2020

BANKING SECTOR REPORT

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CEDAR CAPITAL
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BANKING SECTOR REPORT SUMMARY

Cautious on profit growth

Profitability – in FY19, the banking sector enjoyed a 32% growth in profits to MWK61 billion and by the end of the year, the sector ROE had improved 300bps to 21%. For FY20 we are cautious of profit growth given the lower asset yields, higher expected loan loss provisions and constrained loan book growth.

Restrained loan book growth

Loan book growth – we anticipate slower loan growth as a result of elevated credit risks emanating from Covid-19 pandemic. In the past year, credit had expanded by 10%, which was already slower than previous periods on account of fewer good quality borrowers.

NPLs set to rise

Asset quality - we expect higher NPLs from Covid-19 induced shocks to the economy. In any case, NPLs were already showing signs of worsening even before the pandemic.

NIMs to be under pressure

Net Interest Margin – in FY19, the sector had an average net interest margin of 10%, which we however expect to contract in FY20 on the back of lower treasury bill yields and constrained lending activities. On the other hand, we expect cost of funding to rise, as banks try to shore up liquidity levels during the pandemic induced crisis.

NFI to remain around 35%

Non funded Income – although we expect probably less transactional income and loan establishment fees, we forecast that non-interest income contribution to total income will remain between 35% and 38%.

Cost to income ratios deteriorate

Cost to income ratio – at around 62%, the sector already had higher than normal cost to income ratios. We would expect that the ratio would deteriorate noticeably in FY20, on the back of lower revenues.

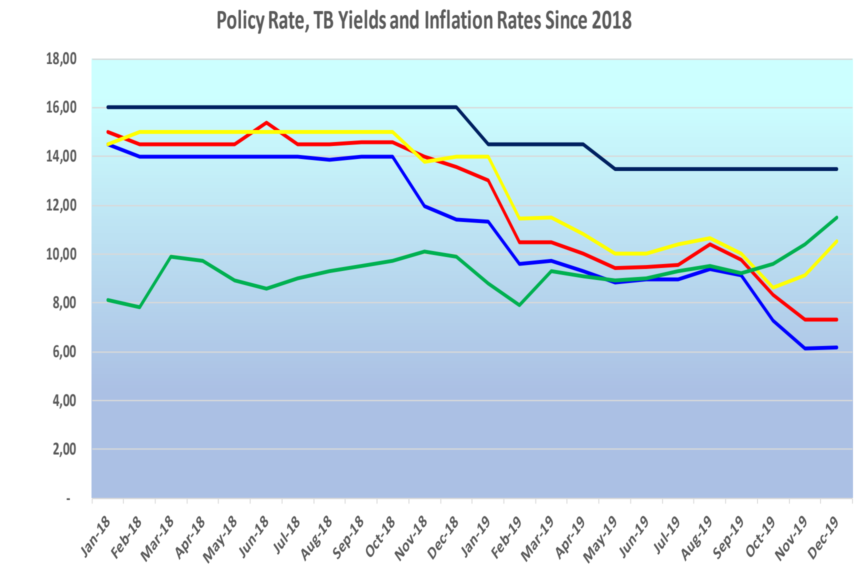
					Growth Rates							
	Price	**P/E**	**P/B**	**ROE**	**Loans**	**Deposits**	**PAT**	**NIM**	**NPLs**	**CIR**	**YTD**	**VERDICT**
NBM	550,00	14,97	2,55	18%	13%	8%	7%	10,99%	12%	61%	5%	**HOLD**
NBS	17,49	11,42	3,32	34%	136%	21%	162%	16,66%	15%	77%	30%	**BUY**
SBM	790,00	11,68	2,13	19%	32%	6%	50%	11,40%	3%	60%	4%	**BUY**

MACRO ECONOMIC OVERVIEW

Agriculture came through…

The Reserve Bank of Malawi (RBM) estimates the domestic economy to have grown by 5% in 2019 compared with 4% in 2018, driven by favourable cropping conditions experienced in the 2018/19 agricultural season leading to 3.9% increase in agricultural output. At the same time, manufacturing grew 4.6% due to improved power supply following the importation of additional power supply from Zambia. The trade sector was estimated to have registered a growth of 4.5%, again benefitting from a good agriculture season which in turn led to increased disposable incomes.

Broad money supply grew 8.1% on account of growth in both domestic and foreign assets in the banking sector.



