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Securities

FIRST NATIONAL BANK BOTSWANA LTD- H1 16 RESULTS

Price (BWP): 3.65
EPS (BWP): 0.21
PER: 17.23x
PBV: 3.81x
Dividend Yield: 5.75%
Recommendation: REDUCE

Equity Research
Botswana
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Results Scorecard

Improved liquidity conditions, but RoEs and NIMs under strain ……

FNBB's results for the interim period ended 31 December 2015 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 improved liquidity conditions attributable to low interest rates, despite a moratorium on bank charges and increased competition in the market. During the 6 months to December 2015, the bank's credit growth slowed to 5.68% compared to 16.00% in 2014; deposits declined by 4.07% and its LDR marginally surpassed the preferred ceiling of 80% at 80.08%.

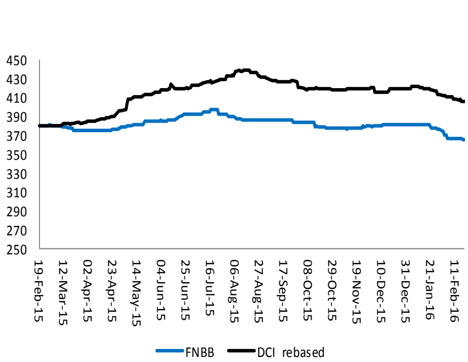
Declining asset yields: Given the pressures of the economy, which have weighed down consumer disposable income levels, the banking giant continued to be prudent when it came to lending, opting to focus on lower risk assets which generally have lower yields. Moreover, the cumulative 150bps downward adjustment by the central bank of the bank rate, now at 6%, during 2015 (50bps during the period under review) further eroded net interest income, which therefore weakened asset yields. This conservative approach was reflected by an 111bps contraction in its average asset yield to 6.52% from 7.63% in the comparative half year, on the back of a 2.03% drop in interest income y-o-y. Net interest expenses rose by 19.61% y-o-y, underpinned by relatively higher deposits which stood at BWP 16.7bn at H1 16 vs. BWP 14.6bn at H1 15, which then by default increased cost of funding by 46bps to 2.55% (H1 15: 2.09%). The result of this was a 132bps decline in NIMs to 4.21% from 5.53% at H1 15.

Falling NIR cover over OPEX: Despite the central bank's two-year moratorium on any upward adjustment of bank charges and fees since January 2014, FNBB continued to achieve its revenue diversification objective, attaining 10.90% growth in non-interest revenue to BWP 465.0m (H1 15: BWP 419.3m). The rise in NIR was due to the increase in transaction volumes through cross selling to its customer base, the deployment of more Automated Deposit Taking Machines (ADTs) and slim line ATMs; and more clients using online banking. This subsequently strengthened the NIR/total income ratio to 58.12% from 51.12% in the comparative period, even though total income shrunk by 1.32% to BWP 800.1m (H1 15: BWP 810.7m), due to declines in contributions of segment revenue across all divisions, except the retail and treasury sectors which saw increases of 8.51% and 35.57%, respectively. The bank achieved its objective of covering its operating costs with NIR, attaining an OPEX cover of 1.1x, slightly down on the comparative period's 1.15x. The rise in OPEX was partly attributable to an increase in costs of compliance/regulation incurred to align the bank's systems and reporting requirements, and the result of this was a 640bps increase in the CIR to 52.04% (H1 15: 45.08%), although this remained well below the current industry average of 63%.

Further tightening of credit risk management: Cost of risk increased by 36bps to 1.57% (H1 15: 1.21%) on the back of a significant rise in non-performing loans (NPLs) emanating from businesses and households taking strain from the headwinds of the economy, which consequently led to a 9.95% rise in impairment charges to BWP 209.5m, (H1 15: BWP 175.2m). This, alongside an increase in the effective tax rate to 24.21% from the previous year's 22.88%, weighed down PAT which registered at BWP 290.8m – a 15.30% decrease on the comparative period's BWP 343.4m. LTM RoaE and RoaA thus declined to 22.50% and 2.80% from 32.10% and 4.10% at H1 15, respectively. The proposed interim dividend for the half year remained flat at 5.0t, indicative of a 5.75% dividend yield and a 2.27x dividend cover.

Income Statement (BWP'm)	H1 16	H 1 15	%ch
Net interest income	431.65	479.27	-9.94%
Non-interest income	465.02	419.32	10.90%
Total income	800.05	810.72	-1.32%
Impairments	96.61	87.87	9.95%
Operating expenses	-416.33	-365.48	13.91%
Profit before tax	383.72	445.24	-13.82%
Attributable earnings	290.83	343.36	-15.30%
EPS (thebe)*	21.18	27.55	-23.12%
DPS (thebe)*	21.00	21.00	0.00%
NAV/share (thebe)	95.75	90.78	5.47%
Balance sheet			
Cash on hand	2 980.60	2 770.77	7.57%
Bank of Botswana Certificates	3 230.10	1 132.09	185.32%
PP&E	553.22	514.77	7.47%
Loans and Advances	13 391.95	12 672.74	5.68%
Other assets	354.28	853.31	-58.48%
Total Assets	20 510.17	17 943.68	14.30%
Total Assets			
Deposits	16 723.78	14 562.84	14.84%
Creditors and accruals	289.95	286.16	1.32%
Borrowings	642.44	499.48	28.62%
Other Liabilities	399.18	314.20	27.05%
Shareholders funds	2 454.81	2 327.33	5.48%
Liabilities & Equity	20 510.17	17 943.68	14.30%
Ratios			
Net interest margin*	4.21%	5.53%	
Cost-income	52.04%	45.08%	
non interest- total income	58.12%	51.72%	
Loan-deposit ratio	81.61%	87.30%	
RoaE*	22.5%	32.1%	
RoaA*	2.80%	4.10%	
CAR	19.22%	19.28%	
PER (x)	17.23	13.50	
PBV (x)	3.81	4.20	
Div yield*	5.75%	5.51%	
Div cover (x)	2.27	2.68	

