First Merchant Bank

ANNUAL REPORT 2001

Contents

Senior Management

Head Office

Chief Executive Officer
Kashinath Chaturvedi

General Manager
Seetharaman Srinivasan

Regional Development Manager
Kersy H Kavina

Head, International Banking
Thomas Kadantot

Information Technology Manager
Kumbakonam Ramankrishnan

Human Resources and Administration Manager
Indira Sharma-Surtee (Mrs)

Senior Finance Manager
Gayatri Kamath (Mrs)

Credit Control Manager
Alex Chigwale

Internal Audit and Inspection Manager (Acting)
George C Pemba

Finance Manager
Vilipo Munthali

Branches

Blantyre

Chief Manager
Ravindra Kamath

Operations Manager
Anna Mafuleka (Mrs)

Limbe

Chief Manager
Ranjit Mehta

Operations Manager
Slyvester Nkwanda

Lilongwe

Chief Manager
(Vacant)

Operations Manager
Evance Bamusi

Capital City

Chief Manager
Friday Chalamba

Mzuzu

Branch Manager
Evelyn Malongo (Mrs)

Chairman's Statement

I am pleased to announce that 2001 was another successful year for the Bank with growth exceeding projections in all key areas, in spite of a rather difficult operating environment.

Overview of the economy

Real growth in gross domestic product is estimated at 1.8% in 2001 compared to 2.1% in 2000. The deceleration is attributable to a slower rate of growth in the agricultural sector and contractions in the manufacturing and professional services sector.

Sustained economic growth at a much higher level is required to enable the country to achieve its objective of reducing poverty. Appropriate policies must be adopted to encourage direct private sector investment in Malawi and spur economic growth. In 2001 total investment was estimated at 12.8% of gross domestic product. However, most of this investment was by the public sector supported by donor funding, for example the ongoing rehabilitation of the country's road network.

The recent withdrawal of Danish aid and reservations expressed by other donors are of concern. It is hoped that these setbacks will only be temporary.

The annual average inflation rate in 2001 was 27.5%, slightly down on the average rate of 29.5% recorded in 2000, but considerably above Government's inflation rate targets. A serious shortage of cereals, in particular the staple food maize, resulted in food price increases in the latter part of the year.

In order to control inflation, Reserve Bank of Malawi focused on management of money supply through the issue of Reserve Bank bills to mop up excess liquidity in the market. Yields on these instruments and on treasury bills, although relatively stable throughout the year, remained high. As a consequence, bank lending rates were also stable during the year. At the year's end our base lending rate was 45%, very similar to rates offered by other financial institutions.

For most of the year supply of foreign exchange exceeded demand enabling the country to build up levels of foreign exchange reserves and causing the Kwacha to appreciate in value against all major trading currencies. However, towards the end of the year, foreign exchange inflows reduced, partly due to the expected decline in export earnings following the end of the agricultural season and partly due to an appreciable reduction in the level of support received from donors. As a result, gross foreign exchange reserves declined to 3.5 months of import cover by year end.

Performance Highlights

The Bank has been successful in increasing its market share in all its areas of operations. By the end of the year, total assets of the Bank had increased to over MK3.5 billion.

During the year the deposits recorded a very impressive increase of 105%. This growth was derived from a broad customer base comprising numerous depositors throughout the country.

The substantial increase in our deposit base could not be matched by a corresponding growth in our credit portfolio which increased by 40% to K620 million. The prevailing economic environment, especially the absence of growth in the manufacturing sector, resulted in reduced demand for facilities from creditworthy borrowers.

The overall quality of our advances portfolio remains good and provisioning in excess of the Reserve Bank guidelines has been maintained. In addition to specific provisions against identified doubtful advances, our policy remains to build up the level of non-specific provisions to cater for any unidentified risk which may be present in our advances portfolio. A further K12 million has been set aside from profits to non-specific provisions which now approximate 5% of our net advances portfolio.

Profit after tax for the year was K164 million, an increase of 67% over the prior year. As at 31 December 2001, the capital base of the Bank, comprising share capital and retained earnings, increased to K243 million.

