



INVESTMENT ADVISORY

“IN SEARCH OF VALUE”

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## Bank Sector Update

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The sector traditionally accounts for 10% of GDP and up to 2003 had seen real growth. This had largely been attributed to the gross imbalances in interest and foreign exchange rates, which have led to huge arbitrage opportunities. However the period since the first quarter of 2004 has been a difficult period for the sector following the imposition of tight monetary policy and regulatory controls, which gave rise to a number of institutions going under curator ship. The larger banks continue to control a significant proportion of deposits in the country owing to the ‘flight to quality’ by depositors following the sector’s well-documented problems in 2004. The listed institutions to be analysed are **ABC**, **Barclays**, **CBZ**, **FBCH**, **Finhold**, **Kingdom**, and **NMB**. For comparative purposes the two largest non-listed banks **Standard Chartered** and **Stanbic** are included in the analysis.

### Sector Statistics

Capitalisation	Total Assets	P/E	NAV Multiple	ROE	ROA	Cost/Income
Z\$4,068 trillion U\$166 million	Z\$19,431 trillion U\$793 million	1.8x	4.5x	52%	5%	60%

### Sector Recommendation: Hold/Trade

#### Additional Notes

Finhold’s Year End is September, so figures are based on interims to March ‘05; all other banks report for the year to December.

#### Holding Companies

- **African Banking Corporation (ABCH);** Includes Stockbrokers, Asset Management, and Finance House (all in Zimbabwe) Geographical spread- Botswana, Malawi, Tanzania, Zambia, Mozambique (commercial banking entities);
- **CBZ Holdings (24% owned by ABSA);** Datvest Asset Management & CBZ Bank (commercial bank);
- **Kingdom Financial Holdings;** Discount House (DCZ), Stockbrokers, Asset Management, Meikles Financial Services (51% stake), Kingdom Bank (commercial bank);
- **FBCH;** Stockbrokers, Reinsurance, Building Society, & FBC Bank (commercial bank)
- **Finhold;** Syfrets Asset Management, & Zimbank (commercial bank)

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**Balance Sheet Growth** (ranked in order of size as at 30<sup>th</sup> June 2005)

	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change
ABC	5,570,852	1,956,459	185%
StanChart	5,430,372	1,773,017	206%
CBZ	4,490,373	1,602,681	180%
Barclays	4,210,000	1,868,000	125%
Finhold	2,729,725	617,746	342%
Stanbic*	2,378,129	2,136,457	11%
FBCH	1,013,608	375,437	170%
Kingdom	925,663	822,771	13%
NMB	491,530	614,748	-20%

**\*Stanbic comparative is December '04.**

Most of the banks managed to grow their balance sheets ahead of average year-on-year inflation for the period of 137%. ABC continues to benefit from having 79% of its assets outside Zimbabwe, thus hedging itself against the depreciating Zimbabwean dollar. Generally most of local banks have resorted to holding substantial amounts of Treasury Bills, in the face of declining advances. Standard Chartered, CBZ, and Barclays had Z\$2,208 trillion, Z\$1,195 trillion and Z\$1,661 trillion respectively in Government Bills at HY1 '05. A concern is the increasing exposure to compulsory Treasury Bills, the most recent of which yield 17% over two year, penalising surpluses, and thus the larger more liquid financial institutions. For example Barclays as at HY1 '04 had compulsory Treasury Bills amounting to Z\$611 billion. NMB's performance was severely hampered by liquidity constraints, which forced the bank to access Z\$93 billion in temporary liquidity support from the Reserve Bank at penalty rates, which has since been paid back.

