Company Research Report
28 November 2018
Armstrong Kamphoni
Kamphonia@cedarcapital.mw
+265 1 832 307

CEDAR CAPITAL

Equity research | Company Research Report

MALAWI

NBS Bank
Your caring Bank

... he is a new creation; old things have passed away, all things have become new!

Commercial Banking

Bloomberg Ticker	NBS.MV
Reuters Ticker	NBS.MV
Market Data	**20-Nov-18**
Closing Price	MK10.50
52 Week High	MK10.50
52 Week Low	MK07.00
Market Cap (b)	MK30.5
Market Cap (m)	USD42
P/E	30.41x
P/B	02.24x
DPS Yield	-

Several growth paths, new CEO to drive execution …

NBS Bank's turnaround, growth, recovery and strategy was well articulated in the rights issue document. The building blocks including amongst others; a capital injection, a new management team and a unique technical agreement with Rabobank, have been put in place. It is now about delivery and the early signs are encouraging with the bank recording a profit of MK479 million in the H1, FY18.

Customer loyalty, strong brand …

The loyalty of the customer, which is a testimony of the strength of the NBS Bank brand was exhibited by the 19% year-on-year rise in deposits to June 2018. This growth rate was among the highest in the sector. Not many financial institutions, experience a near death experience and thereafter not struggle to mobilise deposits. As such, NBS Bank has a strong foundation from which it can anchor the continued turnaround of the bank. An added bonus is the fact that the deposits are coming in cheaper.

Green shoots …

NBS Bank recorded a profit after tax of MK479 million, a feat last achieved in FY14. Most of the important income lines recorded significant gains. The cost to income ratio, although still high at 90% is showing a massive improvement from the 109% as at FY17. As such, the green shoots are beginning to manifest and NBS can now consolidate on these gains.

Credit quality still an issue…

The bank has undertaken extensive clean-ups of the loan book, in addition to plugging operational leakages. The latter has resulted in a marked improvement in revenue collection, evidenced by 61% rise in non-funded income. However, for the loan book, the going has been hard. The NPLs ratio still remains high at 40%. Notwithstanding, we expect the NPLs ratio to unwind to acceptable levels going forward.

Not cheap by your garden variety metrics, but….

At first glance, a P/E of 30.41x and P/B of 2.24x might appear expensive but that would be ignoring the fact that FY17 was a year of yet another beginning for the bank. Having made a profit of MK479 million in the first six months, we expect that for FY18, the bank would make at least MK1 billion. As a turnaround punt, we think the risk-reward at the current share price is particularly attractive. **BUY**

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Investment Thesis

We initiate coverage of NBS Bank (NBS) with a **BUY** recommendation. After recording losses in FY15, FY16 and FY17, the organisation has instituted a number of corrective measures, including changing management, raising capital and accessing technical skills from Rabobank which has the experience of running banks in difficult markets such as Zambia and Tanzania.

The 19% year-on-year growth in deposits is testament to NBS's brand equity which places the financial institution in good stead. The deposits are favourably priced resulting in NBS having a cost of funding of 3.73%, down from 4.52%in FY17 and 7.52% in FY16. Net interest margins are also trending in the right direction, expanding to 9.29% p.a from 8.97% p.a in FY17.

Another positive development was the plugging of the leakages in the collection of commissions, fees and other transactional incomes. Consequently, NBS Bank recorded a significant growth in non-funded income which contributed 54% to total income.

What remains to be sorted is the quality of the credit book, but this is to be expected as it takes longer to unwind.

The green shoots are now evident.

Company Overview

In 1964, three building societies; Central African Building Society (CABS), Commonwealth Century Building Society and First Building Society, were amalgamated into one entity under the banner; New Building Society (NBS), then licensed under the Building Societies Act. In 2004, it converted its banking license to that of a commercial bank, now as NBS Bank Limited.

NBS is a now universal bank offering retail and corporate banking services through various channels. The retail channel comprises 38 branches across the country and is the biggest by footprint in the Malawian banking sector.

