

PRE LISTING RESEARCH NOTE

Taking banking to another level...

Background

BancABC Botswana is a wholly owned subsidiary of ABC Holdings, a pan-African banking group with operations in 5 countries across the SADC region. BancABC Botswana is the largest subsidiary representing 34% of ABCH's asset base as of December 2017 and is Botswana's 4th most profitable bank. The bank has a full-service bank operating across three distinct business segments namely; Retail Banking, Commercial Banking and Treasury. The retail banking is key to the bank constituting the largest proportion of the Bank's current business, although there are ongoing efforts to diversify client offerings and maximize value for shareholders. BancABC's goal is to bolster its market position and become the bank of choice for individuals, corporates and public-sector entities in Botswana by offering differentiated services via technologically advanced customer interaction platforms.

Key Investment themes:

- 4th most profitable bank in Botswana and 5th in terms of assets.
- Strong card solutions with VISA integration.
- Low non -performing loan book supported by robust credit model.
- Established credit partnerships with three of the largest public sector labour unions which boost loan book growth and credit pipeline.
- Sound performance on key financial metrics ie 9.1% CAGR in operating income.
- Part of a forward thinking and innovative Africa-focused banking group – leveraging off its relationships with Atlas Mara to drive technology development, access to dollar funding etc.

BancABC Offer details	
Offer Price	P2.00
Shares in issue	725,000,000
Offer Shares	180,525,000
% of Company Offered	24.9%
Offer size	P361,050,000
Market Cap at Offer Price	P1.45bn
BSE Share code	ABC
Listing P/B	1.65x
Listing PE	9.55x
RECOMMENDATION: BUY	

4th most profitable bank

Salient Features of the Offer:

The offer price is at 200 thebe and so far Irrevocable Undertakings from institutional investors to purchase up to 113 240 547 Offer Shares and firm commitments from institutional investors to purchase up to 36 643 750 Offer Shares have been received through a Private Placement. These combined commitments, amounting to 149 884 297 Offer Shares, represent 83.0% of the Offer Shares, subject to the public offer and the final allocation of the Offer Shares. The offer opens on the 6th of November 2018 and closes on the 23rd of November. The table below shows the salient features of the offer.

Offer price at 200 thebe

Offer Timetable	
Offer opens at 0900hrs on	6 November
Offer closes at 1700hrs on	23 November
Last day of receipt of application forms with payment from subscribers	26 November
Notices of Allocation	27 November
Announcement of Results	06 December
Shares uploaded to CSDB accounts	07 December
Date of Listing	10 December
Trading of Shares commences on the BSE at 0900hrs	10 December
Refund payments if any, on before	10 December

Source: BancABC Pre Listing statement

Rationale for listing

The following are the main reasons for listing;

- Attract important stakeholders in Botswana into the shareholding of the bank which will serve the long-term interest of the ABCH Group;
- Enable the bank to attain greater access to efficient capital markets in raising local funding to support future growth plans; and
- serve as an opportunity for the Selling Shareholder to monetise part of its shareholding in the Company.

Access to efficient capital markets

Use of proceeds

A portion of the proceeds from the Offer will be dedicated to the bank's ongoing efforts to develop and enhance its IT infrastructure and banking platforms. Key investment initiatives which the bank intends to deliver in the medium term will be focused on core banking software and banking channel upgrades to support growth and improve operational efficiencies across the Group. Some of the projects includes inter alia the upgrading of the banks ATM's network, centralised card procession platform, POS procession platform etc. These initiatives are important and will go a long way in improving the banks competitiveness in the market and profitability.

Development of IT infrastructure

Background and history of BancABC

BancABC was first incorporated in 1986, as UDC (Botswana) (Proprietary) Limited. The Company underwent a series of name changes until it became African Banking Corporation of Botswana (Proprietary) Limited in 2001, when it became a subsidiary of ABC Holdings Limited, which was formed as a result of the merger of three banking groups namely UDC Holdings Limited, Bard Holdings Limited and FMB holdings Limited, under the group ABC Holdings. In 2002, ABC Holdings Limited converted into a public company and listed on the Botswana Stock Exchange and Zimbabwe Stock Exchange. In the same year, African Banking Corporation of Botswana (Proprietary) Limited changed its name to African Banking Corporation of Botswana Limited.