	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18
91 days	14,50	13,98	14,00	14,00	14,00	14,00	14,00	13,85	13,97	14,00	11,98	11,42
182 days	15,00	14,50	14,50	14,50	14,50	15,40	14,50	14,50	14,57	14,60	14,00	13,58
364 days	14,50	15,00	15,00	15,00	15,00	15,00	15,00	15,00	15,00	15,00	13,76	14,00
Policy Rate	16,00	16,00	16,00	16,00	16,00	16,00	16,00	16,00	16,00	16,00	16,00	16,00
Inflation Rate	8,10	7,80	9,90	9,70	8,90	8,60	9,00	9,30	9,50	9,70	10,10	9,90

	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
91 days	11,32	9,61	9,74	9,30	8,84	8,95	8,94	9,40	9,13	7,29	6,13	6,19
182 days	13,01	10,50	10,50	10,00	9,41	9,48	9,56	10,41	9,77	8,31	7,33	7,33
364 days	14,00	11,46	11,50	10,80	10,00	10,00	10,41	10,66	10,03	8,61	9,15	10,54
Policy Rate	14,50	14,50	14,50	14,50	13,50	13,50	13,50	13,50	13,50	13,50	13,50	13,50
Inflation Rate	8,80	7,90	9,30	9,10	8,90	9,00	9,30	9,50	9,20	9,60	10,40	11,50

91 days   182 days   364 days   Policy Rate   Inflation Rate

Real TB yield turn negative…

The annual inflation rate closed December 2019 at 11.5% on account of higher food inflation – read maize prices – which rose 19.3% in December 2019. Non-food inflation was benign at 5%. However, the headline annual inflation, as an indicator averaged 9.4% in 2019.

Interest rates continued to soften, with base lending or reference rate reducing to 12.5% from 23.5% in December 2018 and 13.9% in June 2019. The RBM maintained the Policy Rate at around 13.5%. The cut in prime lending rates started in September following the adoption and implementation of the new reference rate by commercial banks.

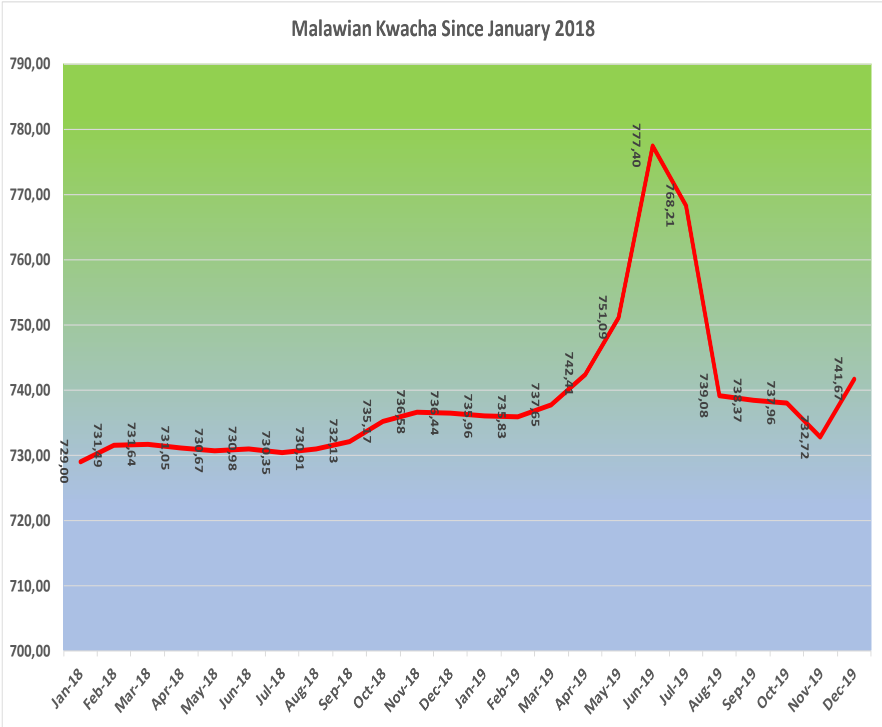
Soft TB yields ...

The "All Type" Treasury bill yield declined during the review period to close at 8.03%pa from 8.95%pa previously. Average yields for the benchmark treasury bills of 91-day and 182-day tenors lost 336bps and 267bps to 6.19%pa and 7.33%pa, respectively, while the 364-day yield gained 71bps to 10.54%pa.

As can be seen from the chart, the gap between the RBM's policy rate and 91-day TB yield continues to widen, unfavourably. Furthermore, in terms of real yields, real returns turned negative in August.

The Malawi Kwacha….

The ups and downs of the Kwacha



The Malawi Kwacha had a sort of roller coast ride, starting off at around MWK740 to the USD and depreciating to MWK785 by half year before a major correction saw the rate closing the year at MWK738. The fall in value in the first half was attributed to some speculative attacks sparked by an anticipation of lower tobacco export inflows.

In the first four months of 2020, the economy experienced a lot of uncertainties including the nullification of presidential elections; the ban on the exportation of tobacco to the United States and restrictions put on imports from different countries due to the coronavirus pandemic.

Following an assessment done to determine the impact of the Covid-19 on the economy, treasury has revised downwards its 2020 and 2021 economic growth projections from 5.50% and 5.80% to 1.90% and 4.50% respectively.

During the month of May 2020, the all-type Treasury bill yield increased to 10.10%pa.