Major shareholders of the bank are;

- Nico Holdings Plc - 54.35%
- Continental Holdings Ltd - 27.25%
- National Investment Trust - 01.30%
- Free float - 17.10%

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Nico Holdings Plc is a regional insurance group, with head office in Malawi and subsidiaries in five Southern African countries. Continental Holdings Ltd, is a Malawian financial services group, commonly known as CDH which ended up with the shares as the underwriter of the 2017 rights issue.

No longer a differentiated business model

The banking sector in Malawi is primarily configured to serve the corporate world and NBS Bank with its roots as a building society was/is configured to serve the mass market. At some point, NBS Bank had more than 70% market share in mortgage products. However, over the years, lending has shifted to wholesale & retail which in June 2018 was 25% of the book.

Malawi Banking Sector Snap Shot

Malawi's banking sector is largely centred on commercial banking which has 7 players comprising National Bank Malawi (NBM), Standard Bank Malawi (SBM), FMB Bank, Nedbank, NBS Bank, Ecobank, and FDH Bank. There is one merchant bank, CDH Investment Bank. SBM and Nedbank are South African owned while Ecobank is a subsidiary of Togolese Ecobank ETI. These players offer standard commercial banking products and services to individuals, small to medium enterprises and big corporates.

There has been a series of mergers and acquisitions, with FDH having acquired Malawi Savings Bank; FMB acquiring Opportunity International Bank and NBM swallowing Indebank.

The banks compete with a large microfinance sector, comprising 57 registered entities which play an integral part of providing credit in the lower end of the market, together with co-operatives and village banks.

The banking sector is usually referred as the "oil" that lubricates the economy, and as such the prospects of the economy are inexorably tied to that of the sector. The banking system provides five key services: (a) savings facilities, (b) credit allocation and monitoring of borrowers, (c) facilitate payments, (d) risk mitigation, and (e) liquidity services.

	2013	2014	2015	2016	2017
Country GDP	1 924 110,08	2 534 656,29	3 212 683,76	3 818 492,51	4 659 488,21
Total Banking Assets	653 000,00	796 100,00	907 000,00	1 239 900,00	1 572 300,00
Total Deposits		481 600,00	629 400,00	809 000,00	995 500,00
Total Loans	256 600,00	304 900,00	370 800,00	438 800,00	448 700,00

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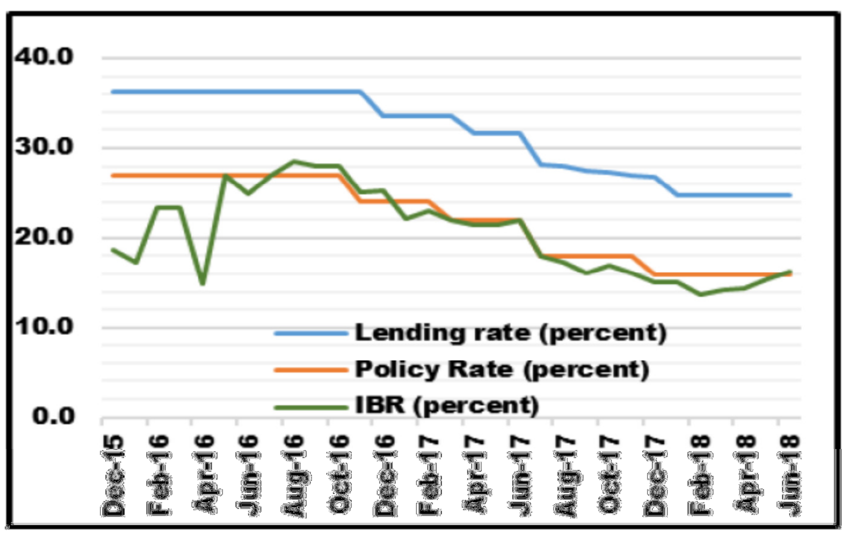
Banking Assets/GDP	33,94	31,41	28,23	32,47	33,74
Deposits/GDP	-	19,00	19,59	21,19	21,37
Loans/GDP (%)	13,34	12,03	11,54	11,49	9,63

Source: RBM Reports & Cedar Capital Research

The deposit/GDP ratio at around 20%, shows that access to financial services in Malawi is very low. In a 2014 survey, FinScope found out that 51% of the adult population in the country were not using any formal, or even informal, financial products, while only 27% were formally banked and a further 15% relied on mostly microfinance products. The same survey found out that 25% of the adult population had an informal product, such as borrowing from employers, getting credit from shops or receiving inputs as credit.

