MMC NMB HOLDINGS HY13 RESULTS REVIEW

Investment Research

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(Members Of The Zimbabwe Stock Exchange)

The Market Making Corporation

Rating	BUY
Date	3-Sep-13
Bloomberg code	NMBZ:ZH
Reuters code	NMB.ZI
Current Price US cent	7.00
Fair Price	10.25
Implied upside	46.43%
52-week price range	
Shares in issue 'm	280.71
Market Cap US$'m	19.65
Book Value US$m	47.95
Price to book	0.41

USD$m	HY2013	HY2012
Net Interest Income	9.49	6.80
Fee income	7.57	6.68
Gross operating income	4.04	3.00
Attributable profits	2.67	2.56
Cost of funds	6.3%	6.5%
Yield on assets	12.9%	13.8%
Net Interest margin	6.6%	7.3%
Cost:Income (CIR)	70.9%	72.9%
Market cap $m	19.65	

Valuation Metric		Sector
PBk	0.41	0.50
ROE	14.0%	23.3%
Loan:Deposit	87%	85%

Nature of Business – Banking

Banking concern NMBH released a fair set of results for the half year ended 30 June 2013 despite a relatively subdued economic and operating environment.

Increased lending spurring income growth

The group's total income grew by 29% to $18.5mln, propelled a 39% increase in net interest income. The growth in net interest income (NII) was a result of increased lending in the bank's asset creation activities. The group's NII growth was due to a 38% growth in interest income relative to a 36% growth in interest expenses. Fee and commission income was up 13.3% to $7.57mln with its contribution to total income declining to 49% from 53% in H1 2012. Growth in NFI was guarded by the effects of the MOU that was signed in February 2013 which reduced bank charges and capped interest rates for banks.

The retail banking unit overtook the corporate banking segment chipping in 46% to total income up from 40% in the prior year relative to corporate banking's 39% (48%:H1'12). The Treasury segment's contribution to the bank's income increased by 3 percentage points to 10%, whilst international banking contribution was flat at 4%. The retail unit was the dominant contributor to bank profitability in the period under review due to an exceptional growth in the bank's retail book. The cheaper retail funds resulted in lower interest expenses for the unit relative to corporate banking hence the higher contribution to profitability.

Worth mentioning is the fact that the bank, which is the dominant SBU for NMBH, experienced a 6% decline in net profits to US$2.18mln. The decline was a result of a 35% decline in corporate banking segment's total income and a corresponding 537% decline in the segment's net profit contribution to US$0.63 mln.

Falling yields exerting pressure on NIM

The group experienced a 20bps decline in the cost of funds (COF) 6.3% in the period under review. The decline in the COF was a result of an increase in the proportion of the cheaper retail deposits and an injection of new equity capital in March. The yield achieved on interest earning assets (YEA) as a result of the MoU declined by 90bps to 12.9% implying a faster decline in YEA relative to COF. Resultantly, the net interest margin (NIM) for the period under review dipped by 70bps to 6.6%.

Our view is that the banking space will remain very competitive going forward and the COF for NMB is set to rise sooner rather than later and this will further squeeze the group's NIM. There is an increased need to grow the bank's NFI if it will keep afloat and grow its attributable profits which grew by 4.2 percentage points in H1'13. The new product developed and in the pipeline will likely drive the growth in NFI considering that aggressive asset creation is a risky strategy in the obtaining environment.

Operating efficiency rising

The banks adjusted CIR improved by 3% to 70% as net operating income grew faster (29%) relative to operating expenditure's 24% growth. Operating expenses growth was mainly driven by a 24% growth in admin expenses to US$6.3mln as the group continues to focus on enhancing its e-banking channels. Staff costs also rose by 21% to US$5.80mln (45% of operating expenses). Based on the notion that E-banking channels are cheaper than the traditional channels, the group's new product development concepts such as mobile banking and internet banking to be launched in September 2013 and December 2013 respectively will result in a further decline in the CIR. The bank has been on a recovery path with regards to operating expenses management signalling improved bank efficiency.