BANKING SECTOR OVERVIEW

Here comes Mybucks…

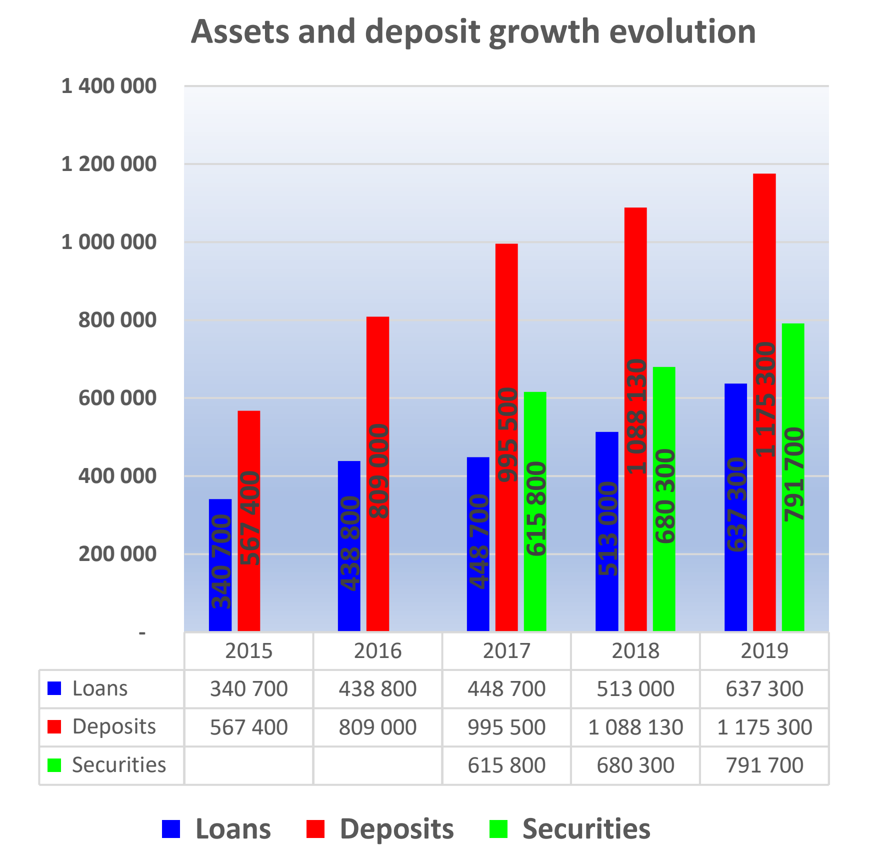
The banking sector composition remained at nine institutions, with the major highlights being that there were neither bank failures nor any mergers. As well, no new licenses were issued during the year. However, there was a change in the management and branding at Nedbank Malawi Limited, which was acquired by MyBucks Banking Corporation.

Two dominant players ..

According to the RBM Financial Stability Report 2019, two banks, namely Standard Bank (SBM) and National Bank of Malawi (NBM) dominate the sector, holding a combined 44% and 46% of total assets and total deposits respectively

Strong preference for fixed income securities…

The sector experienced growth in assets which was ahead of the core-inflation rate at 8.4% (inflation at 5%) to MWK1.9 trillion. There was a seasonality to the growth with the second half being double the first. The growth was anchored on a 10% expansion in loans and advances to MWK637 billion as well as the 13% growth in securities to MWK792 billion.



	2015	2016	2017	2018	2019
Loans	340 700	438 800	448 700	513 000	637 300
Deposits	567 400	809 000	995 500	1 088 130	1 175 300
Securities			615 800	680 300	791 700

This means that the exposure to government through sovereign assets exceeds the stock of outstanding loans. As such, banks are now more exposed to the risk of lower interest income growth as TB yields continue to soften.

The reduction in advances could also indicate the absence of a large pool of quality borrowers.

Diminished pool …

Taking a cross section of the sector asset book shows that securities comprise 42% of the total, with credit making up 34%, an unchanged position when compared with 2018.