**Profitability** (ranked in order of % growth)

	PAT HY1 '05 (Z\$ millions)	PAT HY1 '04 (Z\$ millions)	% Change
ABC	79,990	18,493	333%
CBZ	235,739	107,194	120%
StanChart	279,834	190,021	47%
Finhold	82,734	56,702	46%
FBCH	58,436	44,161	32%
Stanbic	121,828	118,021	3%
Barclays	142,000	196,000	-28%
Kingdom	20,970	38,421	-45%
NMB	(6,770)	14,667	-146%

The general decline in profitability in the sector was borne out of declining interest rates in the period under review compared to the prior comparable period. **ABC's** solid performance was a result of growth from a low base and depreciation of the Botswana Pula (reporting currency) relative to the US dollar. The prior period had seen profits hampered by non-recurring IT and restructuring related costs. Of the exclusively local banks; **CBZ** managed a commendable growth in its asset base on the back of an increase in deposit market share as well as cost containment measures employed. **Kingdom's** return to profitability is to be noted, given that the group made a Z\$21 billion loss in HY2 '05. The group was recapitalised in Q1 '05, following the raising of Z\$100 billion from a rights offer. The group's main shareholders now include two of the largest listed local companies, namely Econet Wireless and Meikles Africa.

**Net Interest Income & Gross Interest Margins** (ranked in order of % growth in net interest income)

	<b>Net Interest Income</b>			<b>Gross Interest Margins</b>	
	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change	HY1'05	HY1 '04
ABC	248,012	120,536	106%	39%	22%
CBZ	464,174	230,593	101%	53%	51%
StanChart	541,070	374,615	44%	82%	90%
FBCH	120,888	99,832	21%	56%	71%
Kingdom	109,182	92,906	18%	38%	37%
Finhold	177,129	152,204	16%	25%	62%
Barclays	411,000	450,000	-9%	55%	82%
Stanbic	146,519	234,060	-37%	55%	91%
NMB	18,741	51,562	-64%	20%	50%
			<b>Average</b>	<b>47%</b>	<b>62%</b>

Growth in net interest income was curtailed by reduced interest rates; Treasury Bill yields in HY1 '05 averaged 95% compared to 320% in the prior comparable period. The issue of the ill-fated financial bills yielding +300% in HY1 '04 did distort net interest income and gross interest margins compared to the period under review. The phasing out of Productive Sector Financing (by HY1 '05) has also reduced another source of revenue. While Minimum Lending rates declined on the prior period; averaging 140-155%, the continued contraction of the economy suggests few economic agents are able to sustain these rates. **NMB** predictably experienced a squeeze in its gross interest margins, following access of temporary liquidity support from the RBZ. Banks, which have been able to maintain gross margins despite the changing environment, include **CBZ**, **Standard Chartered**, and **Kingdom**. Since year-end interest rates have risen to real levels suggesting that there should be margin recovery in HY2 '05.

**Other Income & Sources of Income** (ranked in order of % growth in other income)

	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change	% of Total Income HY1 '05
Finhold	120,915	20,514	489%	41%
Barclays	317,000	60,000	428%	44%
Stanbic	221,166	49,451	347%	60%
CBZ*	162,511	53,726	202%	26%
FBCH	60,823	20,683	194%	33%
Kingdom	54,553	18,764	191%	33%
StanChart	195,702	71,140	175%	27%
NMB	20,770	13,214	57%	53%
ABC	137,897	191,715	-28%	36%
			<b>Average</b>	<b>39%</b>

**\*CBZ's non-interest income in the prior period does not include Datvest Asset Management.**

The arrival of the incumbent Reserve Bank of Governor brought in a call to focus on core banking (net interest income), which has largely been heeded by all institutions. Ultimately, we believe that diversity in earnings insulate a bank from interest rate risk, and in Zimbabwe an erratic regulatory environment. The introduction of the auction system for foreign exchange in Q1 '05 has seen banks derive increasing dealing income, and the recent devaluations should see continued growth in foreign exchange related income.

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Some institutions have increasingly become acquisitive. **CBZ Holdings** acquired **Datvest Asset Management** in Q1 '05, which contributed Z\$26,847 billion to the bottom-line for the period under review. **FBCH** to the credit of management in the past 18 months has acquired a reinsurance arm (contributing Z\$26,583 billion for HY1 '05), a building society, and set-up a stock-broking unit. **Finhold's** apparent excellent growth in other income is somewhat exaggerated by a Z\$57,676 fair value adjustment.