Our capital to risk based asset ratio of 21% comfortably exceeds the prescribed minimum of 10% thus providing ample opportunities for furthering the lending activity.

Information Technology

To improve customer service, the Bank has installed more powerful Oracle based banking software, "Flexcube". The new software has now been successfully implemented throughout the Bank and, from 2002, we will offer customers a number of information technology related products.

New products

In May 2001, the Bank introduced a 'Gold Savings Account', a new product with many attractive features that has been very well received by the market. From September 2001 customers have been issued with cheque guarantee cards with limits of K5,000, K10,000 and K20,000.

Human Resources

At 31 December 2001 our total staff complement was 222. We regard our human resources as our most important asset and remain fully committed to the welfare and development of our staff. During the year, the Bank conducted a programme of in-house courses on various aspects of banking and 118 members of staff attended these courses. In addition, 32 employees attended training courses offered by external institutions.

Donations

The Bank recognizes its social responsibilities and supports a number of worthy causes. During the year the Bank paid school fees of needy students at several secondary schools and made donations to Montfort Resource Centre for the Blind, Malawi Against Polio, Mount View Primary School, International Eye Camp Project, Madalitso Orphanage and Open Arms Infant Home.

Acknowledgements

The Bank owes its success and progress achieved so far to its customers. I wish to thank all our valued customers for their support during the year and assure them that we shall continue to provide excellent service based on sound banking principles.

I take this opportunity to express my gratitude to my colleagues on the Board for their invaluable counsel throughout the year.

Our overseas correspondents and all the domestic financial institutions have supported us throughout the year and I convey my sincere thanks to them.

I also place on record my appreciation of the support and guidance of Reserve Bank of Malawi.

Finally, I would like to thank the management and members of staff for their continued dedication and commitment to customer service.

R. C. Kantaria
Chairman

Customers

Carnival Furnishers

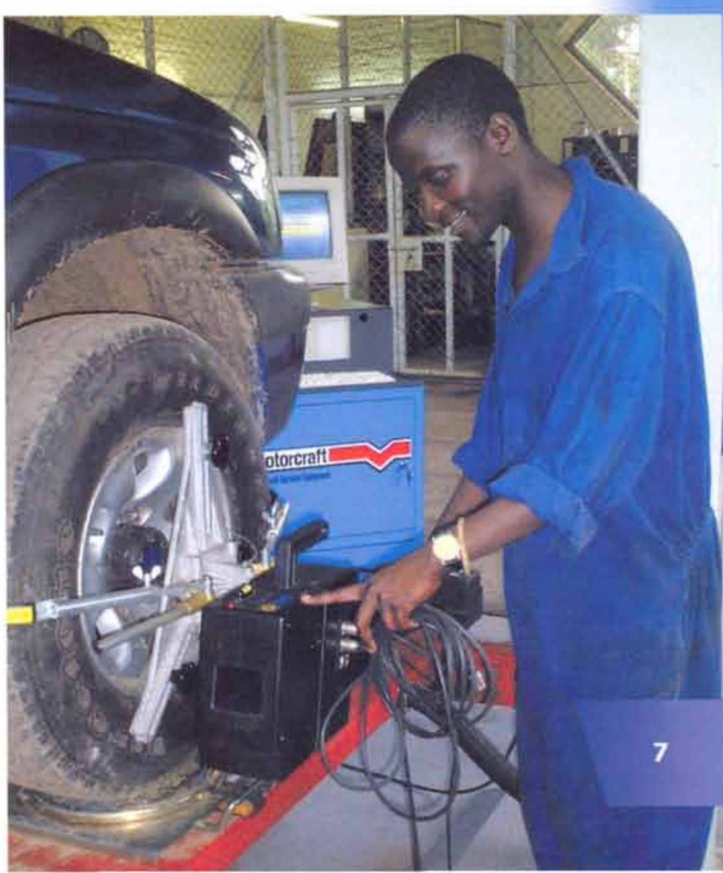
International Haulage Broke

Fresco/Maxi Egg

Multichoice, Malawi

Agora

Mandala Automotive



Economic Review

THE WORLD ECONOMY – YEAR 2001

The global recession already in evidence in 2001 was exacerbated by the 11 September terrorist attacks in New York. As a result world GDP growth is only expected to have grown by 1.5 percent in 2001, however trade is expected to recover slowly from mid-2002 – fueled initially by an economic recovery in the USA.

