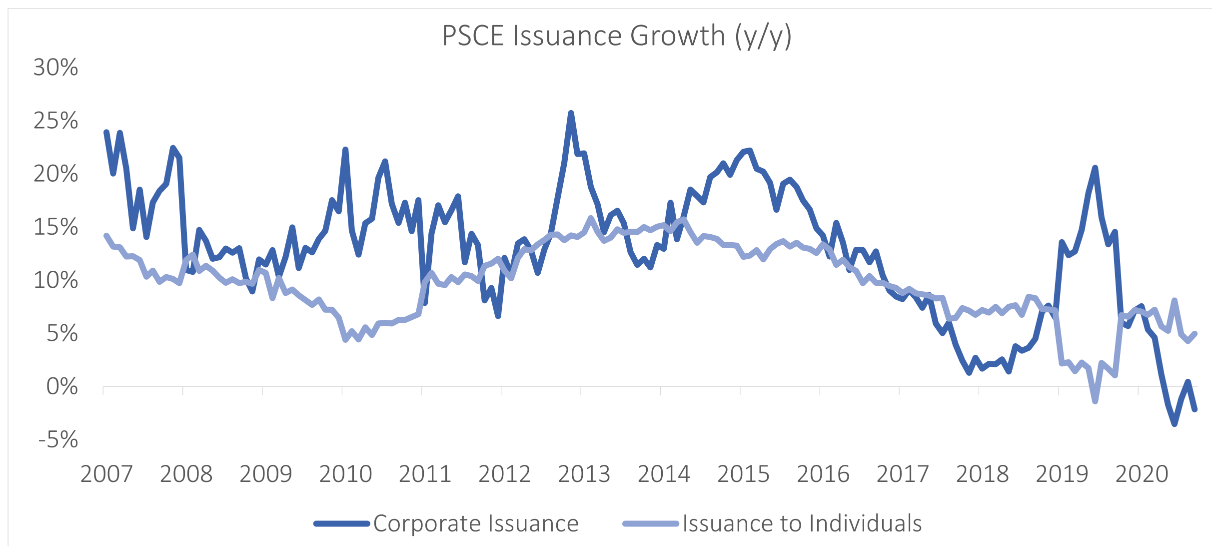


Source: Bloomberg, IJG

Namibian interest rates have historically followed South African rates quite closely. However, the Bank of Namibia has in some instances maintained a 25 basis point spread above the South African repo rate as a buffer against rising interest rates. This was the case in 2018 and has the potential to make Namibia slightly more attractive for deposits than its neighbour. Seeing as Bank of Namibia elected not to alter interest rates at its previous meeting, we expect that the current 25 basis point buffer may be retained.

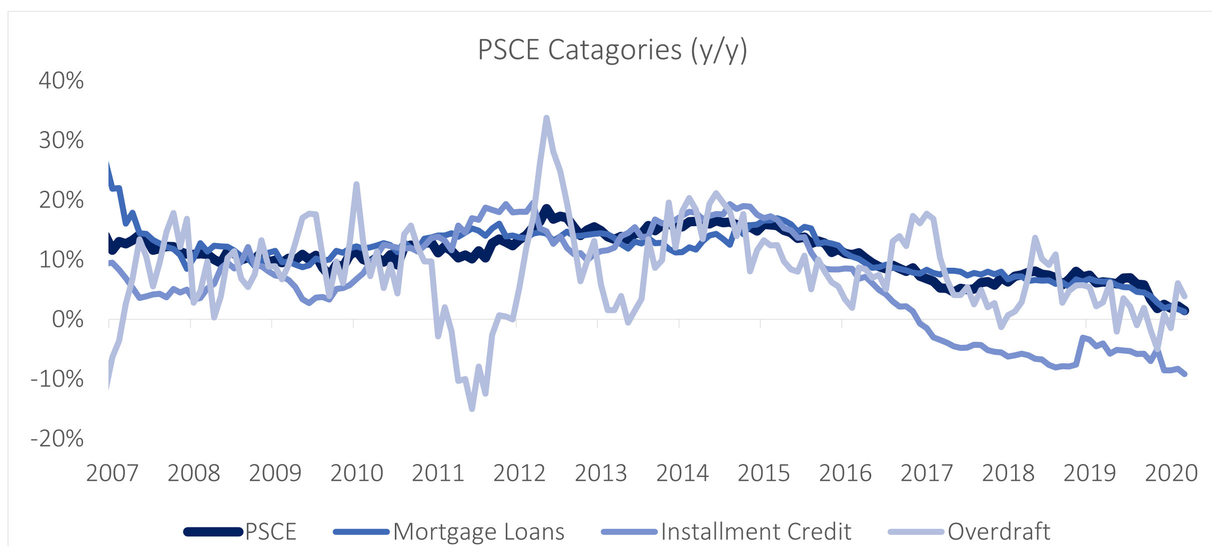
Private Sector Credit Extension

Despite Namibian interest rates now being at their lowest levels yet, this has not seemed to stimulate much lending. Private sector credit extension in Namibia remains very sluggish and recorded 2.5% y/y growth over the 12 month period up to 30 June 2020. This was made up of an 8.1% y/y increase in individual borrowings, while corporates decreased their borrowings by 3.6% or N$1.6 billion. Since the end of the financial year, PSCE has slowed further to 1.5% y/y in September, with corporates posting a 2.2% y/y decline.



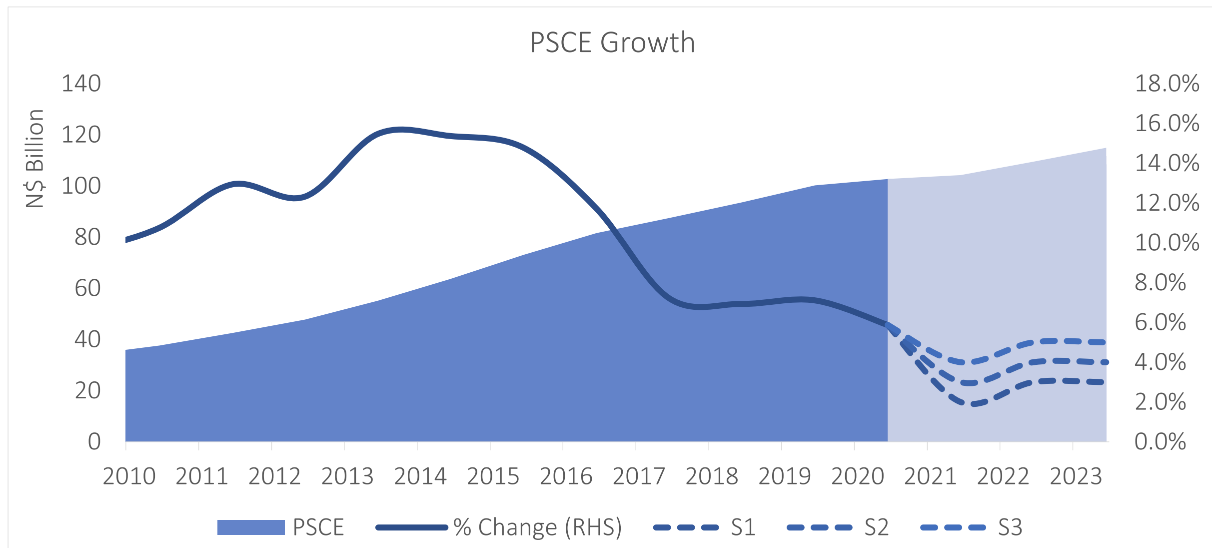
Source: Bank of Namibia, IJG

Although there was decent growth in individual mortgages of 7.8% y/y, other loans and advances to individuals grew at 17.8% y/y as more personal and card loans were issued, while overdraft facilities extended to individuals have displayed a sharp jump 22.4% y/y. The heightened uptake of short-term personal debt and overdrafts is a sign of a stretched consumer, many of whom will have been negatively impacted by the effect of the pandemic and resultant lockdowns.



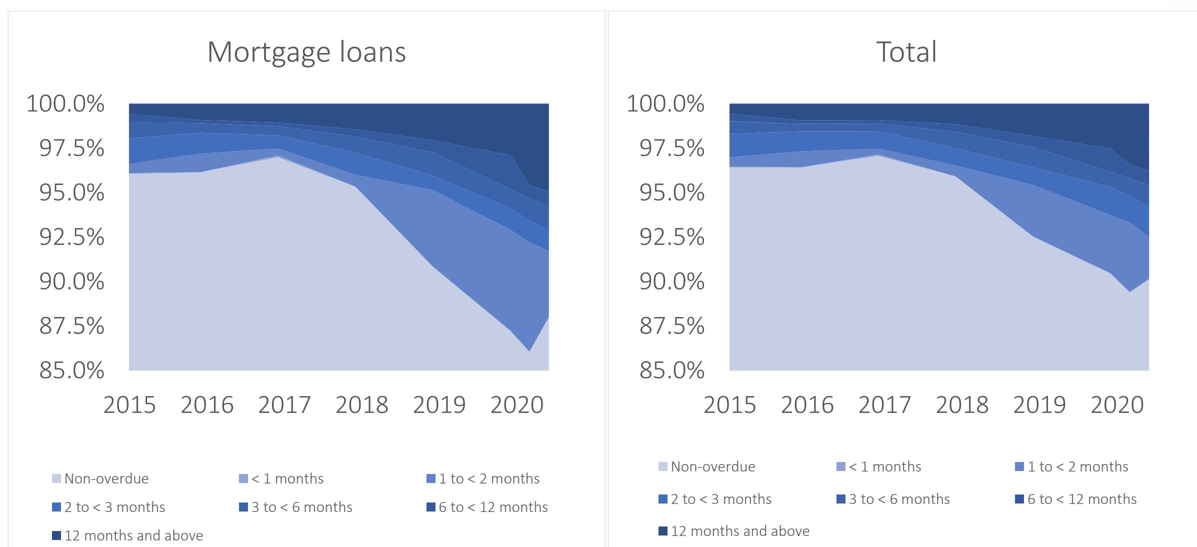
Source: Bank of Namibia, IJG

These are quite worrying trends, as corporate investments in the economy continue to slow as economic activity remains muted and corporates aim to decrease leverage where possible. Annual credit growth was negative for all corporate subcategories except for other loans and advances, which grew by 8.1% y/y. As a result of the above-mentioned factors, namely low economic growth, higher unemployment and lower per capita incomes, we expect to see private credit sector extension continue to slow. Over the next three years, we expect to see PSCE average between 3.5% and 4.5% annual growth.



Source: Bank of Namibia, IJG

On top of slow growth for the foreseeable future, the ageing of loans is another major concern in the Namibian economy. According to Bank of Namibia's aggregated industry results, 12.0% of Namibia's mortgage loans are in arrears, 7.1% of which are more than 90 days in arrears while 4.9% is more than 12 months in arrears. Similarly, when considering all outstanding loans and advances, 9.9% is at least one payment behind, 5.7% is more than 90 days in arrears and 3.8% is more than twelve months behind. This trend has been steadily worsening since 2016 when the economy began to slow and will continue to be impacted by the effects of the pandemic.



The Namibian property market, especially in the capital, remains a worry. The value of mortgage loans more than 12 months in arrear now total N$2.63 billion, roughly 4.9% of the total amount outstanding. Although this number has been growing steadily over the last few years, the pandemic and lockdown have added fuel to the fire. Banks are now in a difficult position, as repossessing properties is often viewed as a very last resort. However, with non-performing loans climbing rapidly, this route is already being followed when other options fail. This means that the number of properties sold on auction should increase in the coming years and this may put increased pressure on housing prices, negatively impacting mortgage loan collateral values.

Developments

Capricorn Group Disposal of Zambian Operations

After years of losses or only marginal profits, the Capricorn Group have decided to dispose of the Zambian banking operations, Cavmont Bank. In what only can be described as a win-win transaction, Access Bank Zambia, a subsidiary of Nigerian banking conglomerate Access Bank Limited will acquire 100% of the issued share capital of Cavmont for a consideration of N$285 million.

Capricorn will then reinvest the N$285 million as preference shares in the merged bank for five years. The transaction is expected to close during the fourth quarter of 2020, subject to the meeting of various conditions which, among others, include shareholder approval, relevant regulatory approvals and the local and regional competition commission authorities. The combined bank would operate under the Access Bank brand, and the larger customer base and higher asset base would give the merged company much better economies of scale and will see the merged entity as one of the top 10 Zambian banks. Cavmont has been reported as a discontinued operation in the FY20 financials.

Introduction of NamPay

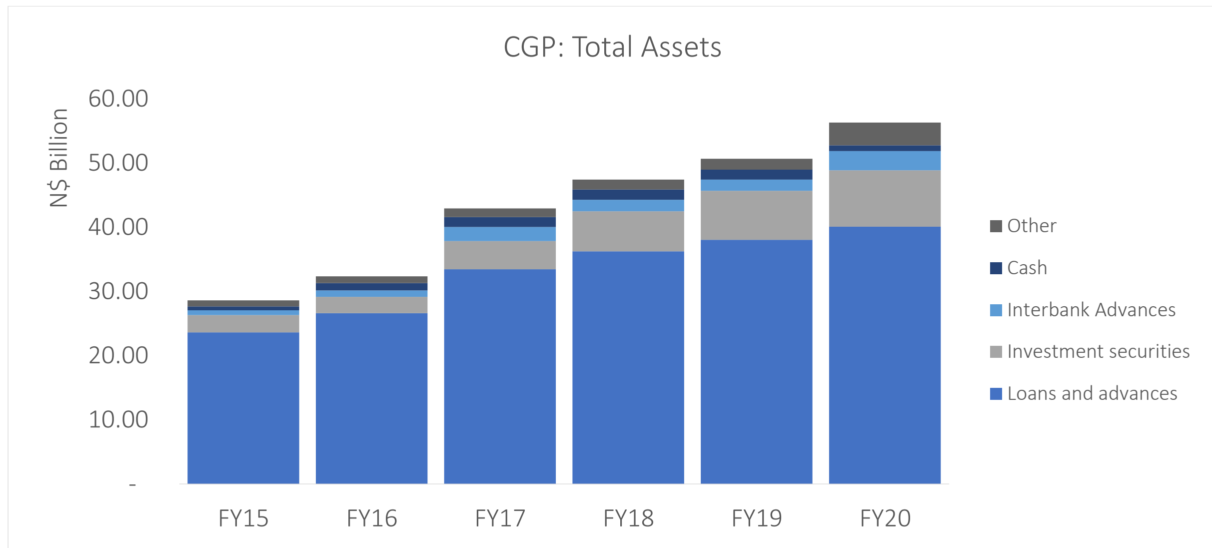
The introduction of NamPay, new national EFT system, was Announced early in 2019 and is expected to be rolled out by the end of the current calendar year. The introduction of NamPay aims to ensure that Namibia and its national payment system remains on par with international standards (ISO 20022). The largest benefit of the new system is the introduction of Near-Real-Time Credit payment stream, which would enable any consumers to transfer money to any beneficiary within the same business day, with payment clearing expected to take roughly 30 minutes.

