IMARA INVESTING IN AFRICA

Securities

FIRST NATIONAL BANK BOTSWANA LTD- H1 15 RESULTS

Price (BWP): 3.80
His EPS (BWP): 0.27
His PER: 13.95x
PBV: 4.20x
Dividend Yield: 5.10%
Recommendation: REDUCE

Equity Research

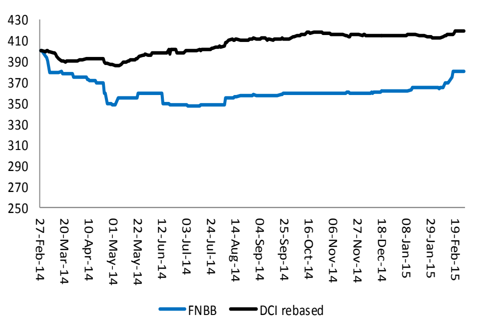
Botswana

March 2015

Results Scorecard

Income Statement (BWP'm)	H1 15	H1 14	%ch
Net interest income	479.27	488.66	-1.92%
Non-interest income	419.32	377.88	10.97%
Total income	810.72	809.80	0.11%
Impairments	87.87	56.73	54.89%
Operating expenses	-365.52	-342.10	6.85%
Profit before tax	445.24	467.72	-4.81%
Attributable earnings	343.36	362.88	-5.38%
EPS (thebe)*	27.55	28.29	-2.62%
DPS (thebe)*	21.00	20.00	5.00%
NAV/share (thebe)	90.78	79.39	14.35%
Balance sheet			
Cash on hand	2,770.77	2,844.68	-2.60%
Bank of Botswana Certificates	1,132.09	1,517.67	-25.41%
PP&E	514.77	493.80	4.25%
Loans and Advances	12,672.74	10,922.76	16.02%
Other assets	853.31	404.82	110.79%
Total Assets	17,943.68	16,183.73	10.87%
Total Assets			
Deposits	14,562.84	13,104.21	11.13%
Creditors and accruals	286.16	234.31	22.13%
Borrowings	499.48	404.49	23.48%
Other Liabilities	314.20	405.37	-22.49%
Shareholders funds	2,327.33	2,035.36	14.34%
Liabilities & Equity	17,943.68	16,183.73	10.87%
Ratios			
Net interest margin*	5.53%	6.16%	
Cost-income	45.08%	42.24%	
non interest- total income	51.72%	46.66%	
Loan-deposit ratio	87.30%	83.35%	
RoaE*	32.1%	38.8%	
RoaA*	4.10%	4.58%	
CAR	19.28%	19.60%	
PER (x)	13.5	14.09	
PBV (x)	4.20	5.04	
Div yield*	5.51%	5.00%	
Div cover (x)	2.70	2.85	

FNBB vs DCI (rebased)



Gone are the days of high RoEs ……

FNBB's results for the interim period ended 31 December 2014 were reflective of a difficult operating environment as witnessed by a decline in asset yields, rising costs, increased cost of risk and a decline in profitability ratios. These results were against a backdrop of low interest rates, tight liquidity constraints, moratorium on bank charges and increasing competition in the market. During the 12 months to December 2014, bank credit growth slowed to 13.5% compared to 15.1% in 2013 but grew at a faster rate than the 6.14% deposits growth, and market LDRs exceeded the preferred ceiling of 80% to 87.6%.

Declining asset yields: Despite a 16.02% rise in loans and advances, FNBB managed a mere 2.01% rise in interest income to BWP 654.4m largely as a result of the continued approach by the bank to grow its more secured book which typically has lower yields to unsecured loans. Interest expenses on the other hand increased by 14.57% to BWP 175.2m (H1 14: BWP 152.9m) as industry-wide liquidity challenges gave rise to expensive cost of funding. On average, what FNBB charged on its loans dropped to 7.4% from 8.2% at H1 14 while average cost of deposits were relatively flat at 2.1% (H1 14: 2.2%). The resultant was a 63bp decline in NIMs to 5.53% from 6.16% at H1 14.