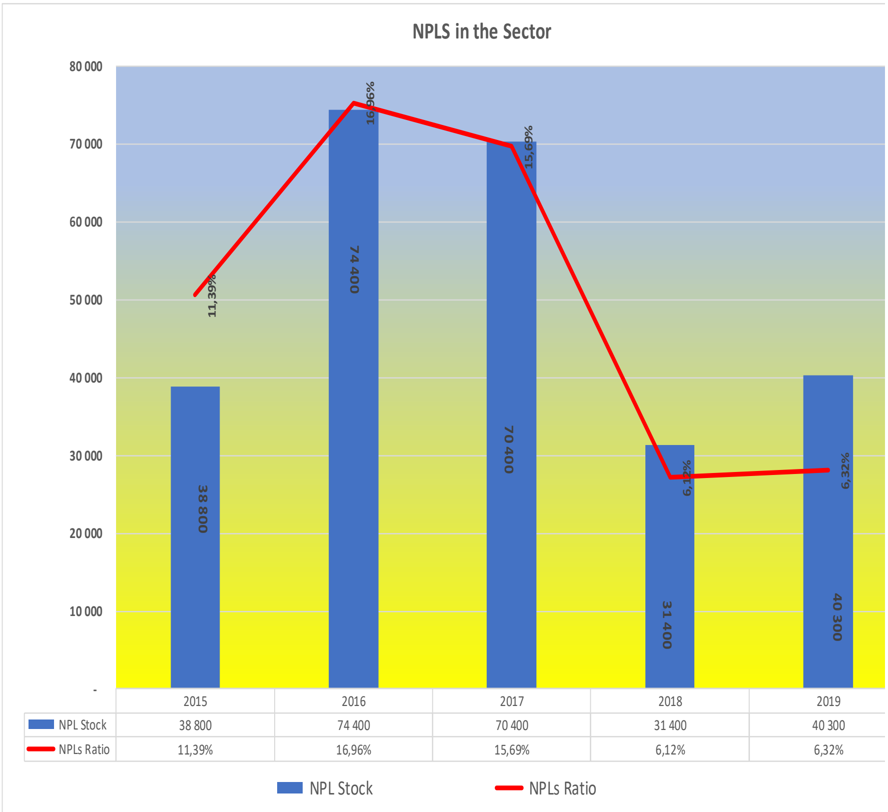
Trade is the borrower of choice…

In terms of sectoral credit concentration, three sectors dominate the share of gross loans namely, trade - wholesale and retail sector – at 23%; agriculture sector and manufacturing sector at 19% and 14% respectively.

Energy sector energises NPLs…

The amount of non-performing loans rose 28% to MWK40.3 billion, which represents an NPL ratio of 6.3%, a 140bps deterioration from 4.6% in 2018. The growth was attributed to a spike in NPLs from the electricity, gas, water and energy sectors. However, the trade sector is expected to dominate new NPL formation in 2020.

The battle with NPLs not yet won…



The rise in NPLs, impacted negatively on the liquidity situation in the sector, with the ratio closing the year at 59% (prudential guideline is 25%), down from 63% in prior year. The ratio remains high, a scenario attributed to the continued investment in fixed income securities.

Mismatched book…

The sector is highly skewed towards short term – demand and savings – funding, which is deployed in some long-term assets. As a result, there is a liquidity gap of MW527 billion in the less than 30day bucket and MWK142 billion in the 30-90day bucket.

A trillion in deposits…

On the funding side, deposits grew 8% to MWK1.2 trillion, of which 40% were demand deposits, while savings and term deposits accounted for 18% and 23% respectively. Foreign currency deposits were almost static at MWK224 billion. Deposits remain the main source of funding, accounting for three quarters of the liabilities. Demand deposits rose strongly in the last quarter attributed to a growth in deposits of agro-companies for the financing of the 2019/20 crop planting season.

Well capitalised…

In terms of strength, the RBM contends that the sector was adequately capitalised with surplus capital buffers exceeding 7% and 6%, above the regulatory core and total capital ratios, respectively. The regulatory minimums are 10% for core capital and 15% for total capital.

Solid growth in net interest income…

The sector P&L shows that interest income rose 11% to MWK215 billion, on account of the growth in loans and investment securities, exceeding the negative impact of low asset yields. The sector also benefited from a 9% reduction in the interest expense to MWK55 billion. This favourable movement in income and expenses saw sector net interest income rise 22% to MWK160 billion.

Treasury and transaction income grew 16% to MWK109 billion, on increased volumes and volatility of the currency.

Above inflation growth in expenses…

Operating expenses on the other hand rose 12% to MWK168 billion, giving a sector cost to income ratio of around 62%, which is above the expected benchmark of 60%. Looking at it the other way, the sector is not able to meet its operating expenses from net interest income.

After debiting credit loss and taxation provisions, the bottom line grew 32% to MWK61 billion. By the end of the year, the sector ROE had improved 300bps to 21%.

Doubling in minimum capital requirements…

Effective 1 January 2020, the minimum capital requirements were increased from USD5 million to USD10 million. Most of the listed banks will be able to comply.

Price (MWK)	550.00
EPS	36.74
NAV	215.80
P/E (x)	14.97
P/B (x)	2.55
ROE	18%

NATIONAL BANK OF MALAWI

More deployment in securities…

The National Bank of Malawi (NBM) grew total balance sheet assets by 10% to MWK459 billion, driven by a 13% expansion in the credit book to MWK188 billion. More resources were deployed in government and money market securities, which rose 20% to MWK166 billion. As such, the interest earning asset book comprised of 48% loans & advances and 42% in sovereign assets. The balance was bank placements and statutory reserves.

The loan book is skewed towards "wholesale/retail" which accounted for 23% of total, followed by agriculture and individuals at 18% each. Manufacturing is sitting at 12% while the energy sector stood at 10%.