A prominent feature of NamPay would be that debit orders will no longer be deducted from clients' accounts in a specific, predetermined prioritised order, but instead, NamPay will assign random sequences to debit orders submitted for collection in the national payment system. This means that it will no longer be possible for service providers to be prioritised. Additionally, Service providers may choose to activate credit checking. Credit tracking is the continuous checking of funds on client accounts where debit orders have been rejected due to insufficient funds. Service providers may choose to check accounts continuously for up to 14 days.

Net Interest Income

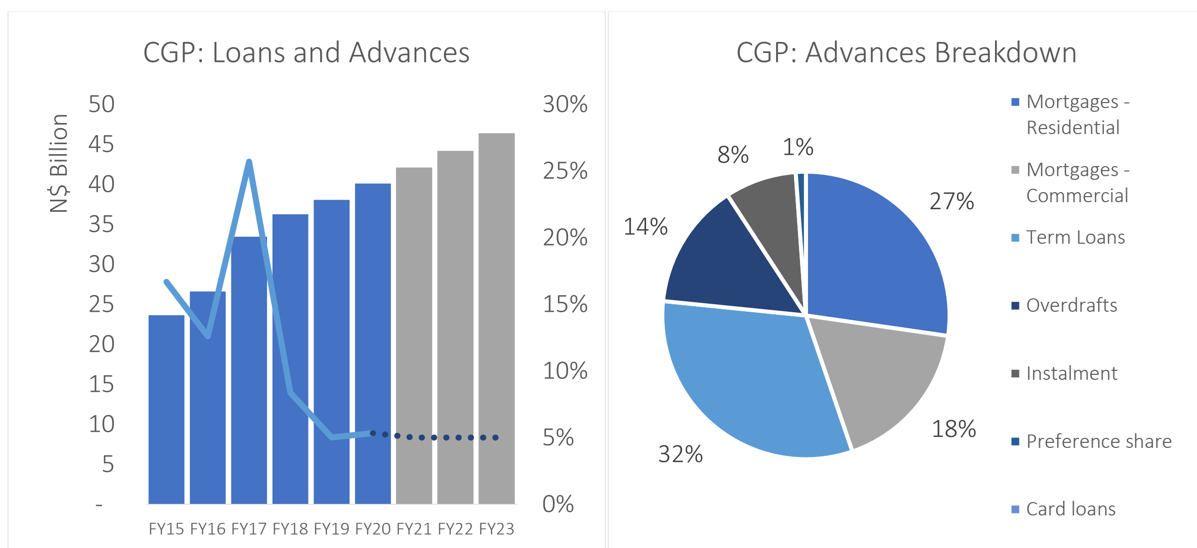
Asset Base

Capricorn Group



Source: CGP, IJG

Capricorn group was able to grow total assets by 11.2% y/y or N$5.66 billion to N$56.34 billion during the period under review. This was made up by decent growth in loans and advances of 5.3% y/y, or N$2.03 billion to N$40.08 billion, while Interbank advances increased by 73.8% y/y, or N$1.27 billion to N$3.00 billion. The strong growth in loans and advances was underpinned by a solid 4.5% y/y increase in advances at Bank Windhoek, which now makes up 81.6% of the total book. Entrepo posted excellent growth of 18.3% y/y while Bank Gaborone also posted stellar growth in its book of 22.5% y/y. As has been the case in recent years, excess funds were invested into investment securities, which increased by 21.7% or N$1.16 billion to N$8.80 billion. Investment securities now make up 15.6% of total assets.



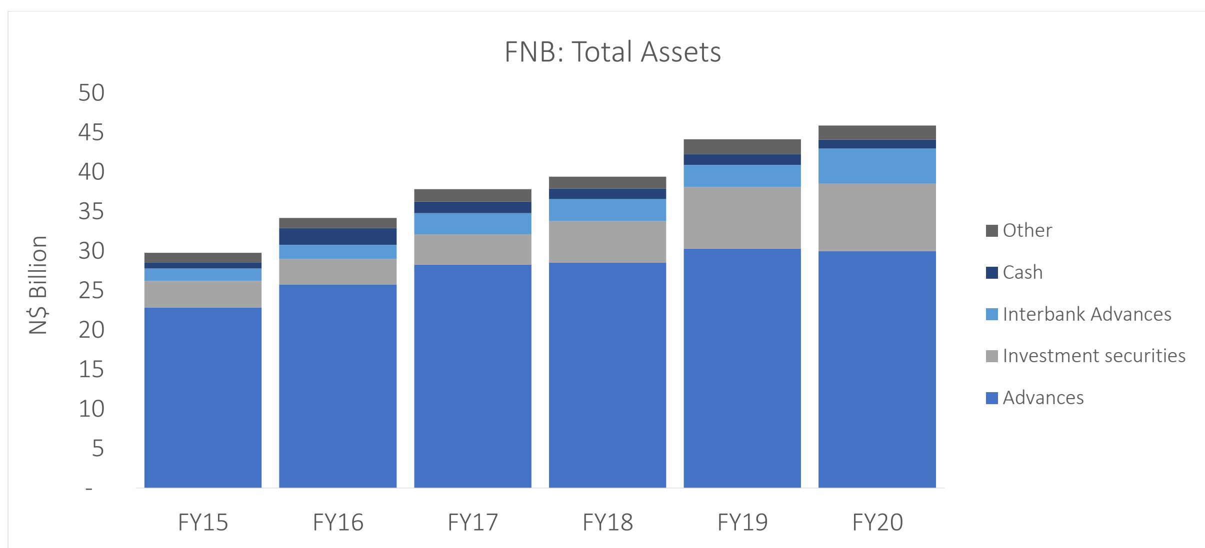
Source: CGP, IJG

The makeup of the loans and advances book is virtually unchanged from FY19, with mortgages still making up roughly 45% of total assets, while term loans have grown slightly to make up 32% of the

book. Microloans account for roughly 3.0% of total advances but accounted for 7.7% of total net interest revenue.

We expect to see advances growth slightly above that of PSCE over the next three years as growth in the micro-lending space and Botswana are expected to grow by double digits, while Namibian credit should grow roughly in line with overall PSCE. Management has indicated that they expect that the uncollateralised lending in Botswana and Microlending in Namibia is expected to remain the main drivers of growth in the advances book. Management remain cognizant of the fact that they are the actively increasing the credit risk of the group, but will keep this risk within their appetite by not overly aggressively growing these segments. This is especially important in the micro-lending space, where the emphasis has to be placed on creating a sustainable business by ensuring that these term loans are used for productive purposes instead of consumptive spending.

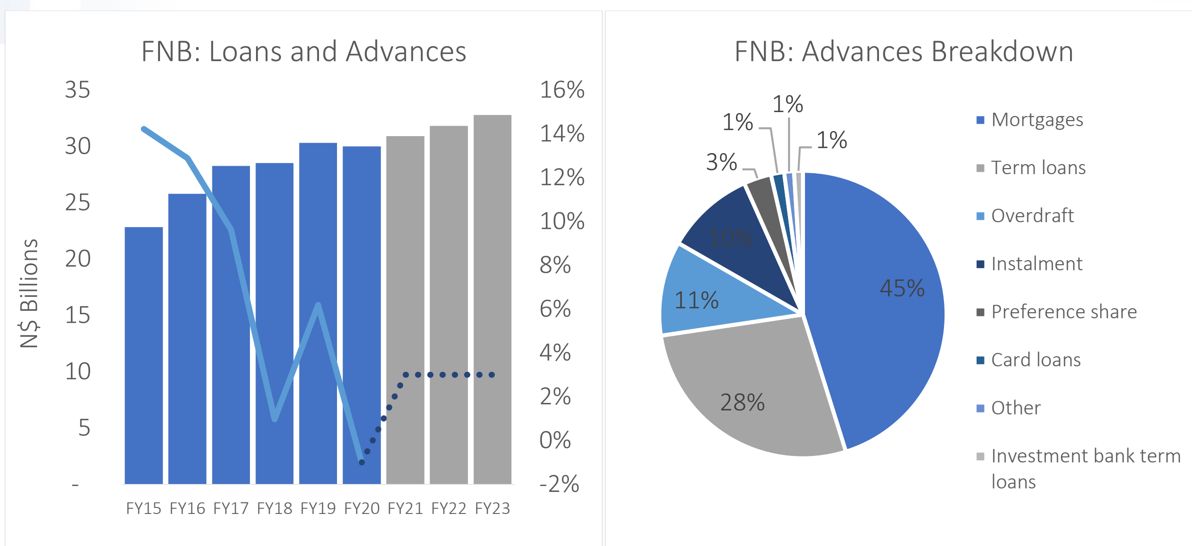
FirstRand Namibia



Source: FNB, IJG

FirstRand Namibia's total assets increased by 3.9% y/y or by N$1.73 billion to N$47.97 billion. This was driven largely by an increase in interbank advances, which grew by N$1.64 billion accounting for 9.7% of total assets. Investment securities increased by 9.3% y/y or N$727.2 million to N$8.53 billion and now makes up 18.6% of total assets. Gross advances increased marginally by 0.7%, lower than overall private sector credit extension growth of 2.5% y/y. However, net advances, contracted by 1.0% y/y or N$304.2 million to N$30.0 billion, largely due to the N$559.7 million impairment charge for FY20. This talks a lot to FirstRand Namibia's strategy of not aggressively pursuing market share and rather aiming to maintain a book of quality assets.

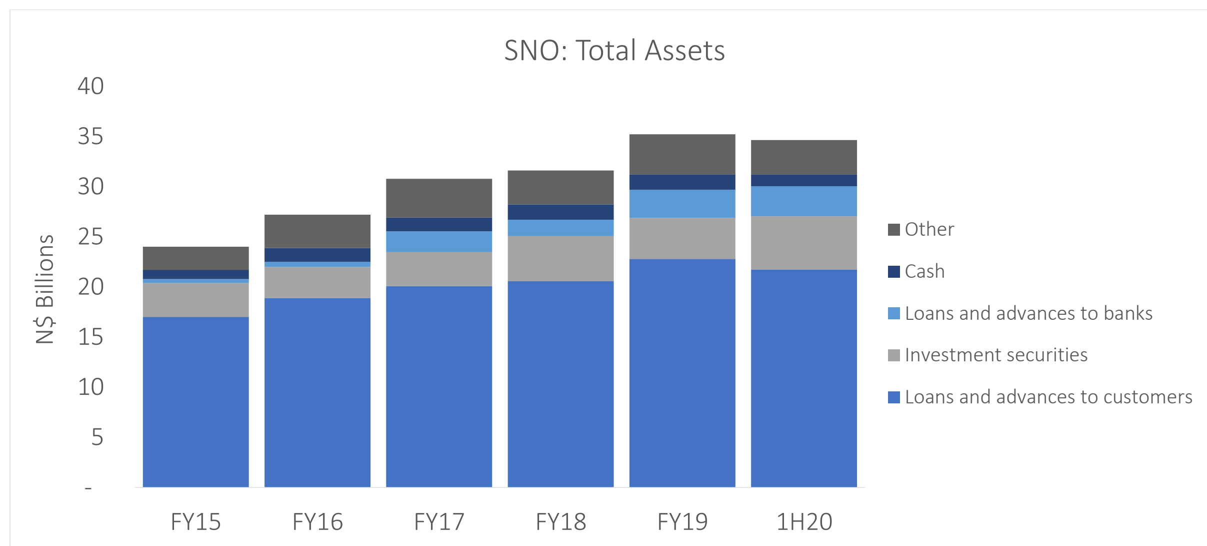
IJG



Source: FNB, IJG

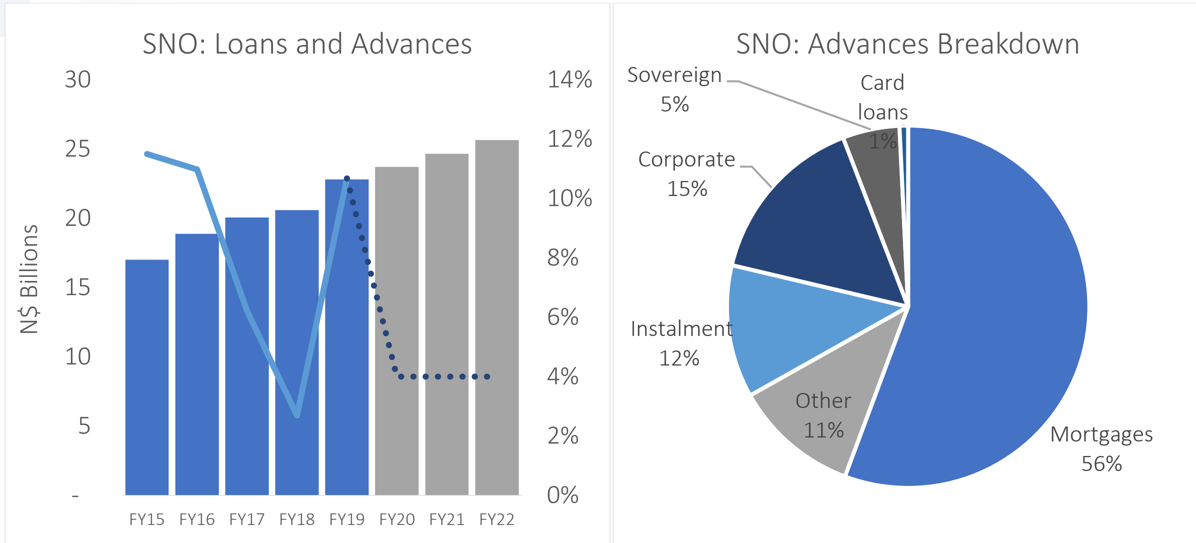
Residential mortgages currently make up 45% of total advances, followed by terms loans at 28%. These two categories were the only two that displayed growth on a gross basis in FY20, growing by 4.1% y/y and 1.8% y/y respectively. We expect FirstRand to continue on their defensive strategy and concentrate on protecting return on equity instead of chasing market share. As a result, we expect to see advances growth below overall private sector credit extension growth, averaging about 3.5% over the next three years.