Incorporated in 1986 as UDC

In 2008, African Banking Corporation of Botswana Limited rebranded its operations as BancABC, after being issued a commercial banking licence. The Bank to this day carries on business under the registered business name of BancABC. The bank was the first to introduce chip and pin EMV cards in 2011 and entered into a partnership with Botswana Life Insurance Limited on payments solutions in 2013. By 2014, BancABC had opened 8 branches, and achieved a partnership with public sector union schemes to scale its retail banking business.

Commercial banking licence in 2008

Acquisition by Atlas Mara Ltd

In 2014, Atlas Mara, a London Stock Exchange (“LSE”) listed financial services group, acquired ABCH, BancABC’s parent, along with other ABCH subsidiaries. Following the acquisition, ABCH delisted from both the Botswana Stock Exchange and Zimbabwean Stock Exchange. In the year 2016 the bank was rebranded as “BancABC, part of Atlas Mara”. To date Atlas Mara has banking operations through its subsidiaries and affiliates across seven markets in Sub-Saharan Africa: Botswana, Mozambique, Nigeria, Rwanda, Tanzania, Zambia and Zimbabwe.

Acquired by Atlas Mara in 2017

Investment Case

BancABC has a remarkable success story in Botswana and has a track record of innovation. It is the first bank in the market to introduce Chip and Pin Visa Cards. The bank pioneered 100% mortgage lending in the Botswana market and is the market leader in Prepaid cards in the industry. In addition the bank has received several awards from various financial institution in recognition of the strong growth achieved over the past years. Below are some of the tail winds for BancABC.



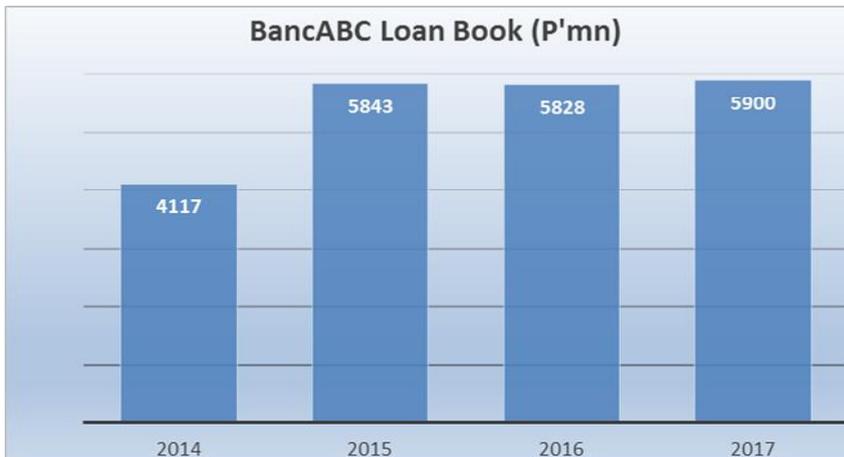
a. Niche challenger bank with significant growth potential

BancABC is the 5th largest bank in Botswana by assets. The bank currently provides a range of banking services to over 60,000 customers through its growing distribution network of branches, VISA enabled ATMs access points, online and mobile banking platforms. BancABC continue to aim to grow its market share in order to become one of the leading financial services businesses in Botswana. As at July 2018, the bank had 9.7% of total assets, 10.6% of loans and 9.9% of deposits within the Botswana commercial banking sector. The banks’ Capital Adequacy Ratio (CAR) stands at 19.4% and positions the bank with a robust capital base which will support its balance sheet growth in the medium term. The loan book has been growing at a CAGR of 10% over the past 4 years and is the 5th largest book in the market.

CAR at 19.4%

b. Growing loan book

BancABC loan book has been growing at a CAGR of 10.5% over the past 4 years and is the 5th largest book in the market.



Loan book growing at CAGR of 10.5%

Source: BancABC Financials

We expect BancABC loan growth to increase further as the bank leverages its partnership model experience to attract new schemes. The continued growth of the balance sheet will have a direct impact on the bank's net interest income and profitability.

c. High quality loan book

BancABC maintains a high quality loan book. NPLs have declined from 4.2% in FY2016 to 3.6% in FY2017 with an average NPL ratio of 3.7% between 2014 and 2017. The ratio is below the industry average of 5.3% as at December 2017.