Asset quality concerns…

The quality of the loan book was suboptimal with NPLs rising 176% to MWK22.6 billion, translating into an NPL ratio of 12%. This was a massive deterioration from the NPL ratio of 4% in FY18. The major culprit was the "energy" sector which contributed 43% to the NPL stock and experienced the highest level of deterioration.

On the funding side, deposits grew 8% to MWK318 billion. This gives a loan to deposit ratio of 59%.

From these strategic decisions in terms of asset deployment and resource mobilisation, interest income rose 8% to MWK51 billion. The sluggish growth in interest income was attributed to the softening of yields, with the base lending rates falling to 12.5%pa from 23%pa and yields on TBs softening from 14%pa to 6.19%pa.

Positive movements in interest income and expense…

Interest expense declined 18% to MWK5 billion, resulting in net interest income of MWK46 billion, up 12% on prior year. The increase in cheaper deposits due to faster repricing, in line with softening market rates, had the bigger impact of reducing the cost of funding 48% bps to 1.61%pa.

Combining these two movements above, net interest margin improved 30bps to 10.99%pa.

Higher loan loss provisions…

As indicated earlier, the quality of the loan book, deteriorated necessitating a higher loan loss provisioning of MWK4 billion, up 124%. The ratio of provisioning to advances was 2.34%.

Non funded income rose 10% to MWK25 billion and the contribution to total banking income remained in line with previous years at 37%.

Controlled costs growth…

Operating expenses growth at 6% to MWK40 billion was below the average inflation of 9.4%, reflecting the impact of the cost rationalisation efforts. The outcome was a little unchanged cost to income ratio of 61%.

At the end of the year, a PAT of MWK17 billion, up 7% on FY18.

Acquisition of AKIBA Commercial Bank

Foray into Tanzania…

NBM has, through cautionary statements, advised shareholders that it intends to acquire a controlling stake in Akiba Commercial Bank (Akiba) of Tanzania. The Fair Trade Commission of Tanzania further advised stakeholders that NBM had signed an agreement, subject to conditions precedent to acquire 75% of Akiba.

Akiba started banking operations in 1997, with a focus on small and medium sized entrepreneurs and companies. The major shareholders of the bank are international institutions such as Triodos Hivos (8%), FMO (7%), Accion (20%) and others.

A small commercial bank with little franchise value…

The bank is one of the smallest, in industry with 41 commercial banks, but dominated by National Microfinance Bank (19% market share) and CRDB Bank (23%). These two big banks control 44% of deposit market share and combined with the fact that top 5 banks control 54% of the market, means that competition is cutthroat. Our calculations indicate that Akiba has a market share of less than 1% and is not in the top 10.

The Tanzanian banking sector has been affected by high NPLs since 2016 and Akiba has not been spared.

Credit quality issues…

The bank has not published its FY19 financials, but the FY18 numbers shows that the bank was not on a sound footing, having made losses in FY17 and FY18 because of higher NPLs. The NPLs reached a high of 30% in FY17 and closed FY18 at 26%.

Loss making in FY17 and FY18..

TZ 'millions	**2016**	**2017**	**2018**
Loans	144 664	101 778	82 996
Deposits	169 105	153 441	119 916
Total assets	211 204	182 625	155 333
NAV	**32 964**	**25 558**	**21 902**
Net Interest Income	33 815	26 923	23 336
Non-Funded Income	11 796	8 927	7 986
Provisions	(2 211)	(13 489)	(3 056)
Expenses	(31 083)	(33 252)	(31 995)
PBT	**12 317**	**(10 891)**	**(3 729)**
NPLs	5 524	30 184	21 630
NPLs Ratio	3,82%	29,66%	26,06%
Loan Growth		(29,65%)	(18,45%)
Deposit Growth		(9,26%)	(21,85%)

Deteriorating operating framework...

We also note that the bank has been losing deposits, possibly because of flight to quality. Most of its metrics were trending southwards.

At the end of FY18, the bank was undercapitalised and could not meet the minimum regulatory capital levels. The board of Akiba, to safeguard the 'going concern' status of the bank was exploring ways of injecting fresh capital.

Marginal impact to NBM asset size…

At the end of 2018, Akiba had assets worth USD67 million, and NAV of USD9.5 million compared with NBM's assets of USD567 million at the end of FY18 and NAV of USD137 million. Assuming the acquisition had taken place on 31 December 2018 and using the pooling method shows that Akiba would have enlarged the asset base of NBM by 10%. The impact on the P&L would have been negative.

Without information on the pricing of the transaction it is not possible to say whether this is a good deal or not. However, we are of the view that should the acquisition be completed, its positive impact on NBM will be minimal in the short to medium term.