Standard Bank Namibia



Source: SNO, IJG

Total assets of SBN holdings have been relatively constant over the last twelve months, increasing by 1.5% on a y/y basis, but 1.6% below the December 2020 level. Interbank lending declined by 17.1% y/y to N$3.03 billion while advances to customers declined by 3.3% y/y to N$$25.46 billion. Advances to customers make currently account for 64.7% of total assets. Mortgages increased by 5.8%, while corporate lending grew by 8.7% y/y. Sovereign lending under corporate and investment banking declined by 46.2% from N$2.12 billion to N$1.14 billion. Investment securities increased by 22.9% y/y or N$986.9 million to N$5.29 billion, and now makes up 15.3% of total assets.



Source: SNO, IJG

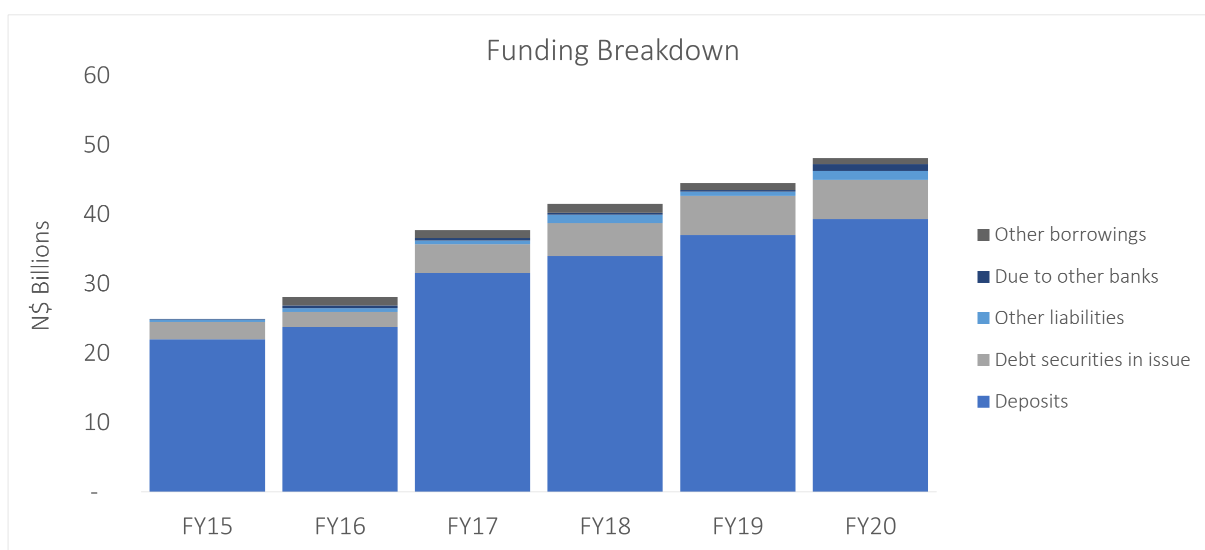
Mortgages make up 56% of the advances book, which means SBN has the highest relative exposure to the residential mortgage loans of the three listed banks. Corporate term loans account for about 15% of the total book. We expect Standard bank to continue growing advances in line with our expectations for private sector credit extension, at roughly 4.0% p.a. over the next three years.

Funding

Strong liquidity conditions and increased savings by individuals allowed the three banks to improve their funding mix by growing retail deposits while decreasing wholesale deposits. Seeing as liquidity conditions are currently quite positive, the banks have used the opportunity to build up a solid base of retail deposits.

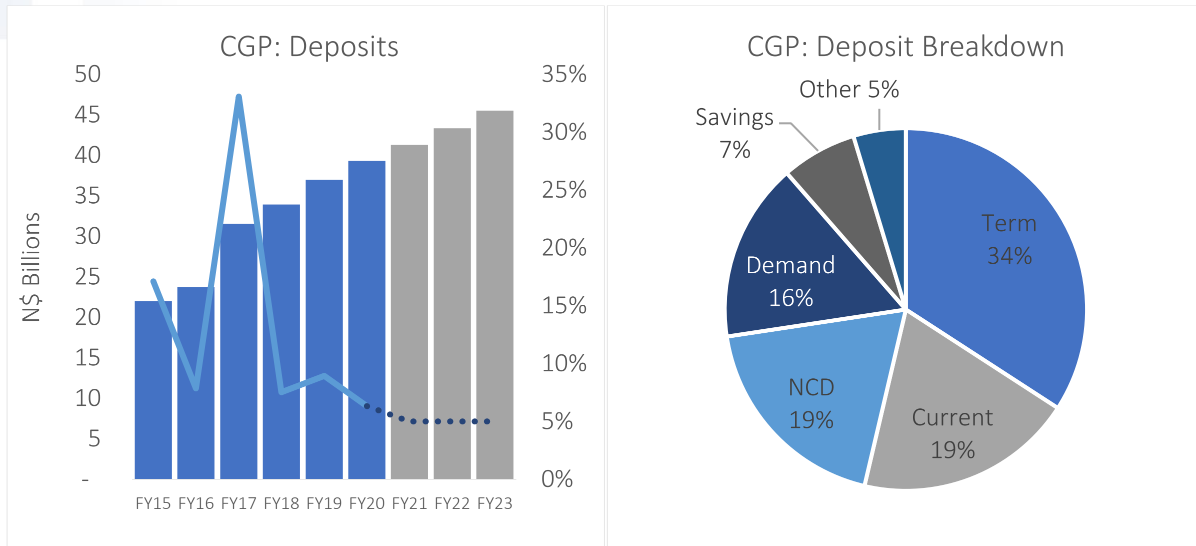
Capricorn Group

Capricorn's increase in assets was funded mainly through an increase in deposits, which grew by 6.3% y/y or N$2.34 billion to a total of N$39.3 billion. Bank Windhoek implemented branch incentives to grow funding from retail sources. This underpinned the growth in deposits which grew by 7.5% y/y. Good growth was witnessed in Botswana, where deposits from customers increased by 13.3% y/y, despite the closure of 6,500 small debit and dormant accounts.



Source: CGP, IJG

A large portion of the increase was made up of current and savings accounts, which increased by 23.5% y/y and 16.5% y/y respectively and added N$1.83 billion of inexpensive retail funding. Additionally, demand deposits increased by 37.3% or N$1.71 billion. NCD funding, on the other hand, decreased sharply, by 17.6% y/y or N$1.59 billion, substantially improving the group's funding mix from a cost perspective. We expect deposit growth to show marginal growth over the next three years to support the growing books in the microlending segment and Botswana, although the microlending business should become self-funding in the medium term.

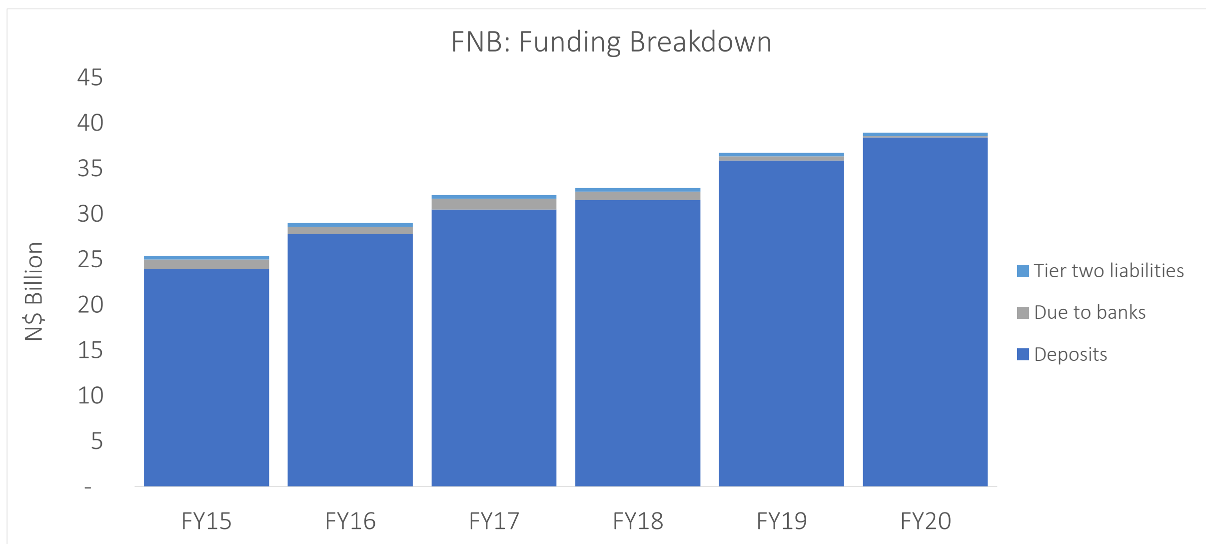


Source: CGP, IJG

In November Bank Windhoek announced the auction of between N$200 million and N$300 million senior, unsecured debt instruments. These will aim to capitalise on the favourable liquidity environment to secure some slightly longer-term funding. This will consist of 3 and 5-year floating rate notes and 3-year fixed-rate notes.

FirstRand Namibia

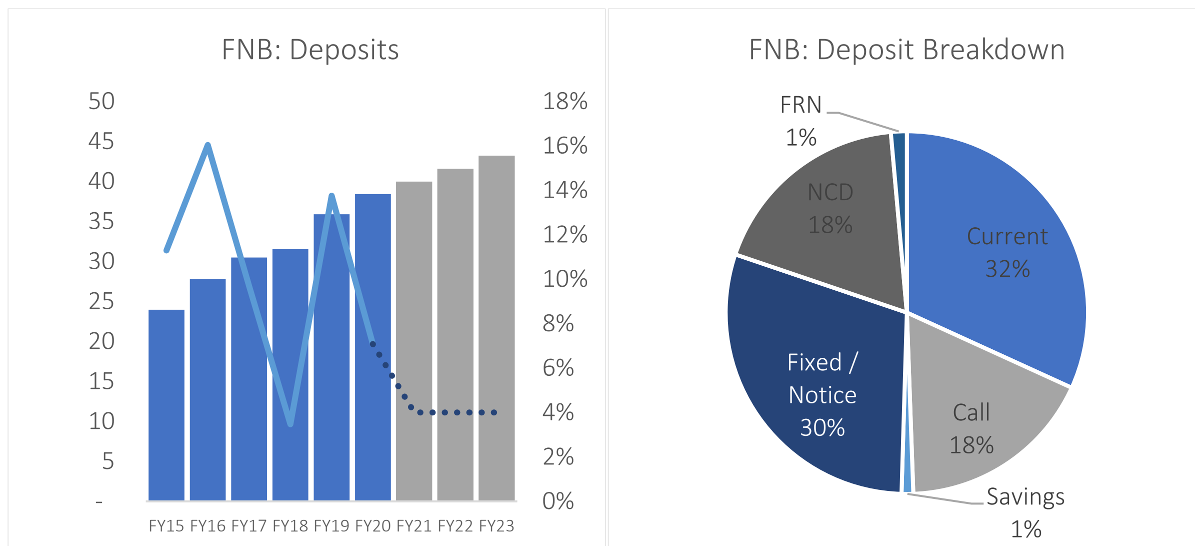
FirstRand's deposit growth was ahead of advances, growing by 7.1% y/y or N$2.54 billion to N$38.4 billion. Retail deposits saw the largest increase as current accounts increased by 22.5% y/y or N$2.24 billion while call accounts increased by 18.9% y/y or N$1.08 billion. Savings accounts, which still make up a small portion of total funding also saw strong growth and were up 36.7% y/y to N$400.3 million. This is a result of increased focus on products like the FNB savings pocket, but largely due to a national trend of increased savings.



Source: FNB, IJG

The large increase in retail deposits has allowed the bank to decrease its exposure to wholesale funding, as NCDs decreased by N$1.46 billion or 17.2% y/y while floating-rate notes decreased by 57.2% y/y,

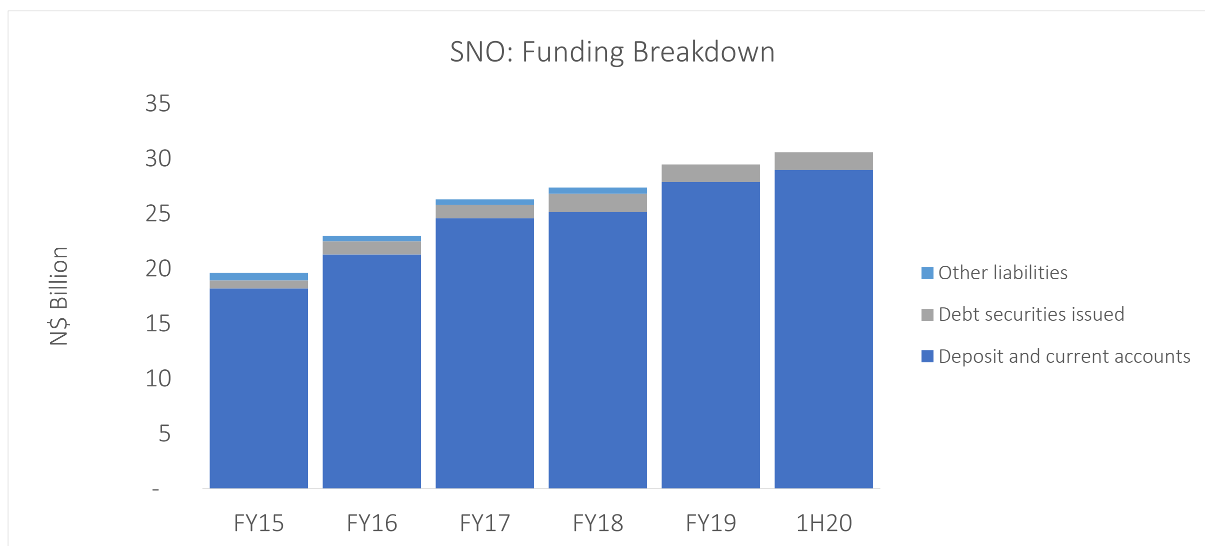
decreasing its overall cost of funding. FNB's funding book is currently heavily weighted towards retail deposits, with about 80% of funding being made up by traditional deposits, while the remaining 20% is made up by debt-like securities like NCDs and FRNs.