This is mainly because the Malawian banking sector is structurally geared towards providing services to the narrow corporate sector and the formally employed people. *This presents a possible "mining" opportunity for banks to go lower and milk the lower income segments.*

According to the June 2018 Financial Stability Report produced by the Reserve Bank of Malawi (RBM), interest rates, another key variable for the banking sector, have been weakening, especially in the period between April 2017 and April 2018, with the Policy Rate declining from 33,6% to 16% p.a. In tandem, the banking sector reduced their lending rates by 600 basis points (bps) to 27,7% p.a. in December 2017. The lending rates further weakened to 24.8% by half year.



Source; RBM Financial Stability Report – June 2018

In terms of growth, total assets in the sector declined 3.7% to MK1,5 trillion at half year, driven by decreases in balances with banks abroad and short-term securities and investments of 30% and 4.8%.

Deposits expanded marginally by 1.8% to MK1 trillion but showing a contrasting picture. On one hand, Malawi Kwacha deposits in the system increased by 7.5% to MK766 billion and on the other forex deposits declined by 13% to MK467 billion. With the Kwacha being stable and not appreciating, this reflects a significant decline the quantum of forex deposits.

Credit growth was in line with local currency deposit growth of 8.5% to MK487 billion. This gives a sector loan to deposit ratio of 48%. In theory Malawi banks should be very liquid and can be accused of not undertaking their intermediation role to their maximum potential. The counter argument is the lack of quality borrowers.

Credit quality remained under pressure, although, the NPLs ratio improved to 12.6% from 15,6% at December 2017. However, this remains a huge concern as it is way above the recommended international benchmark of 5%. As well, the improvement in the ratio was more a result of write-offs and increases in the loan book.

With regards to franchise, two big banks dominate the sector with combined total deposits for the two in excess of 51%. The sector remains exposed to high concentration risk due to the limited number of large creditworthy borrowers.

On the macro-economic front, performance largely depends on weather conditions, which in the face of climatic changes are expected to be more variable. Thus, the economic outlook is greatly influenced by agriculture output, government management programs, commodity prices and donor support levels.

In terms of economic growth, according to the Reserve Bank of Malawi, economic growth rebounded to 4,5% in FY17 from the 2,7% recorded in 2016. The positive outturn was attributed to the recovery in agricultural output following good rains.

Elections in 2019 are expected to increase pressure on fiscal spending as the current administration strengthens its efforts to win a re-election. The ‘empty coffers” hymn which usually accompanies an election, especially if there is a change in administration, presents elevated risks going forward.

Financial Review – 6 months to 30 June 2018

…light at the end of the tunnel

NBS raised USD16.2 million in a rights issue in July 2017, which was the final step in the recalibration of the bank. The question of “how we got here" in terms of the losses recorded between FY15 and FY17 may not need a lot of elaboration, but some of the initiatives that have been undertaken to turnaround the bank includes;

- Entering into a technical arrangement with Rabobank.
- Recruitment of a new CEO, Kwanele Ngwenya with effect from 1 April 2017.
- Re-organising the senior executive management with a dynamic young team now in place, with an average age of 35 years.
- The loan book was basically cleaned up, with write-offs and provisions where necessary.
- a rights issue was undertaken to shore the capital of the bank.
- A number of measures were instituted to ensure maximum revenue collection, especially fees and commissions.

