Chief financial officer's report

In a demanding economic environment, our key performance indicators show that, for the most part, our strategies have been successful.

The past financial year saw significant improvement in insurance operations and a low impairment charge on advances. Group headline earnings for the year rose by 21% to N$428 million (2009: N$353 million). Profit increased by 25% to N$459 million (2009: N$367 million).

Earnings per ordinary share increased by 22% to 166.1 cents (2009: 136.1 cents). Return on average equity was 24% (2009: 23%). The group's cost to income ratio improved to 49% (2009: 51%).

The group has three main operating entities: FNB Namibia Banking Group ("FNB"); Momentum Life Assurance Namibia Ltd ("Momentum Life"); and OUTsurance Insurance Company of Namibia Limited ("OUTsurance"). All three were profitable.

FNB grew profit by 17% from N$317 million to N$370 million. This solid performance reflects a combination of factors, including a low impairment charge, reasonable growth in advances and deposits and higher transactional volumes.

Momentum Life's profit increased by 70% to N$56 million (2009: N$33 million). This was mainly due to a recovery in investment returns in the shareholders portfolio and on non-linked liabilities, together with the profit from insurance activities. At the end of the previous financial year Momentum restructured its shareholders' asset portfolio to protect against market volatility. The portfolio has improved as a result.

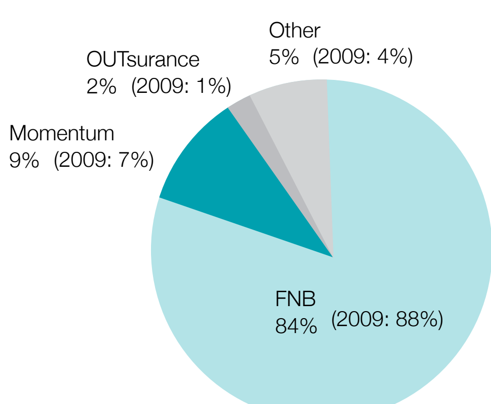
OUTsurance's profit increased to N$8 million (2009: N$2 million). Performance exceeded expectations due to increased sales, lower loss ratios and operational efficiencies.

The chart below illustrates the contribution by each segment to profit before tax. The "other" segment reflects other group companies and group accounting consolidations.

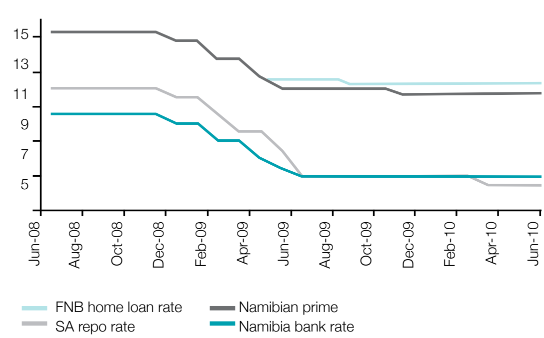
Statement of comprehensive income

Interest income

FNB generates 94% of the group's net interest income. Its net interest income grew by 9% to N$760 million (2009: N$695 million). This was almost in line with the increase in average advances. It was achieved against a background of lower interest rates which had a negative endowment effect. Furthermore, FNB implemented the Bank of Namibia requirement to reduce the margin between prime and repo rate by 50 basis points by the end of October 2009.The negative impact of reducing the prime rate was countered by a reduction in the cost of funds. This came about mainly because the Namibian repo rate was aligned with that of South Africa, and because the home loan base rate was 50 points higher than prime for most of the year, illustrated below.



Interest rates (%)



Impairment losses

	2010		2009	
	N$ million	% average advances	N$ million	% average advances
Specific impairment	10.9	0.1%	16.1	0.1%
Present value of security of non performing loans	7.2		17.2	0.2%
Total specific impairment	18.1	0.1%	33.3	0.3%
Portfolio impairment	(5.1)		5.1	0.1%
Impairment losses of advances	13.0	0.1%	38.4	0.4%

The components of the impairment charge are summarised in the table above.

A combination of lower interest rates, a consistent and sound lending policy and efficiency in the newly centralised legal department culminated in a significantly lower impairment loss on advances. The impairment charge of N$13 million represented a N$25 million improvement on the prior year.

Non interest income

Non interest income increased by 49% to N$644 million (2009: N$433 million). Individual segment contributions were:

N$ million	2010	2009	% change
FNB	554	491	13%
Momentum	70	(73)	196%
OUTsurance	5	6	(17%)
Other	15	10	50%
	644	433	49%

The table illustrates that Momentum's turnaround on investment portfolios was the major element contributing to growth.