NBM FY19	**Dec-19**	**Dec-18**	**YoY**
Net Interest Income	45 697	40 764	12%
Loan loss Charge	(4 412)	(1 970)	124%
NII after credit losses	41 285	38 794	6%
Non-Funded Income	24 546	22 255	10%
Total Income	65 831	61 049	8%
Operating Expenses	(40 480)	(38 033)	6%
PBT	25 351	23 016	10%
Tax	(8 196)	(7 051)	16%
PAT	17 155	15 965	7%
Loans	188 324	166 621	13%
Bank Placements	17 826	22 899	-22%
Investment Securities	166 275	138 158	20%
Total Assets	459 156	417 330	10%
Deposits	318 470	294 525	8%
Borrowings	16 335	19 428	-16%
Capital/NAV	100 762	88 316	14%
NIM	10,99%	11,87%	
NPLs	22 571	8 187	
NFI/Total Income	37%	36%	
CIR	61%	62%	
LDR	59%	57%	
ROA	4%		
ROE	18%		
NPLs Ratio	11,99%	4,91%	
Yield on average	14%		
Cost of Funding	1,61%		

Price (MWK)	17.50
EPS	1.53
NAV	5.27
P/E (x)	11.42
P/B (x)	3.32
ROE	34%

NBS Bank

The progress of the turnaround was further underlined by a 162% growth in the bottom line to MWK4.5 billion. This performance was attributed to an impressive top line performance and provisions write back. Costs on the other hand grew at an above inflation rate.

Turnaround cemented…

Net interest income doubled to MWK20 billion, benefiting from a 97% rise in interest income to MWK26 billion, which outpaced the 79% growth in interest expenses to MWK6 billion. The result was a net interest income margin of 16%. However, the cost of funding deteriorated 133bps to 4.87%, reflecting the reliance on fixed term deposits which comprise 42% of the MWK121 billion deposits base.

Aggressive loan book growth…

This interest income performance was a consequence of a 135% expansion in the credit book to MWK39 billion and a 124% increase in the fixed income assets to MWK82 billion. The increase in lending followed the lifting of restrictions previously imposed by the RBM. The structure of the earning asset portfolio was 58% money market and 47% loans and advances. Most of the new loans were in the "energy" sector which was 32% of the credit book. As at year-end, MWK33 billion in loans were maturing after 12 months, while money market assets worth MWK70 billion still had more than a year before maturing. Money market investments are said to be earning between 7%pa and 24.5%pa. In terms of contribution, 76% of the income was earned on money market investments, an income line which could come under pressure as yields continue to soften.

Solid deposit growth…

The growth in loans and fixed income assets was funded by a 21% growth in deposits to MWK121 billion and a switch of resources from statutory reserves and bank placements to loans and TB trading. In absolute terms, deposits grew by MWK20 billion, which means that without the MWK11 billion deposit from Nico Life Assurance, a related party, deposits would have risen by 10%, in line with peers.

Write back and lower provisions…

The bank wrote back MWK810 million into the P&L, following a 7% decline in NPLs to MWK7.8 billion which aided the overall profit growth. The result was an improvement in the NPLs ratio from 51% to 15%, although this is way above the recommended prudential limit of 5%. The NPL ratio improvement was driven by the increase in new loans which enlarged the denominator and the fact that most of the loans having been underwritten in the year were still green.

Non funded income declined 13% to MWK9 billion, bringing total income to MWK30 billion, up 39% on FY18. Non funded income contributed a third to total income.

Unsustainable CIR…

Operating expense growth of 21% to MWK23 billion meant that neither net interest income nor non funded income could be used exclusively to meet costs. Thus, the cost to income ratio is still an unsustainably high 77%, having improved from the 87% of prior year.

The bank achieved an ROE of 34% and declared a dividend of MWK0.35 per share.

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High leverage ratio…

Though, this performance is remarkable, we would like to highlight that the bank has a relatively high leverage of 10x, which is above the recommended benchmark of 6x. This could suggest that the bank is overtrading and may need to raise new capital. It also suggests that the bank is highly vulnerable to a rise in credit defaults.

High credit concentration…

The other concern is the high exposure to the "energy" sector, which is 98% of capital. This is particularly in the light of the fact that the sector was flagged by the RBM as being responsible for the rise in NPLs in FY19.

Few real assets…

The split of PPE shows that the bank does not have any real estate properties, with the bulk of fixed assets being MWK10.2 billion worth of vehicles, fixtures and fitting on a PPE base of MWK11.4 billion. The bank leases all its branches, including the head office from a related party; ICON Properties.