Source: FNB, IJG

Standard Bank Namibia

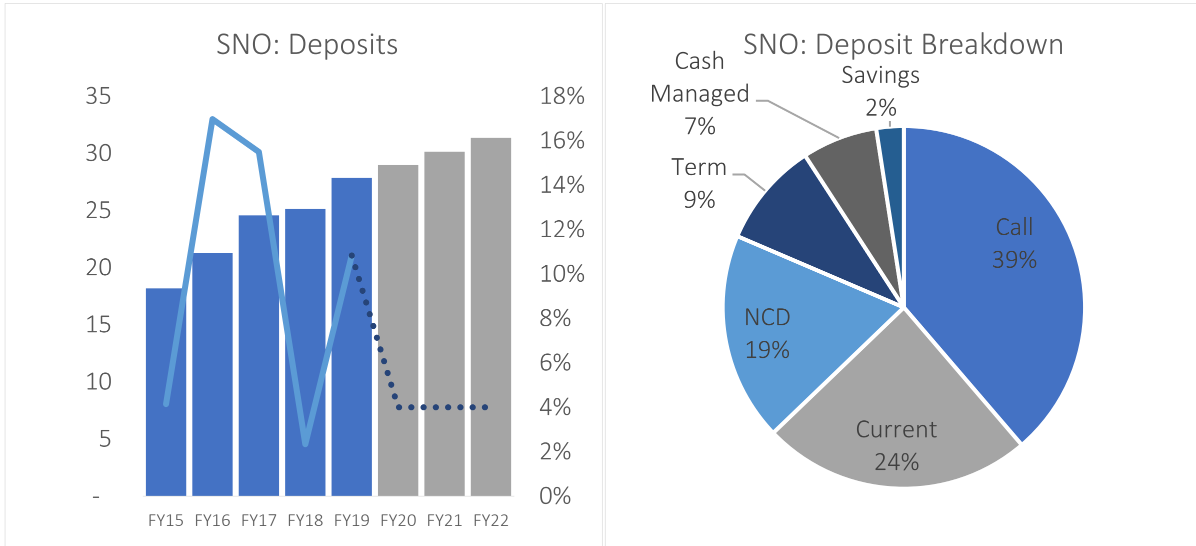
SNO was also recorded decent growth in retail deposits, which replaced some of its more expensive NCD funding. Overall depots from customers grew by 0.7% y/y to N$26.38 billion, more or less in line with the growth in total assets. Call and current accounts grew by 11.7% y/y and 16.9% y/y respectively, while term deposits grew by 31.0% y/y. This allowed NCD funding to be reduced by 28.5% to N$4.90 billion, improving the overall cost of funding to the change in the funding mix. Unfortunately, cash managed accounts, which make up roughly 7% of the funding book, declined by 21.0% as businesses experienced severe cash flow pressures.



Source: SNO, IJG

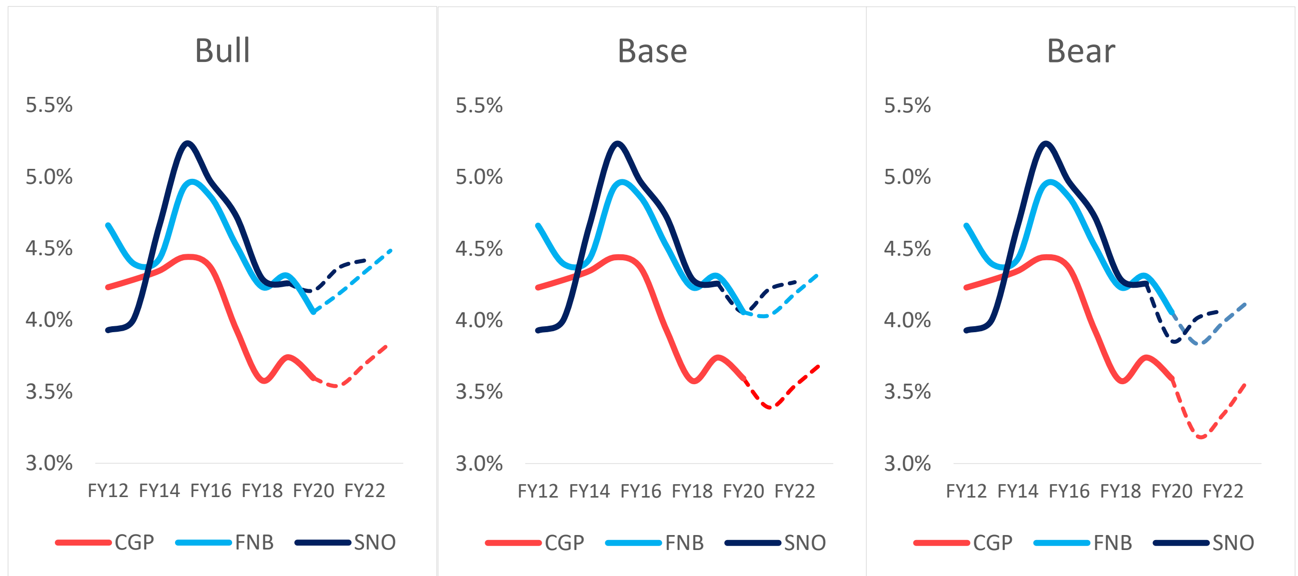
As is the case with the other two banks, SNO was able to reduce its reliance on wholesale funding, specifically NCDs, which now only makes up 19% of deposits. Debt securities remained flat year on year,

however, SNO managed to issue N$300 million on its medium-term note program in October 2020 at an attractive clearing yield of 3-month JIBAR + 88bps.



Source: SNO, IJG

Interest Income and Expenses

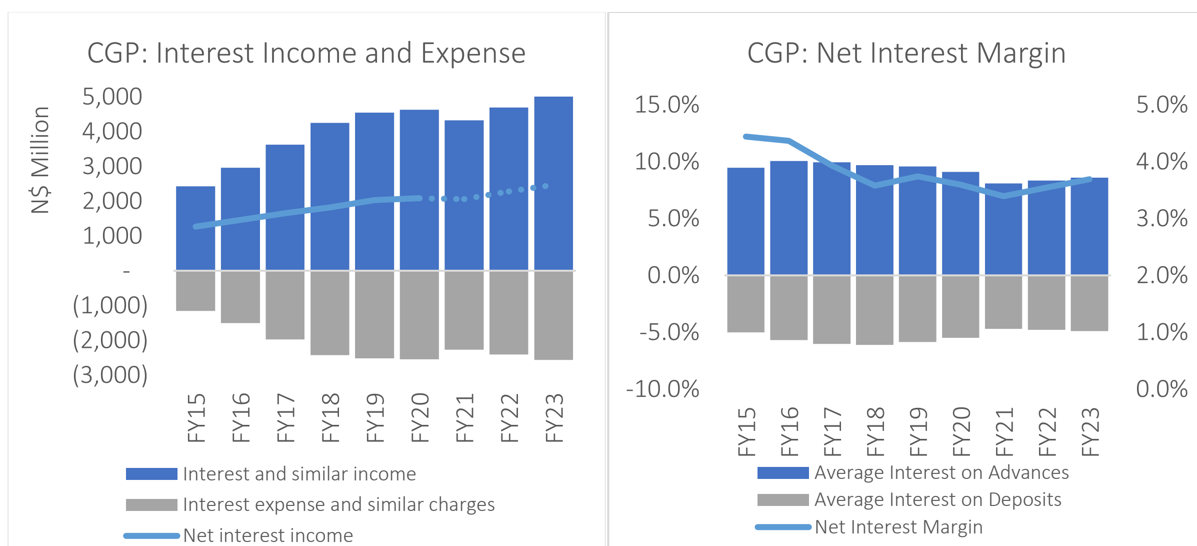


Source, CGP, FNB, SNO, IJG

The rapid decline in interest rates will negatively impact all three of the listed banks due to contacting net interest margins. However, the gradual repricing of deposits, and in some cases the repricing of newly issued advances, should result in a slow recovery of the net interest margins. Our base case scenario assumes that margins will remain under pressure in FY21, before slowly recovering to their pre-COVID levels by the end of FY23.

Capricorn Group

For the Capricorn Group, Bank Windhoek will the most exposed to the 275 basis point cut in interest rates as interest earned on its advances book is closely linked to the administered interest rate. Bank Gaborone faced a similar scenario, although less severe, as there were two interest rate cuts, 25 bps in August 2019 and 50 bps points in May 2020.

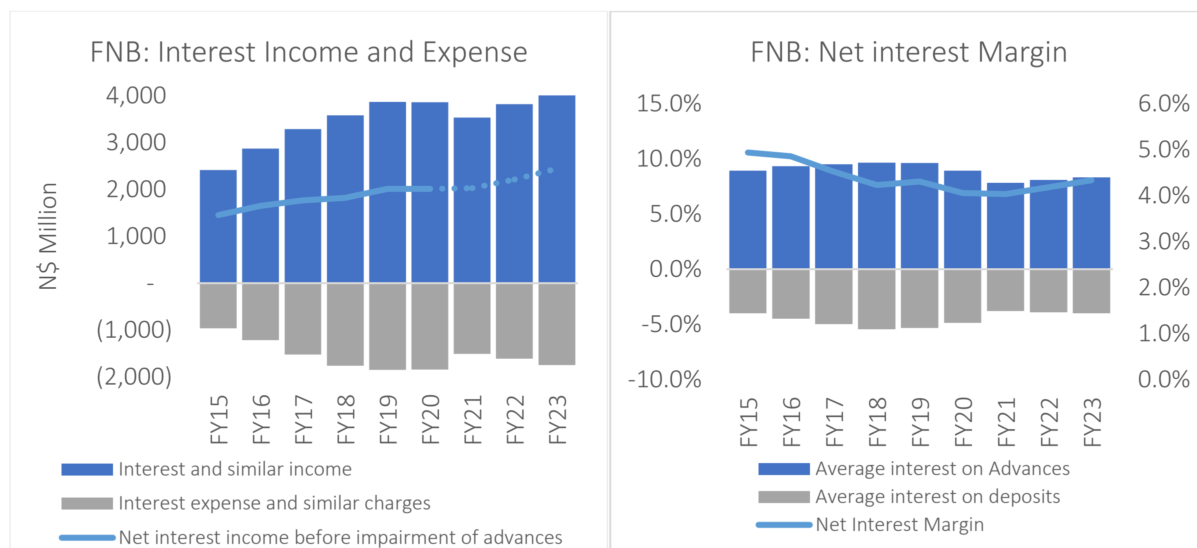


Source: CGP, IJG

On the other hand, Entrepo, the group's microlending division, was less impacted by the decrease in interest rates as they charge a fixed rate over the life of the loan. The delayed impact, however, will likely result in a larger contraction of net interest margin, as the interest rate charged on microlending loans are capped at 2 times multiple of the prime rate. Nevertheless, the absolute margin on these loans remains extremely attractive and will remain a positive contributor to the overall net interest margin going forward. Management has indicated that the repricing of new advances will be an unfortunate reality, to protect net interest margins going forward.

FirstRand Namibia

FirstRand's net interest income also remained relatively flat for FY20 due to the sharp declines in the repo rate in the last quarter of the year, up by only 0.1% y/y to N$2.01 billion. The net interest margin continued to trend down. This was largely due to the decline in interest rates charged on advances. However, there was also pressure on deposit pricing, where much of the retail book is already paying quite low-interest rates. Additionally, the build-up of investment securities has also been a driving factor of lower margins, as advances growth is slow and excess funding is invested in lower-yielding risk-free assets.

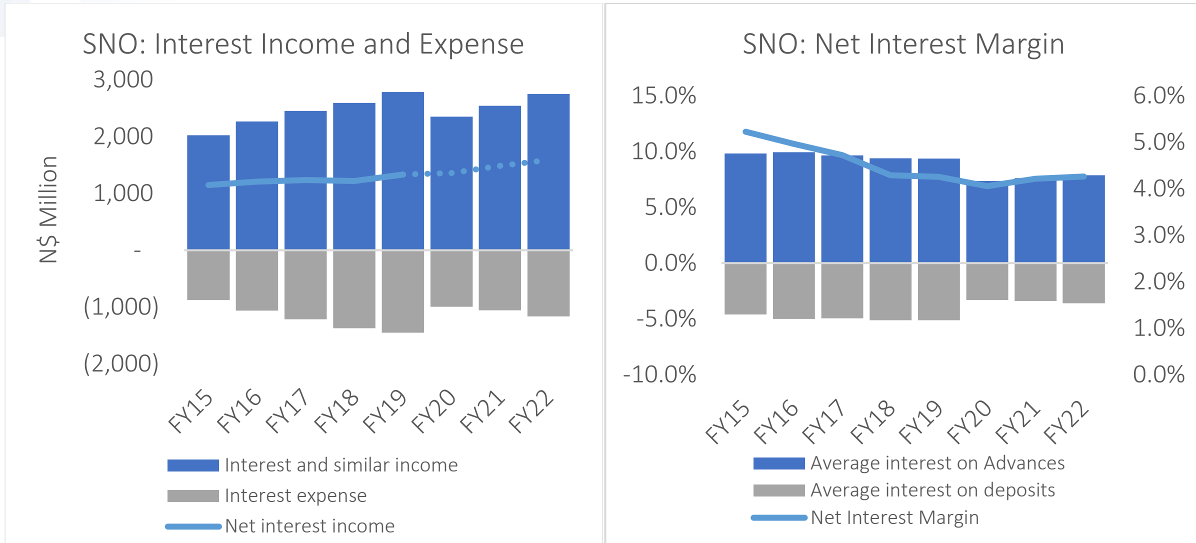


Source: FNB, IJG

FNB estimates that NII was down N$97 million on average during the last quarter of the year due to the decline in interest rates. Management has indicated that they would also be actively repricing new advances to maintain the net interest margin. We expect to see further pressure on the margin in the FY21 financial year before gradual recovery to pre-COVID-19 levels is the deposit and advances books rebalance slowly over time.