FNB increased non interest income by 13%. Fees and commission increased by 20% due to increased volumes and expanded retail network delivery channels. Average price adjustment was in line with inflation. Foreign exchange trading income increased by 12% to N$67 million (2009: N$60 million). The relatively strong Rand/N$ put pressure on foreign exchange trade.

Momentum Life increased non interest income (excluding premium income) by 196% to N$70 million (2009: N$73 million negative) mainly because investment portfolio returns improved as equity markets recovered. A significant portion of the policyholder liabilities is matched by assets, so improved investment returns on the linked policyholders portfolio is also the main contributor to the increase in policyholder liabilities of N$38 million (2009:N$72 million decrease) as reflected in the statement of comprehensive income.

Net insurance premium income grew by 22%, of which Momentum Life contributed 75%. Momentum's premium income increased by 17%, reflecting increased sales and brand visibility. The launch of the Myriad product range has opened up the higher end of the market. New business sales increased by 22%, mainly as result of Myriad and the agency sales force.

OUTsurance premiums increased by 41%, maintaining a trend reported in the prior year. The growth is mainly attributable to personal lines products which started from a low base.

Net claims and benefits paid increased by 14% to N$143 million (2009: N$125 million). Momentum Life, with a 9% increase, contributed the bulk of it, while OUTsurance increased by 31% to N$38 million. OUTsurance's increase should be viewed against the background of new business strain from the personal lines products, which showed significant growth in premium income. However there has been an improvement in its loss ratio.

Operating expenses

Operating costs rose from N$694 million to N$803 million, a 16% increase year on year. This included substantial IT expenses in localising core banking systems and the accelerated amortisation of the Swabou Bank trademark. These were partially offset by the recognition of the pension fund surplus attributable to the group as an employer which eased staff costs.

The focus on cost control was maintained throughout the year. Although operating costs rose by more than average inflation, the investment in infrastructure will bring future benefit.

Tax

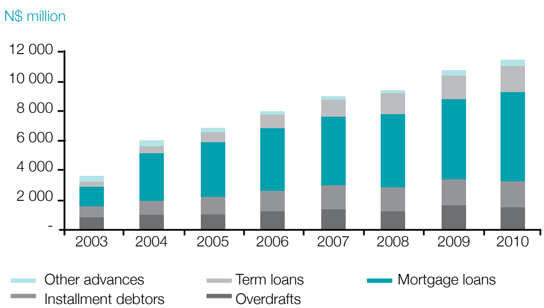
Indirect tax increased by N$7 million to N$20 million, mainly because value added tax increased in line with expenses and stamp duties rose, driven by volume.

The group's effective tax rate decreased to 31% from 33% in 2009 because corporate tax dropped from 35% to 34% during the year, as well as an increase in non-taxable income relating to the insurance operations.

Statement of financial position

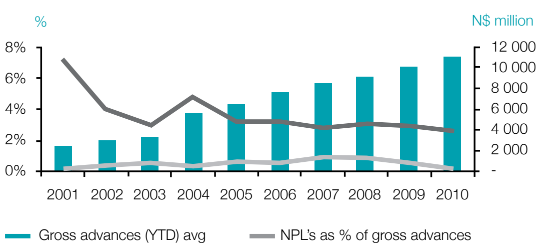
Total assets increased by N$1.8 billion to N$15.9 billion – a year on year growth of 13%. FNB's advances showed reasonable growth, reflecting uncertainty in the economy. Average year to date gross advances grew by 10%, which was in line with the national trend in private credit extension. Year-end advances increased by 7%. Mortgage advances, exceeding 50% of total advances, grew by 7% and FNB retained its position as market leader.

Advances composition



The ratio of non performing loans to average gross advances continued to improve, reducing to 2.6% (2009: 3.2%). Non performing loans reduced by 10% year on year to N$279 million (2009: N$309 million). The healthy trend is illustrated in the chart below.

Gross advances vs non performing loans and impairment charge



The increase in investment securities reflected the liquid asset requirements for FNB and Momentum Life investment portfolio. The FNB portfolio shows a shift from deposits that also qualified as liquid assets to investment securities and increased by N$573 million. Momentum Life's portfolio grew by N$321 million.

Reinsurance assets decreased by N$237 million to N$50 million as a result of a new reinsurance agreement.

Deposits increased by N$1.4 billion. This 14% growth is in line with assets growth. Wholesale funding continued to be the dominant source.