NPL's down to 3.6%



Source: BancABC Financials

The banks credit loss ratio has fallen to just 0.8% in 2017 from 1.3% in 2016 reflecting BancABC's robust credit model and risk management framework as well as the ability to deduct loan repayments directly from customer salaries through the deduction code.

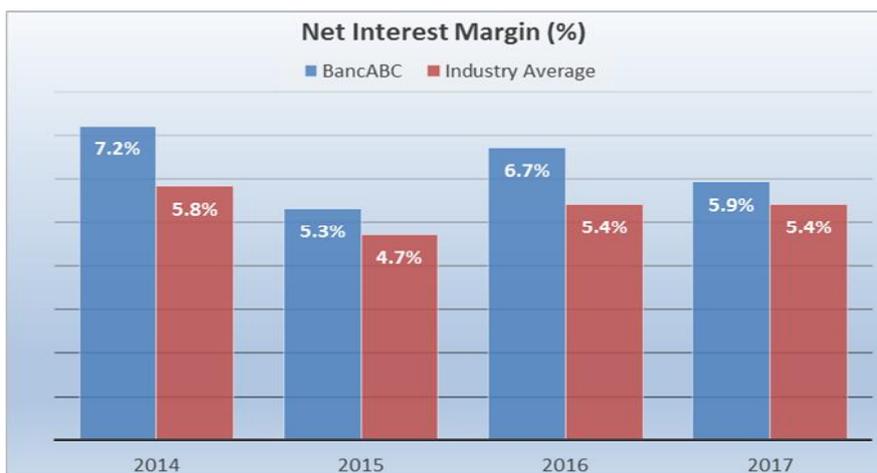
Credit loss ratio at 0.8%



Source: BancABC Financials

d. Profitable bank with competitive NIM's

BancABC is the 4th largest bank in Botswana with net interest margin (NIM) of 5.9% (FY17), although its below the 2016 margin of 6.7%. It is interesting to note that this is higher than the industry average of 5.4%.



Competitive NIM's

Source: BancABC Financials, Bank of Botswana Banking Supervision Annual Report (2017)

The decline in NIM's from a peak of 7.2% in 2014 is in line with the trend in the industry and reflects the cut in the bank rate by the Central

Bank. It also reflects the increased cost of funding as well as reduced lending rates for union customers based on renewed contracts.

e. Key Financial Metrics – Scores well

Operating income have grown at a compounded annual growth rate of 9.1% against a stable to flat loan book growth over the past 4 years. RoE has grown at an annualized rate of 19.2% as at 30 June 2018 while RoA have grown at an annualized rate of 2.4%.

RoE and RoA at 19.2% and 2.4%

Key Performance indicators

	2017	2016	2015	2014
Gross yield	13.4%	14.3%	14.7%	14.7%
Cost of funding	5.9%	3.7%	5.3%	5.3%
Net interest margin	5.9%	6.7%	5.3%	7.2%
Cost to income ratio	62.1%	57.1%	69.7%	56.5%
Credit loss ratio	0.8%	1.3%	0.1%	2.7%
RoA	1.7%	2.7%	2.2%	2.2%
RoE	14.0%	20.2%	17.3%	8.1%
Loans to deposits	95.6%	83.9%	92.0%	82.4%
NPL ratio	3.6%	4.2%	3.3%	3.9%
Coverage ratio	44.0%	57.1%	60.1%	82.1%
Capital adequacy	19.8%	20.2%	15.7%	17.6%

Source: BancABC Prelisting statement

f. Partnership with key stakeholders

BancABC has created partnerships with some of the key institutions such as three of the largest public labour unions. The bank recently renewed its principal union contracts for a further 3 years with civil service unions, representing 76% of the loan book. The agreements are important as they will ensure the continued growth of the loan book and credit pipeline. These agreements have been in place for over 7 years with the deductions done at source helping to minimise impairments. Challenges will only arise if these agreements are renewed at less favourable terms or not renewed altogether. In addition, trade union clients may decide not to use the banks ancillary

Key partnerships...

services, such as funeral insurance cover, and instead use a third party agents. This would lead to a decline in non-interest income to the bank.