In the 6 months to 30 June 2018, the turnaround seems to be on track, with interest income rising 25% year-on-year to MK5.8 billion. The interest income was derived from a loan book of MK19.3 billion, which reflects a 5% growth on the December level. This level is almost half of the loan book of MK30 billion in FY15. The shrinkage in the loan book underlines the cleaning that has been undertaken. Also improving was the yield on the book, which rose 192 basis points (bps) to 15% p.a. On the funding side, deposits grew at a faster pace of 9% to MK77 billion. A positive development was the improvement in the cost of funding to 3.73% p.a from 4.52% p.a. The result was a 35% decline in the interest expense, which resulted in the net interest margin coming out at 9.29% p.a, up 33bps on the FY17 level. Consequently, net interest income growth was a stupendous 84% to MK4.4 billion.

A provision of MK102 million, charged to the income statement, reflects the current state of the loan book.

Non-funded income growth, at 66% to MK5 billion was impressive and contributed positively to profitability, benefiting from management's efforts to enhance revenue collections and more digitised transactional banking. In total, non-funded income contributed 54% to total income, from the 47% previously.

Expenses, which in a bank are fixed in nature, remained stubborn, growing at 11% to MK8.7 billion, largely in line with inflation. The cost to income ratio continues to get better and now at 92% means that the bank is no longer making operational losses. The cost of income ratio peaked at 273% in the first half of FY16.

All these positives culminated in the bank recording a profit after tax of MK479 million. With a return to profitability the ROE worked out at a normalised 15%.

In term of the segmentation of the advances book, concentration remains high in wholesale and retail sector which comprises 25% of the loan book

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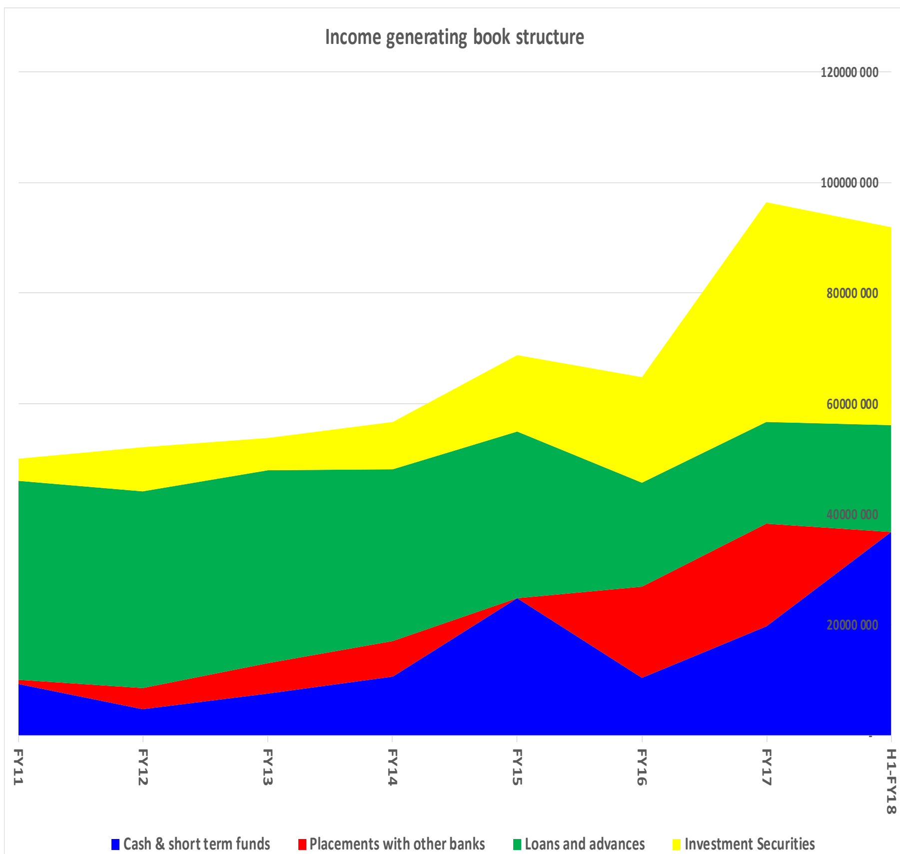
and contributes MK2.9 billion out of the MK9.6 billion of NPLs. In fact, the wholesale and retail book has 30% NPLs. Notwithstanding the clean-up that has taken place, NPLs remain high at around 39% of gross loans.