The following regional factors are worth noting:-

1. Asia

The acceptance of China to the World Trade Organisation should create a huge market for goods and services. However the after effects of the Afghanistan turmoil and simmering tensions between India and Pakistan over the Kashmir's issue continue to cloud the horizon. Japan remains in recession and will need urgent structural reform.

2. Europe

The introduction of the Euro throughout 17 European countries should stimulate trade. Structural reforms will need to be implemented urgently, particularly in Germany, for growth to increase substantially.

3. Latin America

The recent financial crisis in Argentina might well de-stabilize the economies of neighbouring countries and indeed those of other developing nations.

4. Africa

The political crisis in Zimbabwe over the land is ongoing and observers await the outcome of the March 2002 elections. The Zimbabwe issue has and is expected to continue to reverberate negatively in the Central and Southern African Regions.

THE DOMESTIC ECONOMY

In the year 2001, real Gross Domestic Product (GDP) is estimated to have increased by 1.8 percent compared to 2.1 percent in the year 2000. The deceleration is due to a slower growth in the agricultural sector, and contractions in the manufacturing and professional services sector. Total investment as a percentage of GDP is estimated at 12.8 percent in the year. The bulk of investment emanated from the public sector as reflected by the ongoing rehabilitation of the country's road network and the dominance of donor-supported projects.

Currency Appreciation

The Malawi Kwacha continuously gained in value against all of the country's major trading partners. Significant donor inflows were received in the early part of the year and a healthy foreign reserve position built up prior to the opening of the tobacco auctions. As a result of this and partly due to dampened commercial expansion, foreign exchange supply largely exceeded demand throughout the year. The Kwacha appreciated by 15.8 percent against the US Dollar from MK80.008/US$ at the beginning of the year to K67.333/US$ at year end Against the Pound Sterling, the Kwacha appreciated by 25.31 percent during th same period.

Within the sub-region, the Kwacha firme vis-à-vis the official Zimbabwean Dollar ra by 18.6 percent at the official rate and over 400% at the parallel rate in Zimbabv The instability experienced in the Zimb wean economy trickled down to the South African economy, which saw the South African Rand depreciating drastically. The financial crisis in Argentina also had a de-stabilizing effect on this currency. The Kwacha gained against the South African Rand by 52.8 percent from an exchange rate of MK10.9/ZAR registered in January 2001 to MK5.138/ZAR registered at the close of the year under review.

Interest Rates

The commercial bank base rates, which fluctuated wildly at the beginning of the year, settled at 45 percent for the latter part of the year. Similarly, average yields on T-bills which were above 70 percent at the beginning of the year, settled around 45 percent for the second half of the year. During the year the Reserve Bank also introduced RBM bills of 63 day and 91 day tenors. The government thereafter absorbed most of the liquidity using these RBM bills, which for the most period provided yields in the 45 – 46 percent range.

These high interest rates which are more of a result of government over-expenditure than inflation, continue to stagnate growth across the broad spectrum of the economy. The Government will really have to institute strict expenditure controls to remove this obstacle to economic growth and poverty alleviation.

Inflation

Annual average inflation rate for 2001, at 27.5 percent reflected a slight fall from the rate of 29.5 percent recorded in the year 2000. This remains much higher than the forecasted 10 percent inflation rate target set by the government. The appreciation of the Kwacha helped stabilize or reduce prices of most commodities except for the most important commodity, maize, whose price surged during the year due to low levels of planting. Had maize prices been stable, the 10 percent inflation target may have become a possibility.