Headwinds and challenges

a. Low contribution from non-interest income

BancABC lags the industry in terms of non-interest income. This revenue stream is key especially in the current environment where interest rates are at ultra-low levels. Some commercial banks are able to cover their non-interest expenses with non-interest income. For example FNBB non-interest income/total income stands around 45.7% while for BancABC its around 18.8%. The industry average is 38.5% according to Bank of Botswana 2017 Banking Supervision Annual Report.

Non interest income
low

b. Higher cost to income

BancABC cost to income ratio of 62.1% is above the industry average of 59.9% and we believe the bank has scope to reduce operating cost. investment in IT infrastructure will bear fruits in the long term through income growth and improved efficiencies which will help bring costs down. Management are targeting a cost to income ratio of less than 55% in the medium term which we believe is attainable.

c. Loan book composition

The composition of BancABC loan book is more skewed towards consumer lending at 73%. The corporate and lending book make up 15% and 10% respectively. The large part of the loan book is unsecured personal loans. However, the bank collects over 96% of all repayments directly through deduction codes and this model has worked very well for other micro lenders such as Letshego. There is need for the bank to diversify its loan book to manage this risk. This can be done through growing the book from the corporate sector, SME's and mortgage lending. The biggest concerns in the banking sector is the high levels of households indebtedness and diversifying the book from the household will go a long way in managing this risk. Vehicle and asset finance is another area that the bank needs to focus

Loan book skewed to
the retail sector

on as currently it doesn't have a presence at car dealerships in Botswana.

d. High cost of funds

As at December 2017 BancABC cost of funding stood at 4.0% and is relatively higher than its competitors. This is because the bank's deposit base is mainly comprised of institutional clients and these are mostly short term deposits that are somewhat costly as compared to retail deposits. In addition competition is very intense for this type of funding and this all reduces margins. It is therefore imperative for the bank to diversify its funding streams and attract more deposits from the retail sector which is less costly.

High cost of funding

Valuation and Model

Key assumptions and factors affecting the valuation.

- i. Deposits to grow at an average rate of 5.5% p.a.
- ii. The loan book to grow at a conservative average rate of 3% on the back of loan growth initiatives which are being implemented such as signing of new group schemes, introduction of credit cards and advances to the corporate sector.
- iii. Average cost of funds to decrease by between 0.2% and 0.6% in 2019 and the medium term due to the normalisation of market liquidity and cheaper source of funding mostly from the retail portfolio.
- iv. Credit impairments to remain below 3%.
- v. The cost to income ratio to remain on the high side averaging 58% over the next two years before stabilising at 55% in the medium term driven by cost savings from IT investments.

Valuation Methodology.

We compared BancABC valuations with its major competitors such as FNBB, Barclays and StanChart. With an implied Price to Book multiple of 1.65x this is below BancABC competitors such as FNBB (1.93x) and Barclays Bank Botswana (2.38x). In terms of the PE, BancABC has a PE of 9.55x which compares favourably with FNBB (9.2x) and Barclays bank (10.2x). The valuation and implied multiple compares favourably

Favourable valuations

with its peers and is within range with the PE coming in at a discount to the big players in the industry. Using the Dividend Discount Model (DDM) and the relative market multiple valuations we assign a **BUY** recommendation on the offer.

Assign a **BUY** recommendation

Buy	Hold	Reduce	Sell
Sustainable Fundamentals	Balanced	Trading at a Premium	Weak Fundamentals
Strong Opportunities and Growth	Stable Growth	Growth in the long term	Threatened Outlook
Undervalued	Par Valued	Overvalued at current levels	Over Valued

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Disclaimer:

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Addendum - Curriculum Vitae of BancABC Directors

LORATO MOSETLHANYANE (Bcom Commerce) (MBA) (46) – Non-Executive Director

Lorato Mosetlhanyane is a Certified Professional Integral Coach, having successfully completed the Professional Coaching Course (PCC) through the Centre for Coaching who partners with the Graduate School of Business at the University of Cape Town and New Ventures West (NVW) based in San Francisco. For the past five years as a full time Coach, Lorato has worked to coach and train both young and mature leaders, locally and internationally. Lorato brings a wealth of experience to the BancABC board, having worked as an Accountant at different levels across different industries for over seventeen years. She left the corporate world five years ago as Chief Finance Officer of the leading life Insurance company in Botswana, having contributed to the growth and success of the company. Lorato is a Fellow member of the Association of Certified Chartered Accountants (FCCA) and also holds a Master's in Business Administration (MBA) from Oxford Brookes University in the UK. Lorato currently serves in the board of G4S, a security company listed on the Botswana Stock Exchange.