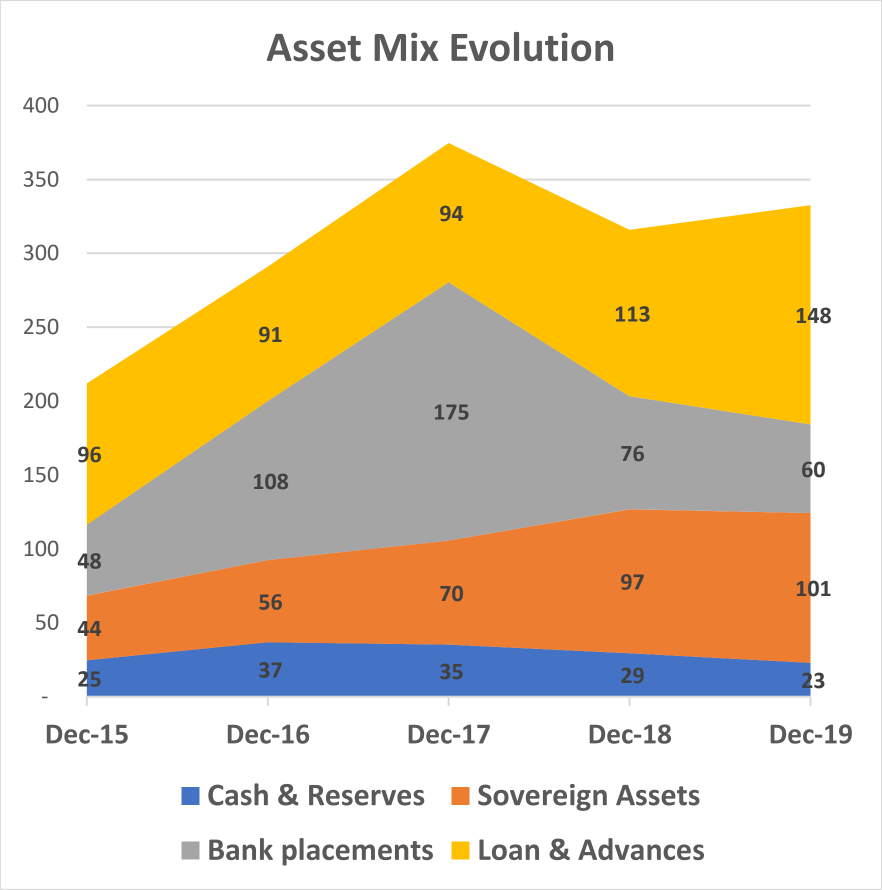
NBS FY19	Dec-19	Dec-18	YoY
Net Interest Income	19 816	9 742	103%
Loan loss Charge	810	1 209	-33%
NII after credit losses	20 626	10 951	88%
Non-Funded Income	9 027	10 406	-13%
Total Income	29 653	21 357	39%
Operating Expenses	(22 784)	(18 824)	21%
PBT	6 869	2 533	171%
Tax	(2 411)	(834)	189%
PAT	4 458	1 699	162%
Loans	38 562	16 350	136%
Bank Placements	8 035	22 665	-65%
Investment Securities	82 267	36 780	124%
Total Assets	160 032	122 311	31%
Deposits	120 739	99 514	21%
Borrowings	7 863	20 010	-61%
Capital/NAV	15 343	10 789	42%
NIM	16,66%	9,68%	
NPLs	5 814	8 297	
NFI/Total Income	30%	49%	
CIR	77%	88%	
LDR	32%	16%	
ROA	1%		
ROE	34%		
NPLs Ratio	15%	51%	
Yield on average	21%		
Cost of Funding	4,51%		

Price (MWK)	790.00
EPS	67.67
NAV	371.75
P/E (x)	11.68
P/B (x)	2.13
ROE	19%

Standard Bank Plc

Asset book restructuring continues…

The FY19 results reflect a change is asset structuring that the bank instituted beginning FY18. Previously the bank was not aggressive on loan growth, preferring to place the funds, especially foreign currency deposits with other group subsidiaries. In FY17, the bulk of the assets were bank placements and these have progressively been replaced by loans and money market securities. Loans now makeup 45% of the interest earning portfolio, from 25% in FY17, with money market instruments increasing from 19% to 30% and bank placements declining to 18% from 47%.



As a result of the strategy implementation, loans and money market instruments grew 32% and 4% respectively to MWK148 billion and MWK101billion respectively, while bank placements declined by 22% to MWK60 billion.

Good net interest income growth…

From this asset portfolio, interest income grew 11% to MWK43 billion reflecting the growth in the asset mix mentioned earlier which offset the decline in yields. On the debit side, the interest expense was flat at MWK4.3 billion. The cost of funding deteriorated slightly by 16bps to 1.82%pa. This was despite the 6% growth in customer deposits to MWK242 billion. The net interest margin improved by just under 100bps to 11.4%pa, with net interest income rising 12% to MWK39 billion.

Once burnt, twice shy…

After having been burnt by its exposure to agriculture, through the now infamous “cotton ginners” scandal, management had vowed to tighten its systems and this is evidenced by the quality of the credit book which keeps on improving as reflected by the NPLs ratio of 3.14% vs 15% in FY17. This is further highlighted by the 62% reduction in the provision charge to MWK1.9 billion. It is worth noting that the bank wrote off MWK5 billion worth of loans, which also aided the NPLs ratio, by reducing the numerator. The loan portfolio is still largely anchored on agriculture which comprises 42% and consumer/retail segment which is 30% of total. The two sectors also registered the biggest amount of growth.