Policyholder liabilities increased due to new business and improvement in the investment values on the linked portfolio.

Dividend policy

The group has maintained the 2.4 times dividend cover on profit attributable to ordinary shareholders. This results in a total distribution for the year of 67 cents, up by 20%.

Capital Management

Banking Group

The optimal level of capital in a banking institution is determined by balancing the requirements of the regulator, the shareholders, deposit holders and debt holders.

Principles

For a banking institution, capital serves as a foundation for growth and a cushion against unexpected losses. It mitigates economic risk that might otherwise threaten its continuation or lead to loss of faith by stakeholders. It is the policy of the bank to be capitalised at the higher figure of economic capital or regulatory capital inclusive of a buffer.

Economic capital is defined as the capital which the banking group must hold, commensurate with its risk profile, under severe stress conditions, to give comfort to third party stakeholders that it will be able to discharge its obligations in accordance with an indicated degree of certainty even under stress conditions, and would continue to operate as a going concern. Tests are performed regularly to assess whether the bank is appropriately capitalised.

Demand for capital

The Bank of Namibia ("BoN") requires banking institutions to hold a minimum amount of capital equal to, or more than, 10% of the calculated risk weighted assets. During the year under review, BoN implemented guidelines developed by the Basel Committee on Banking Supervision – Basel II as provided for in terms of the Banking Institutions Act 1998 (Act No. 2 of 1998) for supervisory purposes. The guidelines include the techniques to calculate capital adequacy ratio as a key prudential measures.

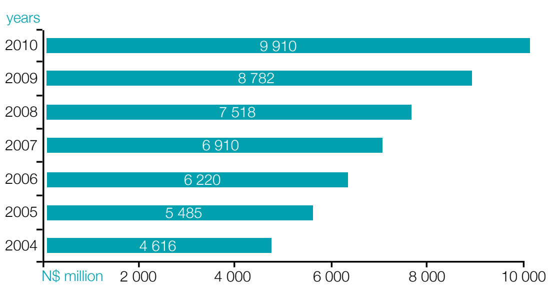
First National Bank of Namibia Limited is required to determine its capital adequacy ratio using the standardised approach. The guidelines provide a range of options for determining the capital requirements for credit risk, market risk and operational risk to allow banks and supervisors to select approaches that are most appropriate for their operations and their financial market infrastructure. In addition, the guidelines also allow for a limited degree of national discretion in the way in which each of these options may be applied, to adapt the standards to different conditions of national market.

With the options available, BoN opted for the standardised approach to be applicable to all the banks under its jurisdiction. The standardised approach is less risk sensitive as compared to internal ratings based approach ("IRB") which has incentives in terms of capital relief but not necessary suitable for the Namibian financial market.

The main changes between the old and newly adopted guidelines lie in the calculation of risk weighted assets and the closer alignment of capital levels to true underlying economic risks. Compliance with Basel II guidelines revealed that there is no material increase in our current economic capital estimates or minimum regulatory levels.

As a subsidiary of a South African Banking Group, where the principles of Basel II were adopted on 1 January 2008, First National Bank of Namibia Limited has complied with the standardised approach to calculate capital for credit, market, equity and operational risks, currently requiring a minimum of 9.75% by the SARB method of calculating risk weighted assets.

The following graph depicts the growth in risk weighted assets since 2004:



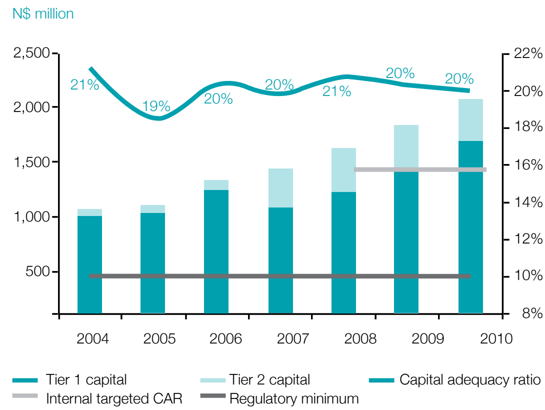
Supply of capital

As the bank generates earnings that are adequate to meet new capital requirements, the focus of management is on arriving at the most cost-effective capital structure. The relatively higher cost of capital, as against debt, means capital levels have to be managed to the minimum required, thus increasing the true economic value added to shareholders.

The implementation of the Basel II principles has allowed current year profit to form part of qualifying capital once appropriated by the board on quarterly bases. Maximum exposures to single borrowers are linked to the capital base. This results in the determination of maximum exposure being reviewed quarterly and could facilitate balance sheet growth during the year.