JACOB MOOKETSE MOTLHABANE (Bcom. Accounting) (46) – Non-Executive Director

Mr. Motlhabane holds a Bachelor of Commence in Accounting from the University of Botswana and he is currently pursuing a Masters of Business Administration at Mancosa in Botswana and Certificate in Management Accounting from the Chartered Institute of Management Accounting. Mr. Motlhabane is the Head of Private Equity at African Alliance in Botswana and was previously the Chief Executive Officer of Turnstar Holdings, a property company listed on the Botswana Stock Exchange. Mr Motlhabane chairs the audit committee, and also seats in the credit committee and the loans review committee.

ADAMS CHILISA DAMBE (Diploma in Hotel Management) (69) – Non-Executive Director

Mr. Dambe is the Chief Executive Director of Gradam Holdings, a tourism company in Botswana and a Director of Chobe Holdings Limited, which owns and operates eco-tourism lodge camps in Botswana and Namibia. Mr. Dambe holds a Master of Arts in Business Administration from Kensington University in California, USA and a Bachelor of Science. He also holds a diploma in Hotel Management from Kenya Utalli College in Nairobi and an advanced Diploma in Labor Relations from UNISA Business School of Leadership. He has also completed an Industrial Relations Development Programme at StellenbUniversity, South Africa, and an Anglo-American Management Programme at UNISA School of Business. Mr Dambe chairs the remuneration committee and seats in the loans review committee, audit committee and the credit committee.

JOSHUA BENJAMIN GALEFOROLWE (Bcom Acc) (66) – Non-Executive Director

Mr. Galeforolwe has an established track record of over 35 years' experience in large scale performance and process improvement, leadership and strategic management, formulation of policies, development of privatisation implementation strategies. He is a former General Manager of Air Botswana as well as CEO of PEEPA. He is a Managing Consultant for West Cliff Capital (Pty) Ltd, a corporate advisory and management consultancy company in Botswana and holds a BCom in accounting from Makerere University, in Kampala, Uganda and has completed Part 1 of BA in Economics at the University of Botswana and a Management and Development Programme at the University of Pittsburg. Mr. Galeforolwe seats in the risk and compliance committee, audit committee, loans review committee, board credit committee and the remuneration and nominations committee.

KGOTSO BANNALOTLHE (Bcom) (ExMPLS) (39) – Executive Director

Mr Bannalotlhe is the Managing Director of the Company and was first appointed as such on 7 August 2017. Kgotso has an established track record at Executive Level in the Banking industry. He joined the Bank from Barclays Bank Botswana, where he served as Head of Corporate and Investment Banking for four years. Prior to this, he held several positions including Barclays Country Treasurer and Head of Markets. He has also worked for Standard Chartered Bank Botswana and Tanzania as Head, Assets and Liabilities Management, and Head of Financial Markets/Co-Head for Wholesale Banking, respectively. Kgotso began his career with First National Bank Botswana. He holds a Bachelor of Commerce from the University of Melbourne and Executive Masters in Positive Leaders and Strategy (ExMPLS) from IE University, Madrid, Spain. Mr. Bannalotlhe has completed level 1 of the CFA program.

BEATRICE HAMZA BASSEY (LLB) (46) – Non-Executive Director

Ms. Hamza Bassey joined Atlas Mara as Group General Counsel after almost two decades representing a roster of multi-national corporate entities in compliance and corporate governance matters. Prior to joining Atlas Mara, Beatrice was a partner in the New York office of the Wall Street firm Hughes Hubbard & Reed where she was chair of the firm's Africa Practice Group and member of their Executive Committee. She has represented numerous financial institutions and represented the Trustee of the liquidation of Lehman Brothers Inc., the largest broker-dealer liquidation in the United States where she led the recovery and return of the multi-billion Dollar customer estate to customers of Lehman Brothers. Beatrice has won many awards and garnered many accolades for her work by various African, US and International media, and has been profiled by Forbes Africa and CNN's African Voices, as a top African lawyer. She obtained her law degrees from the University of Maiduguri, Nigerian Law School and Harvard Law School, Cambridge, Massachusetts. She sits in the risk and compliance committee, loans review committee and the remuneration and nominations committee.