Improved NIR cover over OPEX: FNBB's rule of law is to cover operating expenses with its non-interest revenue. Notwithstanding the central bank's moratorium on increasing bank charges, FNBB did well to increase the NIR line by 11% to BWP 419.3m, a faster rate than the 6.85% increase in OPEX to BWP 365.5m. This was assisted by an increase in transaction volumes of which, according to management, was predominately due to recently launched products such as Automated Deposit Taking Machines (ADTs), Rand- dispensing ATMs, prepaid electricity via cell phone banking channels and a *174# SSID mobile payment solution. This implied an improved OPEX cover of 1.15x from 1.10x at H1 14 and a 506bp increase in NIR/total income ratio to 51.72% (H1 14: 46.7%). However, the bank's CIR still showed signs of strain, increasing by 284bp to 45.08% (H1 14: 42.24%) as total income merely grew 0.11% to BWP 810.7m.

Further tightening of credit risk management. Impairment charges increased significantly by 54.88% to BWP 87.9m (H1 14: BWP 56.7m) as the bank took a more prudent approach to its provisioning policy, particularly increasing portfolio provisions on account of the weakening economic conditions. This resulted in a 20bp y-o-y increase in cost of risk to 1.21%. PAT declined by 5.38% to BWP 343.4m after accounting for an effective tax charge of 22.88% (H1 14: 22.42%). RoaE and RoaA declined to 32.1% and 38.8% from 38.8% and 4.6% at H1 14 respectively. An interim dividend identical to H1 14's 5t per share and an LDR of 6 March 2015 was proposed, as the bank looks to preserve capital for Basel II/III compliance which will be adopted during FY 15. This implies a dividend cover of 2.7x in-line with the bank's target.

Improvements from all subsidiaries except for treasury: All subsidiaries contributed positively to group operating income except for the Treasury division. Each division grew its operating income as follows; Consumer Banking +4.57% to BWP 444.0m, Commercial +5.44% to BWP 286.6m, RMB +5.59% to 117.6m, while the Treasury Tnit's losses rose by 28.26% to BWP 49.5m.

Balance sheet remains robust: The balance sheet grew by 10.87% to BWP 17.9bn (H1 14: BWP 16.2bn), driven by 16% growth in advances to customers to BWP 12.7bn, which accounted for 70.63% (H1 14: 67.4%) of total assets. The growth came mainly from term Loans (+17%), property finance (+16%) and Wesbank (+14%), as the bank maintained its conservative approach to lending. As of H1 15, 65% of FNBB's loan book was secured and the bank increased its loan book market share to 28.08% (H1 13: 27.47%). FNBB also continued to decrease its BoBC holding, which declined by 25.41% to BWP 1.1bn, in pursuit of higher yielding assets in the form of advances. BoBC's on average were yielding 3.09% for the 14 day and 3.27% for the 91 day in 2014.

Despite continued market liquidity challenges, FNBB managed a 11.13% growth in deposits to BWP 14.5bn, compared to the 6.14% achieved by the banking industry over the same period. FNBB therefore increased its share of industry deposits to 28.19% from 27.01% at H1 14. The bank's LDR increased by 395bp to 87.30% (in line with the industry) from 83.35% at H1 14 and CAR closed at 19.30%, 4.3pp above the regulatory minimum. As at December 2014 funding composition stood as follows: demand & term deposits 83.73%, Borrowings 2.87% and equity at 13.38%.

We amend our HOLD call to REDUCE: FNBB's spike in LDR to a new high of 87.30% are signs of the liquidity challenges within the banking sector. The 100bp cut in the bank rate in Q1 15 to a new record low, gives us reason to believe that the liquidity challenges are likely to persist as the industry struggles to attract deposits in the low interest rate environment. This should further exacerbate pressure on NIMs as industry player's competitively price up deposits to attract funding. Other challenges include increasing competition as the central bank issues more licenses, high unemployment and consumer indebtedness to name a few.

We believe that FNBB is firmly positioned within the Botswana market. It is the biggest bank in Botswana on all measures (loans, deposits, total assets and profitability). It also has the largest customer base in Botswana, which assists the bank in the cross selling of its products. This bodes well for the group as we are of the view that growth shall come from its fee based income channels as the bank continues to lead in product innovation. Furthermore, we commend the bank's strategy to try and cover operating expenses with NIR as this is an ideal strategy in an environment where interest margins are under strain. In our view, FNBB's current PER of 13.95x and of PBV 4.20x are a high price to pay relative to its SSA peer averages as well as the Botswana market. Traditionally, the premium that the bank has traded at was justified by high RoE's, however, unless the regulator offers some relief to the industry such as a reduction in the reserve requirement ratio or if a turnaround in the economy occurs, we are bearish on the overall sector. Accordingly we amend our previous **HOLD** call to a **REDUCE**.

Analyst: Ngodya Chimbwete

ngodya.chimbwete@imara.com