Well controlled expense growth…

Non funded income growth was a marginal 3% to MWK22 billion, bringing total income to MWK58 billion, up 15%. Non funded income thus contributed an unchanged 38% to total income. To the credit of management, operating expenses were flat at MWK36 billion, highlighting the cost containment measures initiated by the bank. With income growing and expenses remaining flat, the cost to income ratio improved to 60% from 69% previously. This means that the bank is barely able to cover operating expenses from net interest income. After provisioning for taxation, PAT grew 50% to MWK16 billion, in the main driven by the growth of net interest income, a decline in the provision charge and controlled expenses growth.

SBM FY19	**Dec-19**	**Dec-18**	**YoY**
Net Interest Income	38 877	34 740	12%
Loan loss Charge	(1 872)	(4 902)	-62%
NII after credit losses	37 005	29 838	24%
Non-Funded Income	21 979	21 246	3%
Total Income	58 984	51 084	15%
Operating Expenses	(35 612)	(35 312)	1%
PBT	23 372	15 772	48%
Tax	(7 493)	(5 190)	44%
PAT	15 879	10 582	50%
Loans	148 490	112 632	32%
Bank Placements	59 930	76 448	-22%
Investment Securities	100 631	85 376	18%
Total Assets	375 116	357 158	5%
Deposits	242 082	229 284	6%
Capital/NAV	87 239	77 240	13%
NIM	11,40%	10,05%	
NPLs	4 666	8 155	
NFI/Total Income	37%	42%	
CIR	60%	69%	
LDR	61%	49%	
ROA	4%		
ROE	19%		
NPLs Ratio	3%	7%	
Yield on average	13%		
Cost of Funding	1,82%		

NBS mismatch between ROA and ROE…

The table below shows how the banks stake up against each other, as measured by different metrics. NBS Bank has a low return on assets reflecting the aggressive growth in assets of 31% in FY19. As mentioned earlier, SBM has been improving the quality of its loan book, whilst NBM is showing an unwelcome deterioration.

	Based on 31 December 2019 Results		
Growth Indicators	**NBM**	**NBS**	**SBM**
Gross Loan	13%	136%	32%
Asset	10%	31%	5%
Customer Deposits	8%	21%	6%
Total Operating Income	8%	39%	15%
Net Income	**7%**	**162%**	**50%**
Profitability Indicators			
Return on Average Assets	4%	1%	4%
Return on Average Equity	18%	34%	19%
NIM (%)	**10,99%**	**16,66%**	**11,40%**
Yield on Interest Bearing Assets	14%	21%	13%
Cost of Funds	1,61%	4,51%	1,82%
Efficiency Indicators			
Non-Int expenses/ Assets	8,82%	14,24%	9,49%
Cost to Income Ratio (%)	**61%**	**77%**	**60%**
Liquidity Indicators			
Customer Deposits/Equity	3,16	7,87	2,77
Credit to Deposit Ratio (%)	**59%**	**32%**	**61%**
Equity to Assets Ratio (%)	22%	10%	23%
Credit Quality Indicators			
NPAs to GL	**12%**	**15%**	**3%**

NBS's NIM is high because of a fair amount of money markets discounting activities undertaken during the year. At the same time it is worth noting that the NBS's growth on the bottom line is coming off a low base.

CONCLUSION

The banking landscape has been altered somewhat by the Covid-19 pandemic, with credit risks being highly elevated. Banks are expected to constrain their lending activities, with a lot of existing clients expected to request loan restructuring. In line with RBM directives, banks have made available a moratorium on principal and interest payments as part of the restructuring.

Most management teams have highlighted that the focus for FY20 would be to preserve capital and ensure adequate liquidity levels. In that regard, NBS closed the year with a Tier 1 ratio of 19.25%, NBM had 18% while SBM was 20%. These ratios are well above the prudential limit of 10%.

The other unknown is by how much, transactional income would reduce and by how much margins would also shrink as a result of the shift to digital channels for transactional purposes.

The saving grace would be the fact that the government is not likely to default on the treasury bills and other sovereign assets and the fact that yields are starting to edge upwards.

NBS has outperformed the market to date…

	Price	P/E	P/B	ROE	YTD GAIN
NBM	550,00	14,97	2,55	18%	5%
NBS	17,50	11,42	3,32	34%	30%
SBM	790,00	11,23	2,04	19%	4%

SBM and NBS have published positive H1 FY20 trading statements which would suggest that Malawi has not been as severely affected as we have seen in other Sub Saharan African economies.

- **SBM –** we expect to trade at a forward P/E multiple of under 10x and P/B of under 2x, which are undemanding for the bank. **BUY**

- **NBM** at a **P/B of 2.55x** is trading at the lowest it has been in recent times. We, however, note that the bank's asset quality is trending southwards. We, therefore, assume that provisions will remain high, thus affecting earnings going forward. **HOLD**.

- **NBS** as a turnaround stock is trading at an elevated P/B multiple of 3.32x, which is slightly justified by the ROE of 34%. Going forward, we expect the P/E multiple to unwind to below 10x, as the bank consolidates its turnaround. **BUY.**