From being a dominant player in mortgages, NBS Bank seemed to have shifted its focus towards wholesale and retail, which in FY15 peaked at MK10 billion. In that year, Agriculture lending was MK6 billion. In the first half of 2018, agriculture had shrunk to MK1.2 billion or 2% of the book. The lending is now skewed towards financial services which 18% of total credit.

The structure of the income earning book is such that loans and advances make up 21% of the asset book. The bigger portion is now taken up by investment securities at 39% of the book, as shown in the chart below. After having been burnt by the loan book, whose quality which is still not optimal, management has taken a deliberate strategy to curtail lending. As such, NBS Bank closed H1 with a loan to deposit ratio of 27%.



Source – Company Annual Reports and Cedar Capital Research

Outlook

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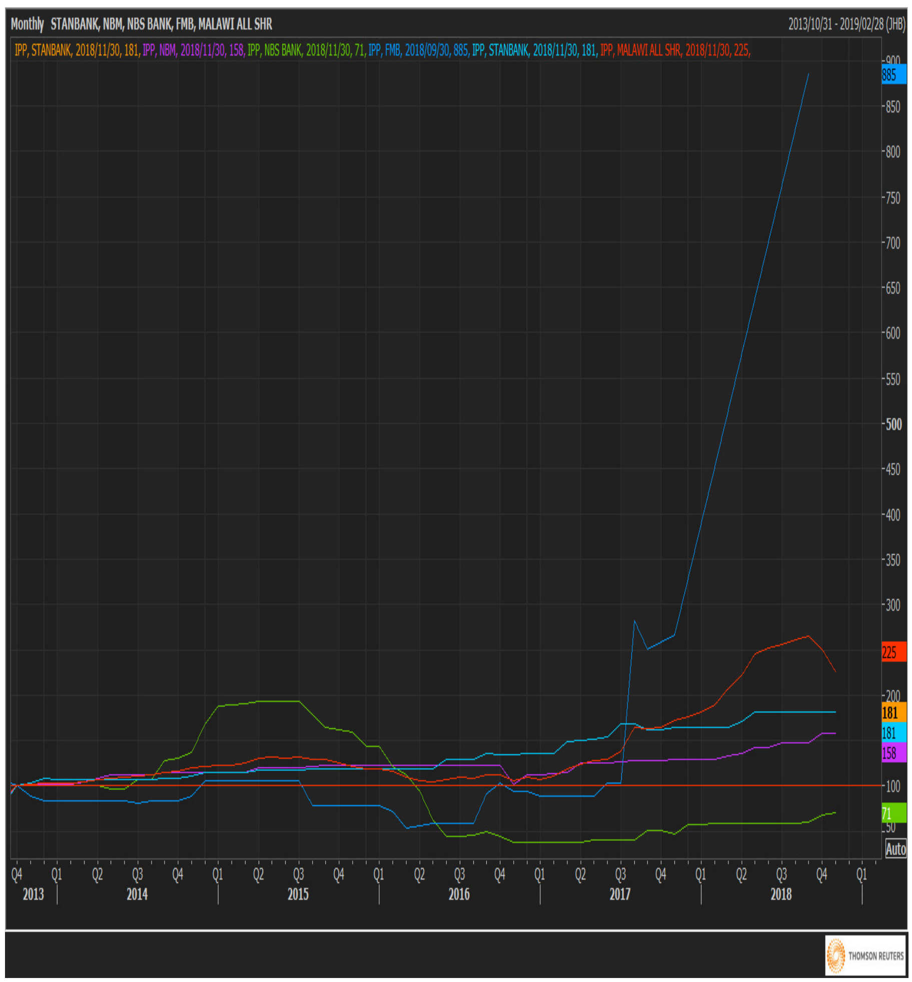
Going forward, NBS Bank seeks to continue consolidating on the turnaround and build on the goodwill reposed in the bank by depositors. The bank now needs to cautiously start sweating the balance sheet. So far, the strategy has been to constrain lending while buying treasury bills. The growth in non-funded income is highly commendable and should augur well for NBS Bank into the future.