Aggressive lending compromising asset quality

Total assets for the group rose by 18% during the period to US$264.78mln **(Table 1)** driven by the 20% growth in loans and advances to US$183.45mln, indicating the groups' desire to grow its asset base. The asset growth is against a 10% growth in deposits to US$211mln, reflective of an aggressive asset creation drive by the group during the period amidst rising liquidity challenges. The aggressive asset creation drive resulted in a jump in the group's gross non-performing loan (NPL) ratio to 22.8% relative to H1'12's NPL ratio of 12%. The net result was a 174% growth in loss provisions in the H1'13 which negatively affected bank profitability. The bank managed to retain sufficient liquid assets which helped it to weather the liquidity crunch that is threatening the sector. Sitting on a cash pile of US$61 mln the bank has a liquid asset ratio (LAR) of 36.10% which is above the regulatory minimum of 30%.

Table 1: Summarized balance sheet

All in USD$m	HY2013	FY2012	Change
Interest-earning assets	250.55	212.50	18%
Non-interest earning assets	14.24	14.04	1%
Total Assets	**264.78**	**226.53**	**17%**
Interest bearing Liabilities	210.67	191.42	10%
Non interest bearing liabilities	6.16	4.17	48%
Equity	47.95	30.94	55%
Total Equity&Liabilities	**264.78**	**226.53**	**17%**

Source: NMBH 2013 Interim Results

NMB showed an exceptional liability gathering ability by growing its deposit base amidst worsening liquidity challenges that besieged the banking sector leading to sector's deposit base shrinking. Total deposits grew by 10% to $210.67mln driven by a 23% in deposits from banks and other financial institutions. A total of $57.4 mln worth of cheaper lines of credit was secured of which US$29mln was utilised and further utilisation should lead to a further decline in COF. Customer deposits grew by 6.7% from the December 2012 figure of US$152.45mln in the face of declining M3 growth. Deposits from the manufacturing sector rose by 5% to US$25mln whilst agriculture took a 27% dip to US$7mln. Financial services' deposits continue to dominate the deposit base, contributing 23% up from the 20% achieved in the December 2012. Overall the loan to deposit ratio increased to 87% from 85% as the group was more aggressive on lending.

The group's loan book is biased towards distribution (30%), individuals (22%) and services (22%). The group has significant exposure to distribution which management hinted was posing collection challenges on the NPLs associated with the loans to the sector. This in turn necessitated an increase in provisions to US$9.2mln from US$8.5mln in the prior year. Impairment provisions-to- loans and advances increased to 4.6% from 3.2% in the prior period. Management is of the view that there will be emphasis on reducing the NPL ratio to below 20% by 31 December 2013.

In terms of capitalisation, the bank's total capital base was US$42.56 million as at the 30th of June 2013 on the back of the US$14.8 million that was raised from the three strategic foreign partners. This was against the mandatory minimum of US$50mln (by June 2013).

Outlook and Valuation

The outlook for the economy is filled with uncertainty and the national savings rate has been declining and is faced with heightening headwinds. Liability gathering is likely to prove to be a challenge as low incomes growth and weak investor confidence will militate against deposit mobilisation. The presence of the foreign partners in NMBH will be pivotal going forward as the bank intensifies its endeavours to source for credit lines which are generally cheaper and of a longer tenure relative to local funds. The e-banking channels which the group intends to introduce will be key in lowering operating costs hence further improving the bank's profitability.

We project a book value per share (BVPS) of US20.50 c for NMBH and using a relative valuation model based on a PBk and a sector PBk of 0.50x, we get a fair price of 10.25c implying a 46% upside potential to the current price. The downside risks, however remains the policies of the new government that will determine accessibility of credit lines and growth in market deposits. We recommend investors to **BUY** the shares.

Disclosure appendix

Analyst Certification

The following analyst(s) who is (are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: **Tawanda Mazorodze** and **Kudzanai Samudzi**.

Important disclosures

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Additional disclosures.

1 This report is dated as at 4 September 2013

2 All market data included in this report are dated as at close of 4 September 2013, unless otherwise indicated in the report.

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