Standard Bank Namibia

Standard bank's net interest margin was also affected, dropping to 3.5% for the first six months of the financial year as almost all its loans and advances repriced with the 2.75% rate adjustment while a significant portion of deposits and current accounts repriced with lower rates. This resulted in a 4.3% y/y decrease in net interest revenue compared to the first half of FY19. The impact of the rate cuts was partially offset by a change in the deposit mix, that was tilted to cheaper retail deposits while more expensive NCD funding was reduced.

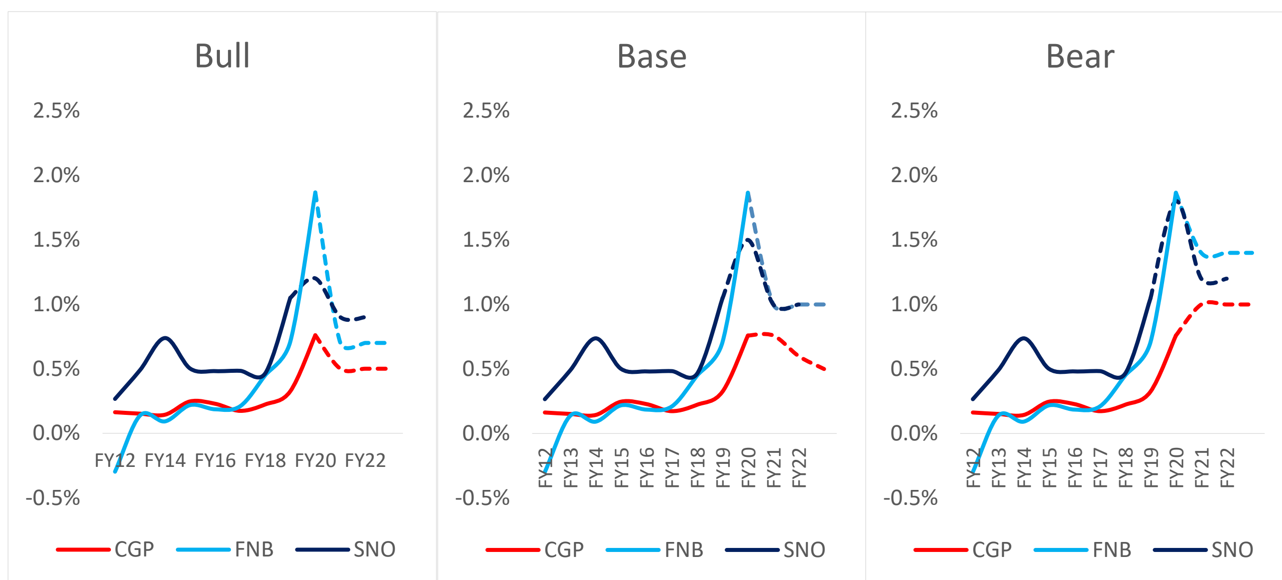


Source: SNO, IJG

Standard Bank has indicated that they would be hesitant to increase the rates charged on advances, pointing out that there will continue to be a lot of competition in the market to gain quality assets. Management has also indicated that they are preparing for a prolonged cycle of very low-interest rates, and as a result, expect net interest revenue to stay under pressure for the foreseeable future. As a result, they will be placing increased emphasis on growing non-interest revenue.

Impairments

Impairments were one of the largest differentiating factors between the financial performance of the various banks over the last three years. The rapid deterioration in economic outlook has resulted in a sharp increase in current year impairments, with impairments going forward expected to remain elevated. The severity of credit losses remains an uncertainty at the moment as global conditions will dictate the Namibian recovery path. The duration of travel restrictions and the severity of infections in Europe will have a direct and lasting impact on the Namibian tourism sector, which feeds into many other segments of the Namibian economy.

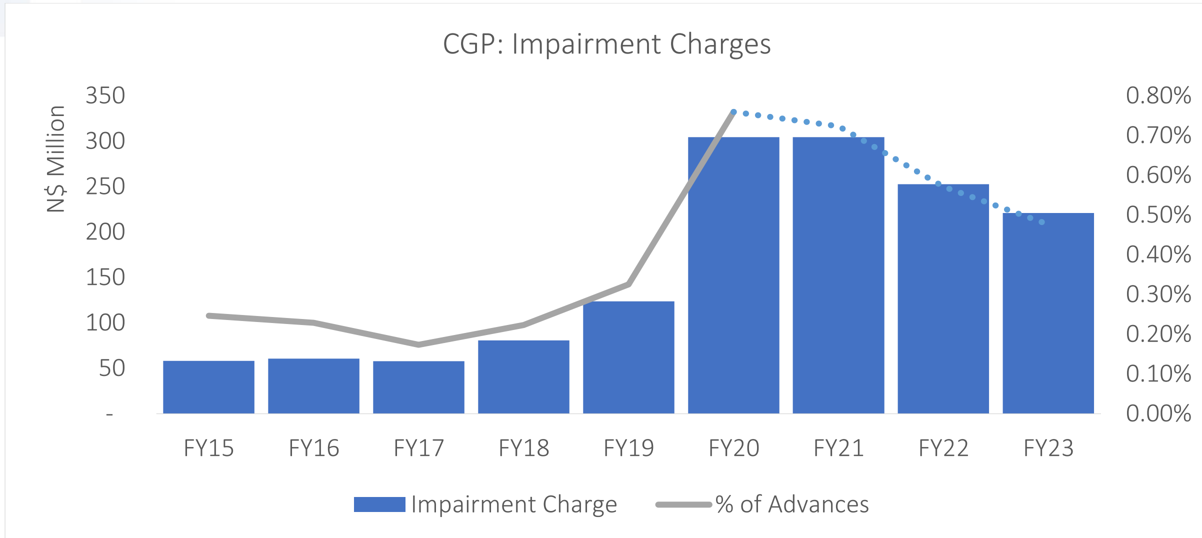


Source, CGP, FNB, SNO, IJG

Capricorn Group

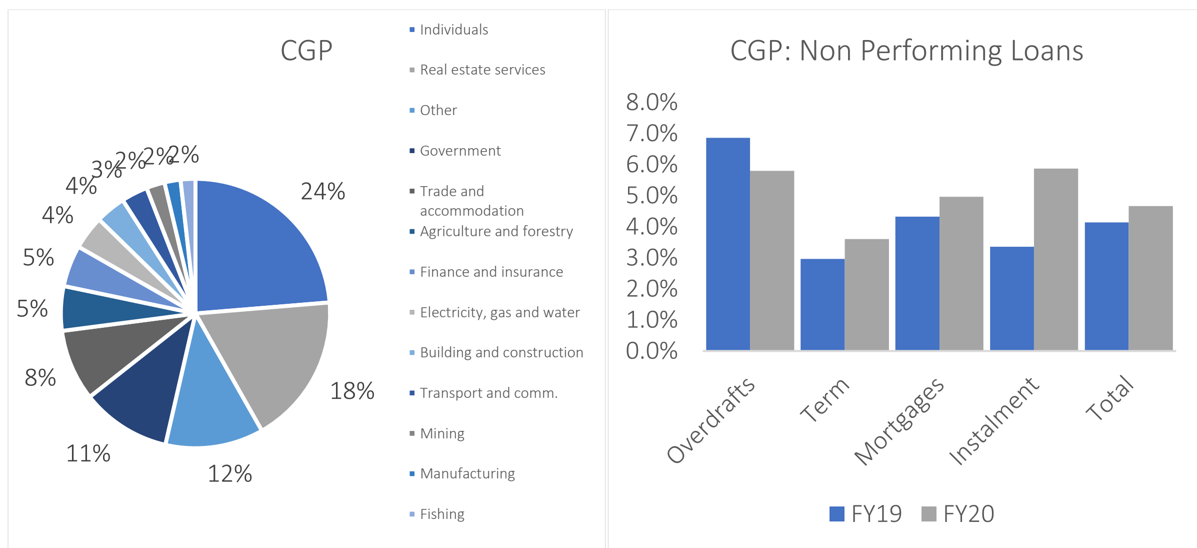
Capricorn's non-performing loans increased from 4.1% of gross advances to 4.7%. The group recorded an impairment charge of N$304 million, which equates to 0.76% of gross advances. This was divided between N$168 million worth of specific impairments and N$136 million of economic overlays, which, according to the financial statements are not reflective of the asset quality of the book. As a result of the significant higher increase in impairment charges compared to the increase in NPLs, the NPL coverage ratio increased from 47.3% to 49.0%.

The credit impairment charge is much lower than the numbers reported by its two peers. Management has attributed the lower impairment charge due to its decentralised business model and closer relationship and management of their clients. Additionally, Namibia had an above-average rainy season which brought some relief to the struggling agricultural sector, which makes up about 5% of advances. Additionally, CGP is much less exposed to individuals than its two peers, which may be a positive factor.



Source: CGP, IJG

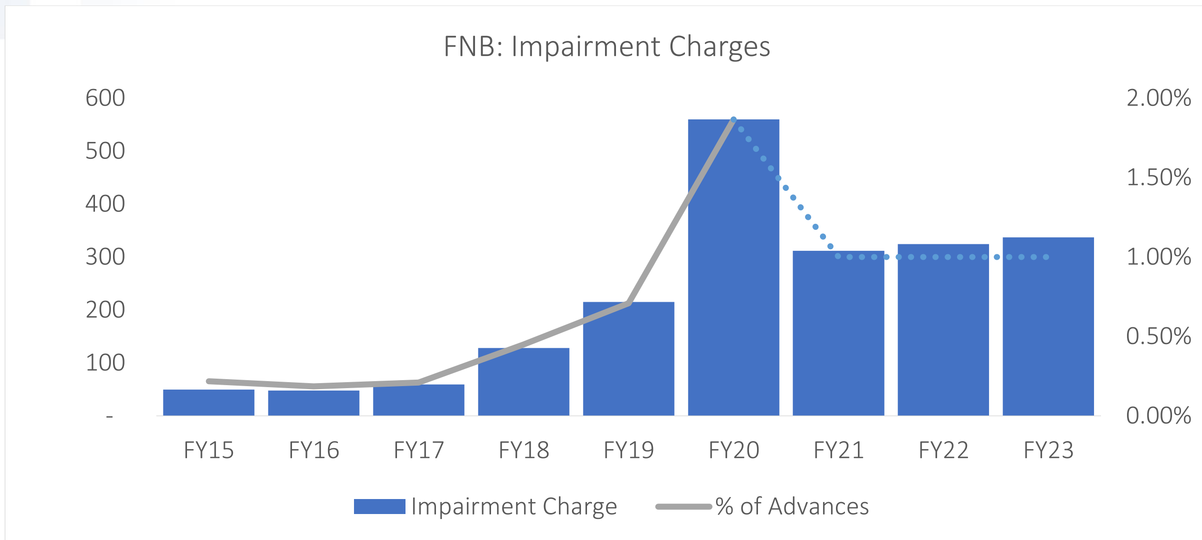
Management has also indicated that they feel that the economic overlays that were applied to the Botswana book were about twice the amount that they considered reasonable, as this was based heavily on the absolute change in annual GDP for the country as a whole. Nevertheless, we expect the credit impairment charge to remain elevated, as the fallout of the pandemic is far from over and second-round effects of higher unemployment and value chains linked to trade and tourism will only become fully apparent in the years to come.



Source: CGP, IJG

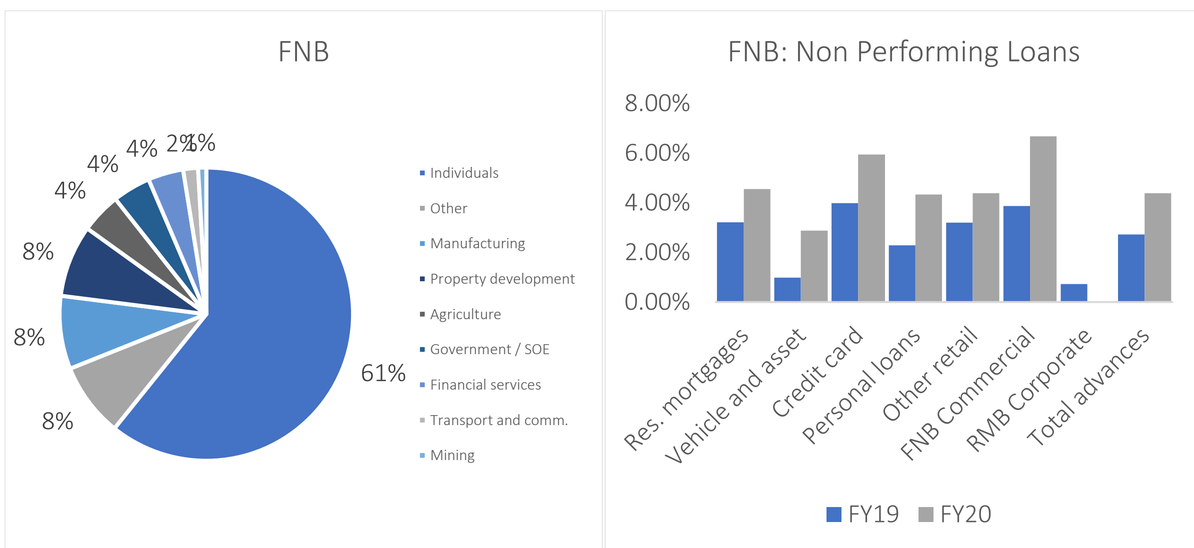
FirstRand Namibia

FirstRand's non-performing loans increased from 2.7% to 4.4% in the period under review. In dollar terms, this is an increase from N$845 million to N$1.37 billion. The total impairment charge of FirstRand increased to N$559.7 million or 1.79% of gross advances. The portfolio impairment charge made up N$276.0 million while economic overlays added N$151 million to this total. According to the financial statements, the group remains prudently provided, with portfolio impairments as a percentage of the performing book at 2.1% while the specific coverage ratio stood at 44.4%.