### Operating Expenses & Cost to Income Ratio (ranked in order of % growth in operating expenses)

	Operating Expenses			Cost to Income Ratio	
	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% increase	HY1'05	HY1 '04
Finhold	195,929	51,112	283%	66%	30%
FBCH	86,569	30,704	182%	48%	25%
CBZ	140,937	62,927	124%	22%	22%
Kingdom	107,562	50,948	111%	66%	46%
Stanbic	125,699	62,539	101%	34%	22%
Barclays	273,000	143,000	91%	38%	28%
StanChart	276,541	146,947	88%	38%	33%
NMB	46,291	33,584	38%	117%	56%
ABC	252,423	216,219	17%	65%	69%
	<b>Average</b>		<b>115%</b>	<b>55%</b>	<b>37%</b>

Cost pressures have been felt most notably in the period under review as shown by the overall increase in cost to income ratios, more as a function of reduced income generation. Staffing continues to be the main cost driver; **Barclays** recorded a 151% increase to staffing costs to Z\$151 billion. **Barclay's** overall costs were not helped by a Z\$52 billion charge relating to a foreign denominated liability. **ABC** is now benefiting from its extensive restructuring exercise undertaken in 2003 & 2004. The group now has 55% of its employees outside Zimbabwe, thereby mitigating against the inherent inflationary pressures in the economy. **CBZ** maintained its cost to income ratio due to a commensurate growth in its income, as well as benefiting from its variable pay structure. **Kingdom**, while experiencing a significant rise in its to cost to income ratio, benefited from its partial disposal of its Botswana subsidiary **KBAL**, which had contributed 10% to group expenses. The upcoming period will be challenging one for banks given the significant increases in inflation since the June '05; already the sector has been awarded 132% salary adjustment for its workers.

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## Deposits & Advances (ranked in order of size of deposits as at HY1 '05)

	Deposits			Advances		
	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change
ABC	3,550,704	2,929,343	21%	1,502,804	1,798,961	-16%
StanChart	3,396,895	1,073,146	217%	753,991	513,354	47%
CBZ	3,260,425	949,514	243%	1,294,832	610,479	112%
Barclays	3,212,000	960,000	235%	670,000	340,000	97%
Finhold	1,993,120	382,178	422%	406,995	243,694	67%
Stanbic*	1,610,970	1,531,211	5%	301,768	252,540	19%
Kingdom	691,808	645,474	7%	402,417	424,886	-5%
FBCH	630,145	217,824	189%	117,234	167,627	-30%
NMB	387,164	251,177	54%	248,412	176,421	41%
		<b>Average</b>	<b>155%</b>		<b>Average</b>	<b>37%</b>

*\*Stanbic comparative is December '04.*

As highlighted earlier there has been a notable slow-down in lending given the limited opportunities in the current hostile economic environment, and the phasing out of PSF (concessionary financing). Maturity analysis of the loan books of these financial institutions reveals the short term nature of loans (overdrafts), in effect attempting to minimise credit risk. Banks have been increasingly acquiring government stock, in preference to increasing their loan books. 81% of **ABC's** deposits emanate for outside Zimbabwe. **CBZ** continues to aggressively acquire market share, and now has the second largest deposit base in the country.

## Provisioning

	Provisioning			% of Loan Book	
	HY1 '05 (Z\$ millions)	HY1 '04 (Z\$ millions)	% Change	HY1'05	HY1 '04
ABC	28,693	24,912	15%	2%	1%
Barclays	59,000	58,000	2%	9%	17%
CBZ	109,503	48,014	128%	8%	8%
FBCH	6,522	22,021	-70%	6%	13%
Finhold	1,114	30,975	-96%	0%	13%
Kingdom	18,129	2,606	596%	5%	1%
NMB	2,994	7,020	-57%	1%	4%
Stanbic	52,768	38,333	38%	17%	15%
StanChart	10,089	2,636	283%	1%	1%
			<b>Average</b>	<b>6%</b>	<b>8%</b>

Predictably the level of provisioning has shown a general decline, in light of a real decline in lending. The increased income in the prior period may have induced a certain amount of over provisioning in the period concerned. **Kingdom** and **CBZ** are the only institutions to have increased provisions in relation to their loan book. Management of both companies sited the removal of Productive Sector Funding as a key factor in increases in provisioning.