The board of directors approved a 5.5% buffer above the 10% minimum level determined by the Bank of Namibia. The buffer is also influenced by economic capital requirements.

The following graph depicts the capital adequacy ratio and internal target:



Dividend payment

The banking group declared an interim dividend of N$74 million in February 2009 and a final dividend of N$94 million in August 2010.

Capital adequacy of the banking group on 30 June

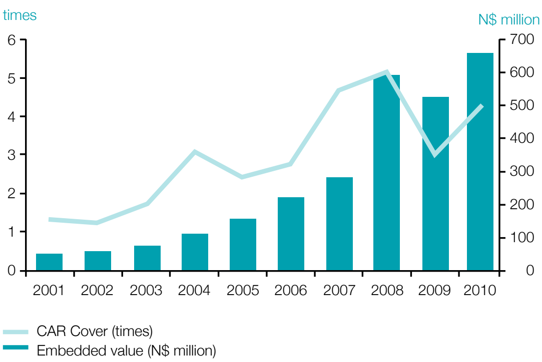
N$ million	BII 2010	BI 2009
Risk weighted assets		
Credit risk		
Portfolios subject to Basel II	8 474	
Portfolios subject to Basel I		8 782
Market risk		
Standardised approach	25	
Operational risk		
Standardised approach	1 411	
Total risk weighted assests (RWAs)	9 910	8 782
Regulatory capital		
Tier 1		
Share capital and share premium	1 143	1 143
Retained profits	756	491
Capital impairment: intangible assets	(241)	(261)
Total tier 1	1 658	1 373
Tier 2		
Eligible subordinated debt	260	260
General risk reserve, including portfolio impairment	106	152
Total tier 2	366	412
Total tier 1 and tier 2 capital	2 024	1 785
Capital adequacy ratios		
Tier 1	16.7%	15.6%
Tier 2	3.7%	4.7%
Total	20.4%	20.3%

Insurance operations

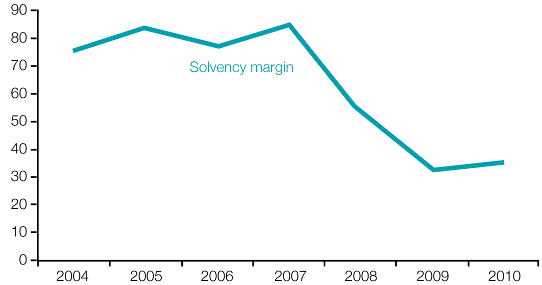
Momentum's policy is to invest capital required for the capital adequacy requirement ("CAR") in cash or near cash instruments. The objective is to ensure a sufficient excess of assets over liabilities to guard against severely negative conditions in future. When the Momentum transaction was approved, the court determined that a CAR cover of 1.5 times should be maintained. In terms of the revised capital management framework of Momentum, the company will maintain a buffer of 0.4 times above that minimum.

The CAR of Momentum is N$81.0 million (30 June 2009: N$94.8 million). Free reserves cover the capital adequacy requirement 4.3 times (30 June 2009: 3.0 times). Momentum did not declare a dividend during the year (2009: N$100 million).

The embedded value increased to N$659 million (2009: N$526 million). The value of in-force increased by 21% to N$363 million (30 June 2009: N$301 million) and the value of new business was N$76 million (30 June 2009: N$59 million).



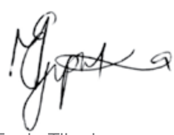
OUTsurance's capital adequacy is measured by the solvency margin that is the free reserve ratio of shareholders' funds expressed as a percentage of net premium income. The company targeted solvency margin range is between 25% and 50%, while the regulatory minimum is 15%. The solvency margin at 30 June 2010 was 35% (2009: 32%), a sound and healthy position. OUTsurance declared a dividend of N$5 million in August 2010.



Conclusion

The signs of recovery in the global economy are encouraging, but its sustainability is uncertain. Domestically the economy remains influenced by external events. Encouraging trends are emerging in new vehicle sales as consumer confidence returns. According to the FNB housing index, house sale volumes are edging higher, pointing to some recovery towards the end of 2010. The group does not foresee major downward risk and expects interest rates to remain benign for longer, supporting recovery in 2011.

Against the background of anticipated regulatory pressure and pressure on interest and non interest income, the focus remains on improving efficiencies and cost management. Mechanisms are being put in place to limit the impact of these pressures. The group will continue its strategy of growing profitable business while taking into account the risks involved. It intends to create long-term value for stakeholders.



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