Source: FNB, IJG

FirstRand's management has indicated that they will remain cautious on provisioning going forward, but feel comfortable with the current level due to high collateral values on non-performing loans. They further indicated that due to the immense amount of uncertainty it was better to err on the side of caution, however, in the months following the lockdown, the economic outlook has improved slightly. We suspect that the high impairment charge will not be repeated in FY21, as most of the sudden deterioration in economic outlook has now been absorbed, however, impairment charges will undoubtedly remain elevated in years to come.

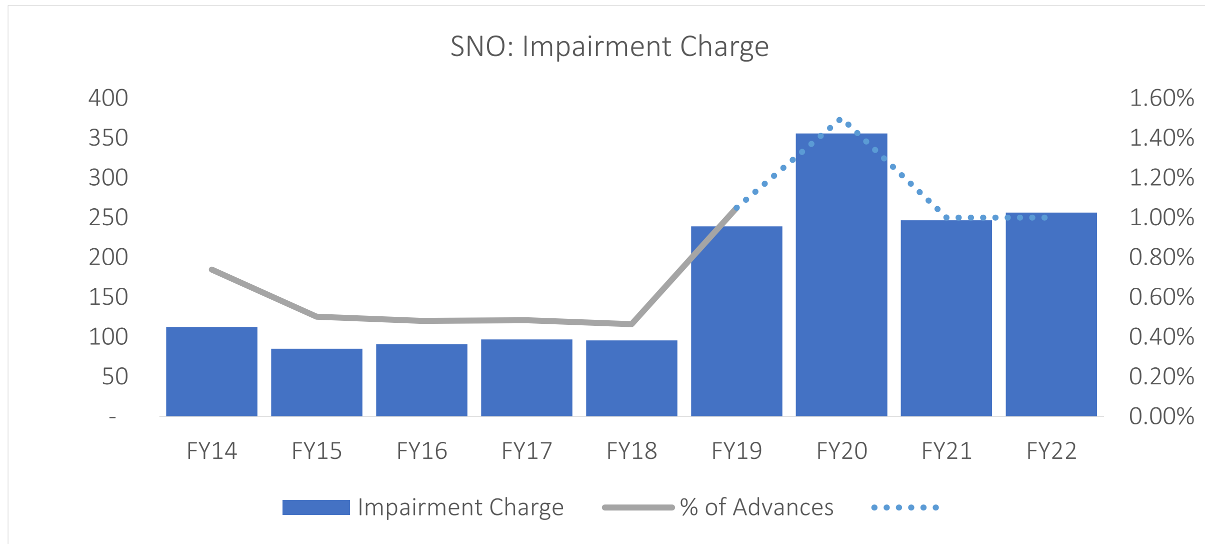


Source: FNB, IJG

Standard Bank Namibia

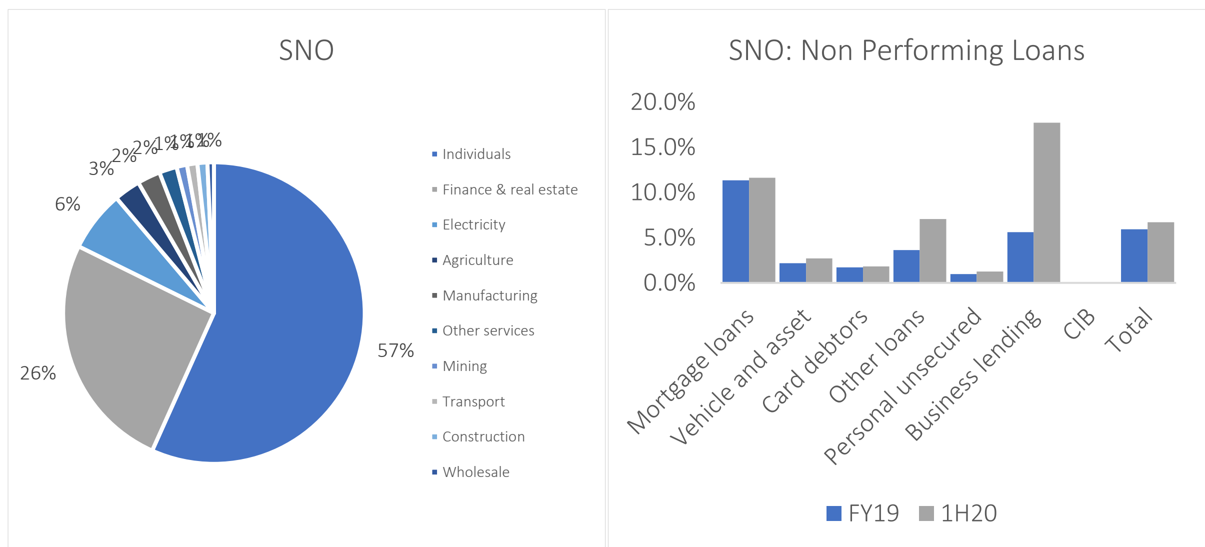
Standard Bank Namibia's impairment charges decreased by 15.3% y/y, to N$151.2 million, compared to 1H19. However, this is because a large specific impairment was raised in the previous period. This resulted in the credit loss ratio declining from 1.9% to 1.5% of total advances. Standard bank has the highest non-performing loan figure of the three banks, which is currently standing at 6.7% of total advances. This is largely due to the mortgage book which has an uncomfortably high NPL ratio of 11.6%,

up from 11.3% at the end of FY19. However, the main contributor to the increase in NPLs has been the business banking lending segment which is up from 5.6% NPLs to 17.7%.



Source: SNO, IJG

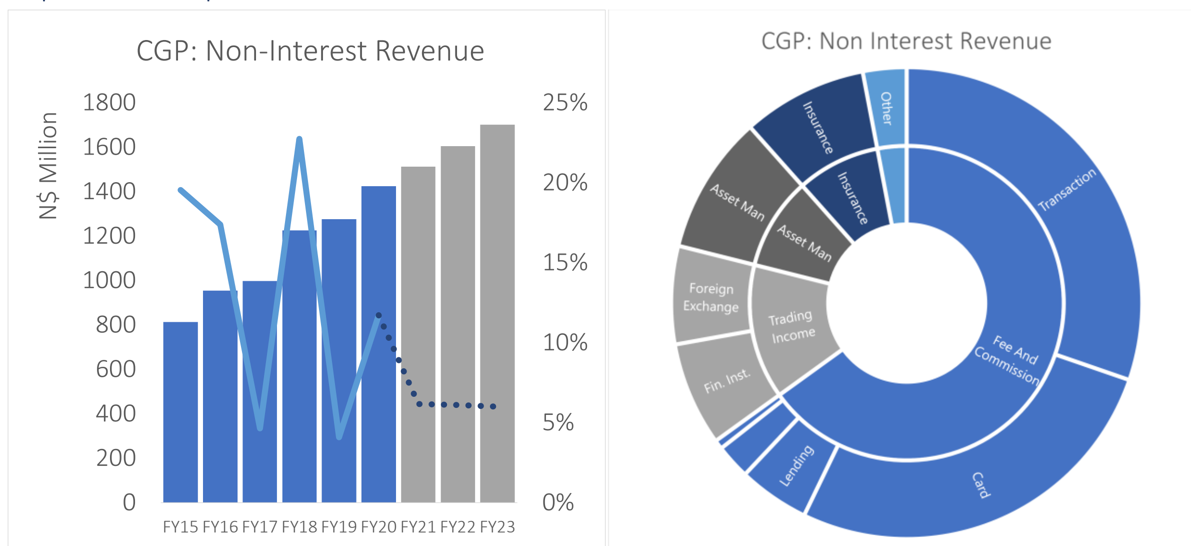
Seeing as this was an interim period we expect to see a full year impairment charge raised in the second half of the year to reflect the deterioration in the economic outlook. We expect a credit loss ratio in the vicinity of 1.5% for the full year followed by lower, but heightened impairment charges going forward.



Source: SNO, IJG

Non-Interest Revenue

Capricorn Group



Source: CGP, IJG

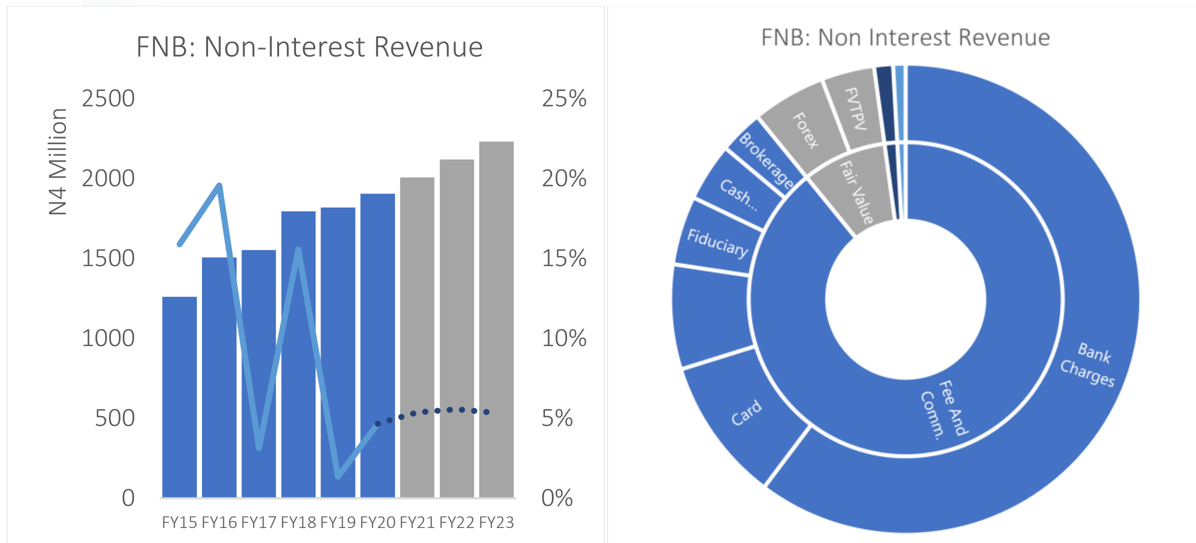
Despite the challenging conditions, the Capricorn group was able to grow non-interest revenue by double digits. Non-interest revenue increased by 11.7% y/y or N$149.5 million. This was underpinned by Bank Windhoek and bank Gaborone, which grew revenue by 2.4% y/y and 6.3% y/y respectively. Digital channels accounted for most of the growth in transaction fees which were up 7.7% y/y. However, overall growth in non-interest revenue was driven by Entrepo, which saw its insurance income rise by 18.6% to N$123.3 million, in line with its advances growth.

Capricorn Asset Management was another contributor to growth seeing a 14.6% increase in asset management fee income to N$135.4 million. Capricorn Asset Management now boasts Assets Under Management of N$31.3 billion, with most of the growth seen in the low-risk asset classes like the money market portfolios.

According to management, Capricorn Capital underperformed expectations, which was largely a factor of lower than expected demand for advisory services coupled with some competition in the field. Management has indicated that they have reassessed their growth expectations for the division and have also “right-sized” the organisation, which is now running at break-even levels.

The investment in Paratus is well-positioned to deliver long term value and capitalise on the synergies between financial services and telecommunications. The investment in Paratus Namibia has already started paying dividends and the Namibian operations seem to be ramping up quickly. Additionally, Paratus has announced a very exciting transaction. Paratus Namibia has entered into a 15-year agreement with Blue Path Technology Company and ZA Asset Management – collectively Google – to be the landing partner for the Equino undersea cable in Namibia. The transaction provides Namibia with much-needed redundancy, should the WACS subsea cable be out of service. Additionally, the company has also announced the construction of a data centre in Windhoek expected to host 150 cabinets, of which Google will be the anchor tenant.

FirstRand Namibia



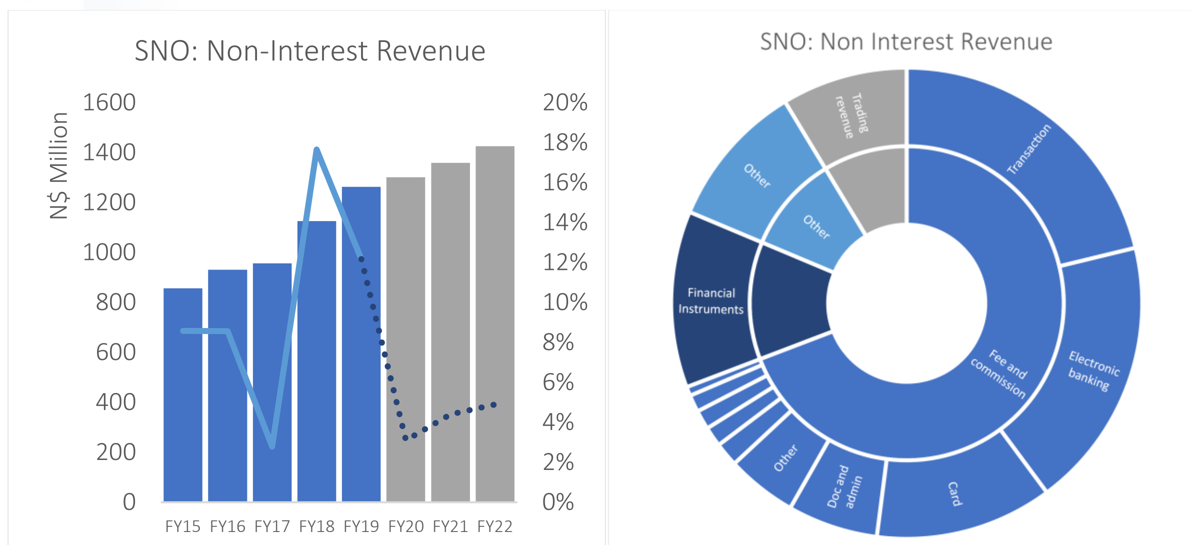
Source: FNB, IJG

FNB's non-interest revenue grew by 4.7% y/y driven by decent growth in fee and commission income which increased by 6.2% y/y. Net fee and commission income represent roughly 85% of total non - interest revenue and is made up mostly of bank charges. The increase in bank charges was largely a function of increased use of digital channels. Cell phone banking volumes increased by 12%. The number of customers using the FNB app increased from 51,000 to 86,000, with volumes increasing 133.7%, the COIVD 19 outbreak being a major catalyst for the rapid uptake.