## Capital Adequacy Ratios

	CAR (Tier 1 & 2)	
	HY1'05	HY1 '04
ABC*	19.20%	-
Barclays	45%	27%
CBZ	28%	23%
FBCH	15%	32%
Finhold	-	-
Kingdom	35%	
NMB	0.15%	8.37%
Stanbic	-	-
StanChart	74%	39%

ABC\* is a regional average of its operations.

We don't anticipate any of the banks to have any problems complying with the newly announced capital requirements for commercial banks amounting to \$100 billion by September '06. We reserve our judgment on **NMB** which has yet to reveal the details of its recapitalization plans.

## Summary

The second half of the year is likely to see higher operating cost pressures compensated by increased interest income in line with the move to real interest rates by the authorities. Lending is likely to remain subdued, and financial institutions will look to their Treasuries to drive earnings. This may present itself as an opportunity for investors to trade the sector, however we anticipate the present interest rate cycle to relax in Q1' 06. The sector will continue to be exposed to erratic and often arbitrary monetary policy. Another factor is the increasing government risk undertaken by many banks, we expect monetary authorities to undertake unorthodox measures to stem the likely surge in money supply from Treasury Bill maturities in Q1 '05. The sector continues to be over banked and longer term the sector's prosperity hinges on broad economic recovery, on the back of increased disposable incomes.

## Recommendation & Valuation

	PER	NAV Multiple	ROE	ROA	EPS (+1)	PER (+1)	Target Price	Rec.
<b>ABC</b>	1.1	0.17x	34%	3%	\$1,959.22	0.56x	\$3,918.44	Accumulate
<b>Barclays</b>	7.4	3.22x	45%	4%	\$204.16	3.72x	\$1,173.92	Hold
<b>CBZ</b>	1.6	1.62x	86%	10%	\$995.42	1.21x	\$3,483.97	Buy
<b>FBCH</b>	3.6	2.17x	60%	3%	\$482.24	0.93x	\$1,687.84	Spec Buy
<b>Finhold</b>	1.4	4.03	55%	6%	\$1,370.00	3.36x	\$6,850.00	Hold
<b>Kingdom</b>	5.1	1.66	32%	2%	\$175.03	4.00x	\$988.92	Hold
<b>NMB</b>	-7.4	18.32	-568%	-3%	N/A	N/A	N/A	N/A
						<b>2.30x</b>		

## Technical Analysis

### 3IA Financial Index (Daily)



- **In a long term uptrend; year to date has seen banks stagnate.**
- **The Index is heading into an apex; a break above the ensuing resistance line would be positive, while break below support would be bearish.**

### 3IA Financial Index relative to the Industrial Index (Daily)



- **The graph shows significant underperformance by financials for the last 5 years relative to the industrial Index.**
- **The short and long term trend is decidedly bearish.**
- **A break above the 5 year support line may give an indication to a reversal in the trend.**

**Key:**

**Black Line-**

**Red Line-**

**Blue Lines-**

**Security**

**30 Day Moving Average**

**Trend lines**

**Explanation of Recommendations**

<b>Trading Buy;</b>	implies gains within the short term.
<b>Buy;</b>	expect out-performance in short and medium term.
<b>Accumulate;</b>	expect out-performance in medium to long term.
<b>Reduce;</b>	Bearish short term outlook also implies taking profit.
<b>Sell;</b>	Bearish short and long term outlook on security.

Comments and Recommendations are based entirely on technical analysis which may contradict with fundamental recommendations.

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