FNBB vs DCI (rebased)



Declines in all subsidiaries except for treasury and retail: The Retail division's contribution to group operating income increased to 41.07% from 37.77% in the comparative period, owing to an 8.15% rise in its revenues to BWP 368.2m (H1 15: BWP 339.4m). The Treasury sector's revenue was also up y-o-y by 35.57% to BWP 62.2m, edging up its contribution to total revenues to 6.67% (H1 15: 4.91%). Conversely, the Commercial division's revenue fell by 9.37% on the back of a 25.96% decrease in the division's net interest income, the result of corporates being cautious due to the subdued economic climate. RMB and WesBank also reported declines of 2.61% and 26.80% in their segment revenues to BWP 65.8m and BWP 35.7m, respectively.

Balance sheet in the red: Given the prevailing economic challenges, with an expected overall GDP growth rate of a modest 1% for the year 2015, FNBB's balance sheet shrank slightly by 2.2% during H1 16 to BWP 20.5bn from BWP 21.0bn at FY 15 despite a 43.16% increase in BoBC holdings which accounted for 15.75% of total assets at H1 16, compared to 10.76% at FY 15. This came about as a result of improved liquidity driven by a 5pp cut in the central bank's reserve requirements from 10% to 5% in 2015; and a senior debt issuance programme which saw BWP 238.0m injected into the group. Accordingly, the excess liquidity was placed in investment securities, despite the low yields on the 14 day and 91 day BoBCs, which fell to an average of 1.30% and 1.58% from 3.09% and 3.27% at H1 15, respectively. The 4.25% growth in advances during the half year to BWP 13.4bn (FY 15: BWP 12.8bn) increased their contribution to total assets to 65.29% in H1 16, 4.04pp higher than 61.25% at FY 15. The bank recorded a 36.58% increase in NPLs to BWP 770.5m, (FY 15: BWP 564.2m) which subsequently underpinned a 157bp rise in the NPL ratio from 4.18% at FY 15 to 5.75% at H1 16, higher than the average industry ratio of 3.6% for the same period.

Although borrowings increased by 62.49% to BWP 642.4m (FY 15: BWP 395.4m), brought about by the senior debt funding, total deposits (which accounted for 92.63% of total liabilities) decreased by 4.07% to BWP 16.7bn from (FY 15: BWP 17.4bn) due to management's deliberate efforts to control interest expenses, which consequently anchored the 2.54% reduction in total liabilities to BWP 18.1bn (FY 15: BWP 18.5bn). As a result the bank's LDR rose by 272bp to 80.08% from the 77.36% attained at FY 15. The group's capital position remained solid, with a CAR of 19.22% at H1 16, a marginal 0.23pp increase on the 18.99% registered at FY 15, and 4.22pp above the regulatory minimum of 15%. While FNBB increased its BoBC holdings by 43.16% during the period under review, cash and short term funds declined by 31.81% to BWP 3.0bn in H1 16 (FY 15: BWP 4.4bn) which consequently led to a 6.29% decrease in liquid assets. Despite the 4.07% decrease in total deposits to BWP 16.7bn (FY 15: 17.4bn), our calculated liquidity ratio weakened marginally by 1pp to 37% in H1 16 from 38% at FY 15, 17pp higher than the statutory prescribed 20%.

We maintain our REDUCE recommendation: Market liquidity conditions improved due to lower rates and yields and the banking giant's liquidity ratio was reflective of this as it closed the half year well above the statutory minimum. Challenges such as increasing competition, as the central bank issues more licenses and high unemployment levels constricting consumer disposable incomes potentially leading to higher indebtedness, may exert pressure on the bank's future earnings. However, the mild economic recovery forecast for 2016, led by services sector growth and some recovery in the mining sector may ease pressure on corporates and households which accordingly should decrease impairments & NPLs. We believe that FNBB is firmly positioned within the Botswana market. It is the biggest bank by all measures (loans, deposits, total assets and profitability) and has the largest customer base, which assists the bank in the cross selling of its products. Furthermore, we commend the bank's unique strategy to try and cover operating expenses with NIR as this is an ideal strategy in an environment where interest margins are under strain. Nevertheless, in our view, FNBB's current PER of 17.23x and PBV of 3.81x remain elevated given the decline in RoaE and relative to its SSA peer averages as well as the Botswana market. Accordingly we maintain our **REDUCE** recommendation.

Analyst: Kaone Kebonang

kaone.kebonang@imara.com