On the flip-side, volumes in branches were down 9.0% y/y. According to the financial statements, roughly N$105 million of net interest revenue was lost due to the lockdown. This included a N$35 million fair value adjustment in Ashburton.

The insurance segment continued to show signs of decline, as premium income declined by 3.7% y/y to N$161.1 million as many policies lapsed due to non-payment. Additionally, heightened competition in the market has limited the scope for premium increases. However, claims were down by 10.1% to N$77.5 million, which left N$83.6 million in net insurance income, a 3.2% y/y increase.

Standard Bank Namibia

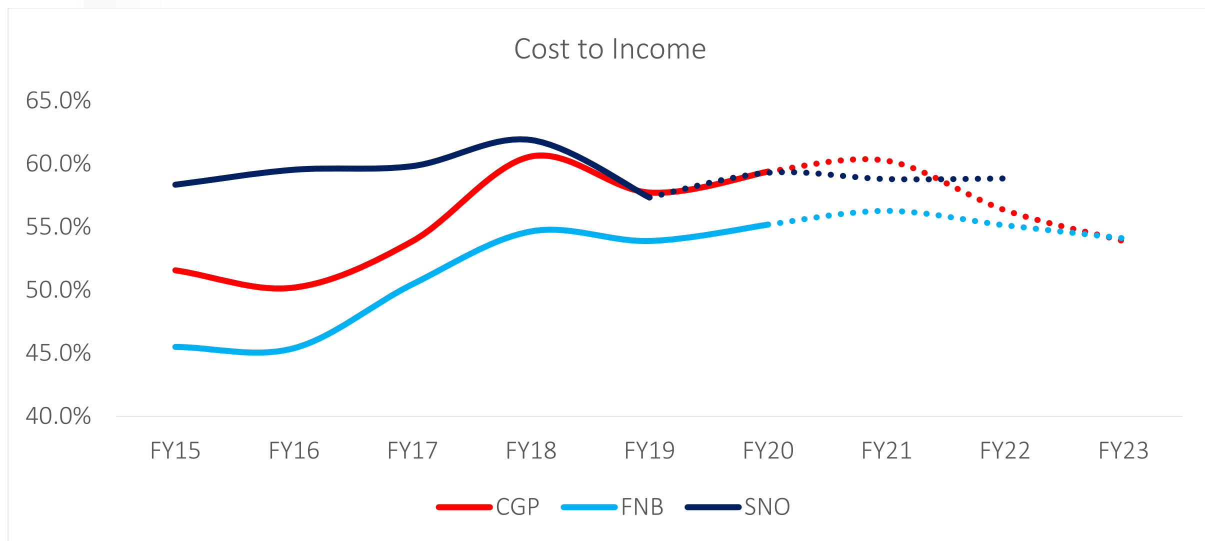


Source: SNO, IJG

Non-interest revenue at SNO was down 3.6% y/y for the first six-month period due to a decline in transactional volumes during the lockdown period. Personal and business banking saw its non-interest revenue declined by 5.4% y/y, while corporate and investment banking recorded a 3.6% y/y contraction. Fee and commission revenue declined by 4.7% y/y due to lower transactional volumes which saw account transaction fees decline by 15.1% while electronic banking fees also declined by 0.2%. Arrangement fees suffered due to low credit demand. Fee and commission expense, however, increased by 5.0% contributing to the decline in net non-interest income. Seeing as net interest revenue streams will likely remain under pressure for the foreseeable future, SNO has highlighted that their goal is to unlock new revenue streams and focus on growing existing noninterest revenue streams.

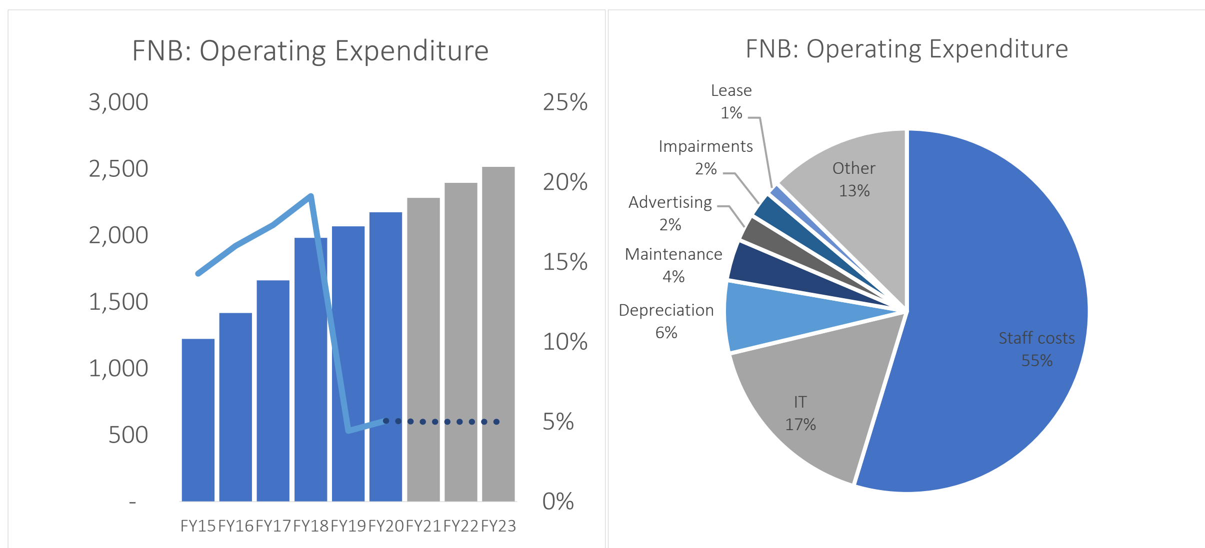
SNO boasted good uptake of its digital channels, seeing double-digit growth in its users for internet banking (+13% y/y) SmartApp (+12%) and cellphone banking (+15%). According to management, although the COVID-19 lockdown has accelerated the takeup of digital channels, they still see scope to migrate more of their client base to the online self-help channels. PayPulse, the digital wallet and money transfer platform grew volumes by 255% and transaction values were up by an astounding 486% to N$304 million. Management attributes the success of the payment app largely to the fact that it is being marketed to both retail and corporate clients and offers a wide range of payment solutions including mobile money transfers, ATM tokens, electricity and airtime purchases and invoice payments.

Operating Costs



Source, CGP, FNB, SNO, IJG

FirstRand Namibia

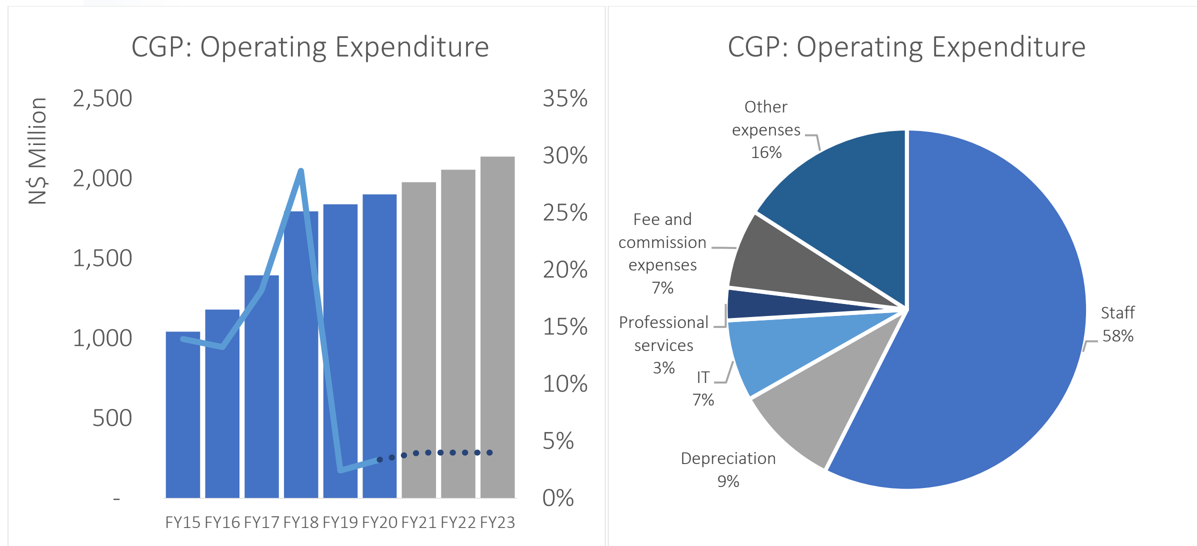


Source: FNB, IJG

FNB's operating expenditure grew by 5.0% y/y to N$2.17 billion, however, expenditure grew by only 2.6% y/y on a normalised basis. The once-off transaction that was excluded from the normalised expenditure was a N$51.4milion impairment of goodwill which was recognised on the acquisition of Pointbreak group. This resulted in a cost to income ratio of 55.0%, (52.9% normalised) by far the lowest of the three listed banks.

IT-related expenditure only increased by 4.0% y/y but makes up 16.6% or N$359.9 million of total expenditure. Staff costs increased by 5.5% y/y due to an above-inflation wage settlement agreement for the unionised non-managerial staff, while managerial variable pay was adjusted down for the financial year. According to the financial statements, the inflationary cost growth is due to a culmination of branch transformation strategies implemented in previous years, which is now bearing fruit. This is evident in the strong growth of digital channel use.

Capricorn Group

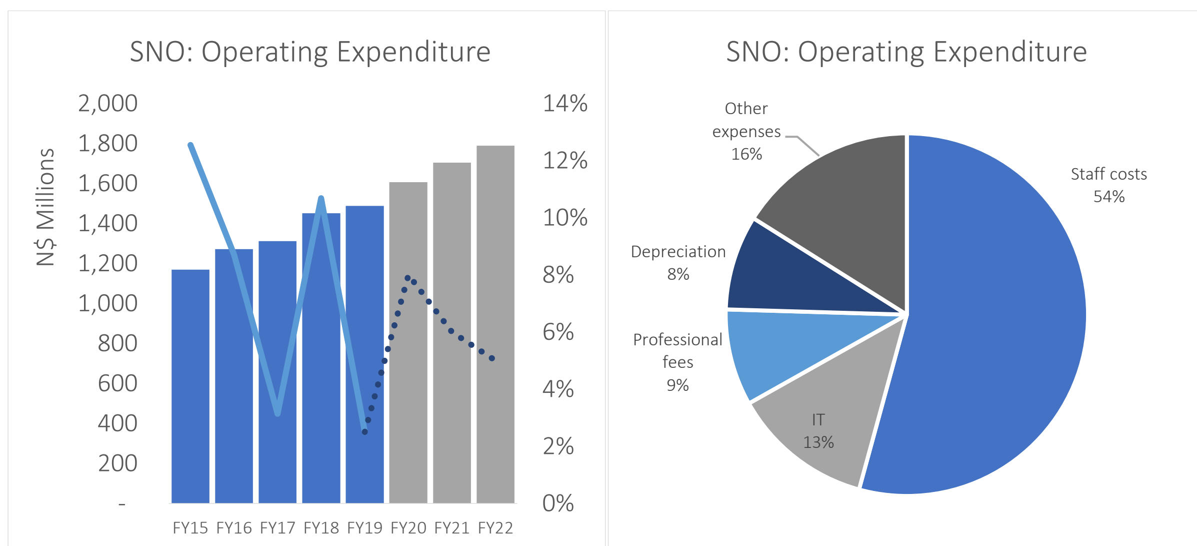


Source: CGP, IJG

Capricorn group was able to contain their increase in operating expenditure to 3.4% y/y to N$1.90 billion. IT-related expenditure increased by 36.6% y/y to N$138.1 million, and currently makes up roughly 7.3% of total operating expenditure. According to the financial statements, this was largely driven by a depreciating currency against the US dollar. Staff costs increased by 6.2% y/y, mostly due to an increase in the IT headcount of 29 people to increase the group's focus on digital migration. Fee and commission related expenditure decreased by 2.3% y/y.

The group targets a cost to income ratio of below 60%, thus the decline in income prompted an aggressive cut in expenditure in the last quarter of the year. Although many fixed costs could not be reduced, the group still managed to report a cost to income ratio of 59.4%. The disposal of the Zambian operation should see this ratio improve somewhat.