Shareholder Returns

Rebasing to the beginning of FY13, we note that NBS (green line) has unsurprisingly underperformed the market and its peers.



Source – Thompson Reuters Eikon

Recommendation

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Given the difficulties that the bank has endured and how the performance has been negative, it is difficult to forecast earnings. The bank in the rights issue had given guidance that it would be profitable in FY17 and make MK2.2 billion in FY18. However, given that the bank only managed MK479 million in H1, we would estimate that the bank would achieve at least MK1.2 billion.

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	31-Dec-13	31-Dec-14	31-Dec-15	31-Dec-16	31-Dec-17
Interest on loans & Advances	*13 619 778,00*	*12 241 547,00*	*10 397 062,00*	*4 993 173,00*	*3 662 270,00*
Investments & Other Securities	*3 528 440,00*	*2 201 789,00*	*3 722 732,00*	*4 883 552,00*	*5 646 032,00*
Interest on Bank Deposits & Placements	*50 270,00*	*68 971,00*	*133 759,00*	*880 039,00*	*1 251 083,00*
Interest Income	**17 198 488**	**14 512 307**	**14 253 553**	**10 756 764**	**10 559 385**
Customer Deposits	*(6 281 660)*	*(3 537 335)*	*(3 355 959)*	*(3 872 131)*	*(2 624 638)*
Deposits from other banks	*(381 613)*	*(100 262)*	*(94 015)*	*(163 819)*	*(100 328)*
Bonds and Notes	*(1 158 829)*				
Euro Bond Interest Expense	*(64 653)*	*(105 564)*	*(259 599)*	*(731 360)*	*(607 655)*
Interest Expense	**(7 886 755)**	**(3 743 161)**	**(3 709 573)**	**(4 767 310)**	**(3 332 621)**
Net Interest Income	**9 311 733**	**10 769 146**	**10 543 980**	**5 989 454**	**7 226 764**
Provision for Loan Losses	(3 213 762)	(4 348 600)	(6 243 455)	(7 545 412)	1 073 586
NNI after Provisions	**6 097 971**	**6 420 546**	**4 300 525**	**(1 555 958)**	**8 300 350**
Forex Income	1 945 286	3 199 405	2 141 947	1 771 283	1 465 848
Commissions & Fee Income	2 325 094	3 514 612	4 231 494	5 965 013	5 386 718
Non-funded income	**4 270 380**	**6 714 017**	**6 373 441**	**7 736 296**	**6 852 566**
Total banking income	**10 368 351**	**13 134 563**	**10 673 966**	**6 180 338**	**15 152 916**
Operating Expenses	(7 517 705)	(9 069 160)	(10 910 203)	(16 844 026)	(16 567 956)
Profit/Losses Before Taxes	**2 850 646**	**4 065 403**	**(236 237)**	**(10 663 688)**	**(1 415 040)**
Taxation	(938 063)	(1 372 885)	40 776	2 267 363	322 733
Net Profit/loss	**1 912 583**	**2 692 518**	**(195 461)**	**(8 396 325)**	**(1 092 307)**
No of shares in issue	727 643 000	727 643 000	727 643 000	727 643 000	2 910 574 000
EPS	2,628	3,700	(0,27)	(11,54)	(0,38)
P/E	0,22	0,13	(1,41)	(0,04)	(1,15)
Price/NAV	46,89	29,27	24,83	126,90	99,96
Net Interest Margin (%)	**17,56**	**19,47**	**16,80**	**8,97**	**8,96**
Interest Spread (%)	16,04	18,91	16,39	8,99	8,57
Net Interest Income/ Average Total Assets (%)	15,54	16,75	13,84	7,19	7,42
Cost of Funding (%)	16,40	7,32	6,32	7,11	4,52
Cost of deposits (%)	15,79	8,20	6,93	6,91	4,17
Leverage (x)	6,67	5,83	7,54	30,18	8,96
Impairments/Average Advances (%)	9,22	14,02	20,71	40,50	(5,84)
NPLS/Advances (%)	-	79,23	92,74	140,76	51,28
Return on Equity (%)	23,66	25,93	-1,71	-121,00	-14,31
Return on Assets (%)	3,19	4,19	-0,26	-10,07	-1,12
Yield on Advances (%)	38,60	37,16	34,00	20,48	19,79
Yield on securities (%)	50,91	30,23	33,37	29,70	19,18
Yield on Interest Earnings Assets (%)	32,44	26,23	22,71	16,10	13,09
Loans/Deposits Ratio (%)	81,38	71,35	56,48	31,73	27,37
Debt/Equity Ratio (%)	15,18	45,64	25,43	134,24	0,16

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Cost to Income Ratio (%)	72,51	69,05	102,21	272,54	109,34
BALANCE SHEETS					
	31-Dec-13	**31-Dec-14**	**31-Dec-15**	**31-Dec-16**	**31-Dec-17**
Cash & short term funds	7 713 692	10 607 811	24 889 153	10 451 878	19 799 558
Placements with other banks	5 329 783	6 545 748	-	16 604 707	18 610 321
Loans and advances	34 861 318	31 023 652	30 140 392	18 632 166	18 372 690
Investment Securities	6 039 438	8 525 097	13 786 071	19 100 510	39 760 868
Total Interest Earning (Operating) Assets	**53 944 231**	**56 702 308**	**68 815 616**	**64 789 261**	**96 543 437**
Other Assets	983 605	5 884 053	4 662 852	7 288 915	7 431 319
Equity Investments	33 665	48 665	48 665	48 665	63 665
Intangibles	128 957	115 823	5 503 937	5 828 193	4 116 974
PPE	5 123 219	5 610 443	4 963 755	4 766 889	4 034 208
Total Non Operating (Fixed Assets)	**6 269 446**	**11 658 984**	**15 179 209**	**17 932 662**	**15 646 166**
Total Assets	**60 213 677**	**68 361 292**	**83 994 825**	**82 721 923**	**112 189 603**
Deposits - customer accounts	42 839 160	43 483 288	53 360 214	58 722 746	67 129 652
Forex Deposits	4 340 911	4 830 975	7 528 462	7 942 913	9 851 632
Short term loans	935 190	5 037 404	2 634 054	3 600 000	-
Long term loans	435 961	317 118	198 275	79 431	20 010
Total Interest Bearing Liabilities	**48 551 222**	**53 668 785**	**63 721 005**	**70 345 090**	**77 001 294**
Other Liabilities	1 800 007	2 047 384	8 999 236	9 635 920	22 667 946
Taxation	831 735	912 220	137 346	-	-
Total Non Interest Bearing Liabilities	**2 631 742**	**2 959 604**	**9 136 582**	**9 635 920**	**22 667 946**
Tier I Capital	363 822	363 822	363 822	363 822	1 455 291
Share Premium	2 323 895	2 323 895	2 323 895	2 323 895	12 104 183
Revaluation reserve	552 017	552 017	552 017	552 017	17 481
Loan loss reserve	(9 672)	2 085 402	9 446 263	5 181 208	4 032 208
Retained Earnings	5 800 651	6 407 767	(1 548 759)	(5 680 029)	(5 088 800)
Shareholders Equity	**9 030 713**	**11 732 903**	**11 137 238**	**2 740 913**	**12 520 363**
Minority Interest	-				
Total Equity	**9 030 713**	**11 732 903**	**11 137 238**	**2 740 913**	**12 520 363**
Total Equity and Liabilities	**60 213 677**	**68 361 292**	**83 994 825**	**82 721 923**	**112 189 603**
NAV/Share	0,0124	0,0161	0,0153	0,0038	0,0043

Cedar Capital Limited
4th Floor, Livingstone Towers
Sir Glyn Jones Road
P O Box 3340
Blantyre, Malawi
+265 1 831 995
Feedback: nzimar@cedarcapital.mw