Standard Bank Namibia



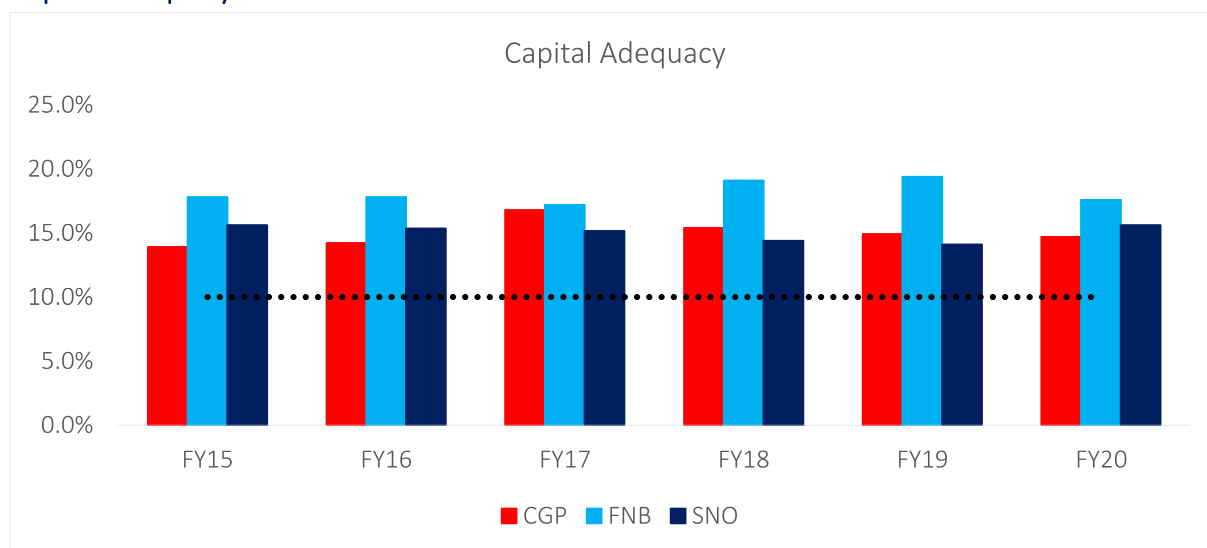
Source: SNO, IJG

For the first six months of FY20, SNO's operating expenditure increased by 7.7% mainly due to a large increase in IT-related expenditure which increased by 74.9% y/y for the first half of the year. Additionally, a higher depreciation charge and lower lease rentals are due to the relation of the now self-owned head office. Amortisation was higher due to higher intangible assets following the completion of various strategic and regulatory projects. On the other hand, staff costs declined by 1%, as headcount was reduced in line with the bank's strategy of digitalisation and optimisation of workflows.

IT spending was aimed at improving the customer experience, ensuring online security and higher software costs due to a depreciating currency. Management pointed out that IT cost will likely be a key cost driver going forward, as this is an essential element of remaining competitive and relevant in the current environment. Additionally, seeing as net interest income will be under pressure for the foreseeable future, investment into non-interest revenue-generating systems is a key priority.

Furthermore, management has pointed out that their cost to income will likely remain elevated in the short term, mostly due to the decline in net interest income, but they are targeting a through the cycle cost to income ratio of 55%.

Capital Adequacy



Source: CGP, IJG

The Namibian regulators announced a relaxation of capital adequacy requirements as part of a stimulus package to counter the economic effects of the COVID-19 pandemic. The Bank of Namibia reduced the capital conservation buffer rate on 26 March 2020 to 0% for at least 24 months to support banking institutions to supply credit to the economy. Additionally, the Bank of Botswana reduced the minimum capital adequacy ratio from 15% to 12.5% for the same reason. However, seeing as private sector credit extension has been quite low and that the three listed banks experienced little growth in risk-weighted assets, all three banks have recorded relatively healthy capital adequacy ratios. We expect this to remain the case for the next three years.

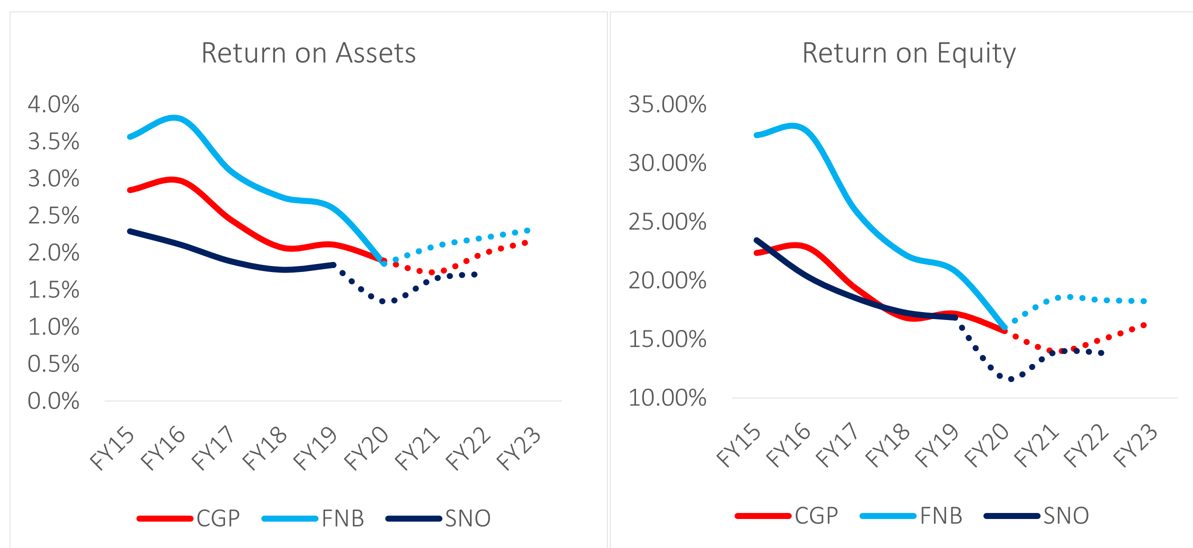
Due to the onset of the pandemic, the phased-in implementation of Basel III has been further delayed. However, the phased-in approach will still see the total risk-weighted capital adequacy ratio increase

from the current 10.0% to 12.5%, from 2022. Additionally, the implementation of Basel III will see the introduction of a liquidity coverage ratio and a net stable funding ratio, that will require higher levels of high-quality liquid assets and stable funding. However, at this stage, all three of the listed banks should be able to comfortably comply with the new requirements. However, as a result of higher capital requirements, the chances of another special dividend from FirstRand Namibia has been reduced and we do not anticipate any changes in dividend policy from the other two counters.

Outlook

The outlook for the Namibian economy as a whole is relatively dim. Although the decline in GDP for 2020 will likely be smaller than IJG's initial expectations, growth before the pandemic had been lacklustre at best and prospects for the years ahead also do not indicate that a strong economic recovery is on the books any time soon. This is one of the main reasons that demand for credit has been low, and will likely continue to remain low for the medium term. Corporate issuance is under the most pressure as business owners are reluctant to incur more debt, the weak economic outlook hampers their ability to generate sustainable income which they need to repay their loans.

The three listed banks have all done very well in expanding their digital capability, as it will be a defining factor in generating non-interest revenue ging forward. In this race, FNB is spending the highest proportion of its operating expenditure on IT-related projects, which may give them some advantage on this front.



Source: CGP, IJG

All three banks have made it clear that returns going forward will be significantly lower than the previous five years. However, we expect to see some rebound in ROA and ROE as the initial IFRS 9 shock should hopefully be a once-off, while net interest margins should be able to adjust over time. Nevertheless, the risks remain tilted to the downside as the pandemic remains far from over.

Valuation

We value the three listed banks using our panel of valuation techniques. These include three discounted cash flow methodologies and two justified multiple approaches. The outputs of the different methodologies were equally weighed.

	CGP	FNB	SNO
Cost of Equity	15.5%	15.2%	15.5%
Sustainable ROE	15.5%	17.0%	14.5%
Long term Dividend Payout Ratio	33.0%	50.0%	42.0%

Two of the main valuation input assumptions are the cost of equity and the long-term sustainable growth rate. The cost of equity was calculated using the capital asset pricing model (CAPM). To calculate the cost of equity a 5.0% equity risk premium and a risk-free rate equal to the generic 10-year Namibian bond of 10.0% were used. Sensitivity analysis of these variables was also conducted and is presented at the end of the document. Using the above assumptions and three scenarios regarding PSCE growth, net interest margins and credit impairment charges yielded the following one-year target prices for the three counters:

	CGP	FNB	SNO
Bear	10.24	22.18	5.53
Base	**12.05**	**25.20**	**6.49**
Bull	13.64	27.56	7.31

Including our anticipated dividends, the total expected return on these securities are given below:

	CGP	FNB	SNO
Bear	-15.0%	2.7%	-15.7%
Base	-2.7%	15.8%	-1.0%
Bull	9.6%	26.0%	11.6%

Although the share prices have rerated substantially since our last update, it is apparent that the current share price of CGP and SNO still do not offer significant value. From a relative value perspective, FNB Namibia seems to be the most attractive option. Seeing as we expect negative returns on CGP and SNO at the current share price, we maintain our **SELL** recommendation on CGP and SNO but upgrade FNB to a **HOLD**.

IJG

CGP	Value (NS Million)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	N$5,275	10.16	5.2	5.3	0.8	0.7	4.9%	5.8%	20%
Residual Income	N$7,359	14.17	7.3	7.4	1.1	1.0	3.5%	4.2%	20%
Dividend Discount	N$6,019	11.59	5.9	6.1	0.9	0.8	4.3%	5.1%	20%
Justified Price to Earnings	N$6,492	12.50	6.4	6.6	1.0	0.9	4.0%	4.7%	20%
Justified Price to Book	N$6,125	11.80	6.1	6.2	0.9	0.8	4.2%	5.0%	20%
Weighted Average	**N$6,254**	**12.05**	**6.2**	**6.3**	**0.9**	**0.8**	**4.2%**	**4.9%**	**100%**

FNB	Value (NS'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	N$5,726	21.40	6.9	5.9	1.1	1.0	7.2%	7.1%	20%
Residual Income	N$7,897	29.51	9.5	8.1	1.6	1.4	5.2%	5.2%	20%
Dividend Discount	N$7,159	26.75	8.6	7.3	1.4	1.3	5.8%	5.7%	20%
Justified Price to Earnings	N$6,146	22.97	7.4	6.3	1.2	1.1	6.7%	6.7%	20%
Justified Price to Book	N$6,788	25.37	8.1	7.0	1.4	1.2	6.1%	6.0%	20%
Weighted Average	**N$6,743**	**25.20**	**8.1**	**6.9**	**1.3**	**1.2**	**6.2%**	**6.1%**	**100%**

SNO	Value (NS'000)	Price per Share	Price to Earnings	Forward PE	Price to Book	Forward PB	Dividend Yield	Forward DY	Weight
Free Cash Flow to Equity	N$3,377	6.46	5.5	7.0	0.8	0.8	4.2%	6.0%	20%
Residual Income	N$2,989	5.72	4.9	6.2	0.7	0.7	4.7%	6.8%	20%
Dividend Discount	N$3,555	6.80	5.8	7.4	0.9	0.8	4.0%	5.7%	20%
Justified Price to Earnings	N$3,619	6.93	5.9	7.5	0.9	0.8	3.9%	5.6%	20%
Justified Price to Book	N$3,415	6.54	5.6	7.1	0.9	0.8	4.1%	5.9%	20%
Weighted Average	**N$3,391**	**6.49**	**5.5**	**7.0**	**0.8**	**0.8**	**4.2%**	**6.0%**	**100%**

IJG

Sensitivity Analysis

Capricorn Group

Sensitivity Analysis: CGP

	15.1%	15.2%	15.3%	15.4%	15.5%	15.6%	15.7%	15.8%	15.9%
SGR @ 10.0%	12.46	12.23	12.01	11.80	11.59	11.39	11.20	11.02	10.84
SGR @ 10.1%	12.59	12.35	12.13	11.91	11.70	11.50	11.30	11.11	10.93
SGR @ 10.2%	12.73	12.49	12.25	12.03	11.81	11.60	11.40	11.21	11.02
SGR @ 10.3%	12.87	12.62	12.38	12.15	11.93	11.71	11.50	11.30	11.11
SGR @ 10.4%	13.02	12.76	12.51	12.28	12.05	11.82	11.61	11.41	11.21
SGR @ 10.5%	13.18	12.91	12.65	12.41	12.17	11.94	11.72	11.51	11.31
SGR @ 10.6%	13.34	13.06	12.80	12.54	12.30	12.07	11.84	11.62	11.41
SGR @ 10.7%	13.51	13.22	12.95	12.69	12.44	12.19	11.96	11.74	11.52
SGR @ 10.8%	13.69	13.39	13.11	12.84	12.58	12.33	12.09	11.86	11.64

Source: IJG

FirstRand Namibia

Sensitivity Analysis: FNB

	14.9%	15.0%	15.1%	15.2%	15.3%	15.4%	15.5%	15.6%	15.7%
SGR @ 8.1%	25.72	25.36	25.01	24.67	24.34	24.01	23.70	23.39	23.09
SGR @ 8.2%	25.96	25.59	25.23	24.88	24.54	24.21	23.89	23.58	23.27
SGR @ 8.3%	26.21	25.83	25.46	25.10	24.76	24.42	24.09	23.77	23.46
SGR @ 8.4%	26.46	26.07	25.70	25.33	24.97	24.63	24.29	23.96	23.64
SGR @ 8.5%	26.72	26.32	25.94	25.56	25.20	24.84	24.50	24.16	23.84
SGR @ 8.6%	26.99	26.58	26.19	25.80	25.43	25.07	24.71	24.37	24.04
SGR @ 8.7%	27.27	26.85	26.44	26.05	25.67	25.30	24.94	24.58	24.24
SGR @ 8.8%	27.56	27.13	26.71	26.31	25.91	25.53	25.16	24.80	24.46
SGR @ 8.9%	27.86	27.41	26.98	26.57	26.17	25.78	25.40	25.03	24.67

Source: IJG

Standard Bank Namibia

Sensitivity Analysis : SNO

	15.1%	15.2%	15.3%	15.4%	15.5%	15.6%	15.7%	15.8%	15.9%
SGR @ 8.0%	6.59	6.52	6.45	6.39	6.33	6.27	6.21	6.15	6.09
SGR @ 8.1%	6.63	6.56	6.50	6.43	6.37	6.30	6.24	6.19	6.13
SGR @ 8.2%	6.68	6.61	6.54	6.47	6.41	6.34	6.28	6.22	6.16
SGR @ 8.3%	6.73	6.65	6.58	6.51	6.45	6.38	6.32	6.26	6.20
SGR @ 8.4%	6.77	6.70	6.63	6.56	6.49	6.42	6.36	6.30	6.24
SGR @ 8.5%	6.82	6.75	6.67	6.60	6.53	6.47	6.40	6.34	6.27
SGR @ 8.6%	6.88	6.80	6.72	6.65	6.58	6.51	6.44	6.38	6.31
SGR @ 8.7%	6.93	6.85	6.77	6.70	6.62	6.55	6.48	6.42	6.35
SGR @ 8.8%	6.98	6.90	6.82	6.75	6.67	6.60	6.53	6.46	6.39

Source: IJG

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