Stock Market

In 260 business days of the year 2001, a mere 182,928, 035 shares were traded on the MSE at a total consideration of MK1.453 billion (US$21,235,324) in 1,327 trades. This presents an average daily turnover of MK5.590 million (US$81,674.32) reflecting a 163.25 percent increase from the daily average turnover of MK2.123 million registered in 2000. With regards to share volume, the daily average increased by 67.23 percent from the volume of 109,385,588 shares recorded in 2000. The greatest share volume was recorded in the fourth quarter of the year with 142,757,563 shares traded at a total turnover of MK1.081 billion (US$16,223,000) in 182 trades representing 78.04 percent of the traded shares in the year under review. The larger volumes of the year 2001 are attributable primarily to the block sale of 120,000,000 shares in Commercial Bank of Malawi to Stanbic of South Africa.

The Malawi Domestic Index opened the year at 270.12 points and rose to an alltime high of 283.87 points in September 2001. This was however followed by a minor drop to close the year at 280.15 points.

Eight stocks are listed on Malawi Stock Exchange and all were generally inactive during the year and more often than not there were no buyers for shares that were on offer. Press Corporation Ltd shares in particular were hard to sell as there were large blocks of shares available for sale for which there appeared to be no significant takers.

Economic Review (cont.)

PERFORMANCE BY ECONOMIC SECTOR IN MALAWI

AGRICULTURE

Real output in the agricultural sector increased by 1.8 percent in 2001 compared to a growth of 5.4 percent, a year earlier. Smallholder production accounts for the larger share of agricultural output, with the emphasis being placed mainly on subsistence crops, particularly maize. The small scale sector registered a positive growth of 6.2 percent against a marginal 1.7 percent growth a year earlier. The large scale agricultural sector registered negative growth of 13.9 percent against a positive growth of 21.0 percent in the year 2000 as lower prices and the Kwacha appreciation negatively affected Kwacha export proceeds.

Tobacco

Tobacco (which is responsible for over 70 percent of export income) sales amounted to 124.6 million kgs (158.9 million kgs in 2000), which reflects 27 percent decrease. This resulted in exports of US$144.203 million against US$163.4 million in 2000. Tobacco remains a very important component of the Malawi economy with excellent capital infrastructure already in place.

Tea

Tea production in the year 2001 fell by 4 percent to 40.15 million kgs in 2001 compared with 42.1 million kgs in 2000. The drop in production is attributed to poor rainfall experienced during the third quarter of 2001.

Maize

A crop of around 1.7 m tonnes was recorded in 2001, against a crop of around 2.5 m tonnes, in the year 2000. As a result, the country experienced a severe maize shortage causing famine in various areas. The main causes for the shortfall were reduced plantings due to low producer prices in the previous year and reduced yields due to flooding in certain areas.

Other Crops

Sugar production in the year 2001 was 207.80 million kgs, compared to 187.39 million kgs in the year 2000. This is expected to increase further due to expansion of capacity by Illovo. This may present the opportunity to take advantage of increased preferential export quotas granted to Malawi by the EU.

Malawi continues to pursue avenues of diversification from tobacco production to other cash crops. There has been a determined effort to increase production of crops like paprika, chillies, pigeon peas, etc.

MANUFACTURING

The worrying decline in the performance of the manufacturing sector continues. This is because cheaper imported substitutes are available in the local market, and there continues to be smuggling across borders.

This problem was further accentuated by imports, official and unofficial, from Zimbabwe, from where Malawian importers were able to procure goods at the parallel foreign exchange rate.

Much has been made of the potential for growth in the manufacturing sector arising from export opportunities presented by AGOA (Africa Growth Opportunity Act). However, it remains to be seen whether AGOA will have any significant impact. The demands on quality and timely deliveries from the US are very high and Malawi based businesses will find profitable penetration much harder than many commentators realize.

CONSTRUCTION

Value added in this sector increased by 1.9 percent and activity was reasonably vibrant in the year. This was due to the many donor funded and government projects in progress during the year, particularly in the area of road construction and maintenance. SADC meetings held during the year boosted construction as infrastructure rehabilitation like roads, airports, hotels etc.

DISTRIBUTION

Value added in this sector increased by 7.8 percent compared to negative growth in the year 2000. Higher imports, due to the strong Kwacha, likely was the main contributing factor.

TRANSPORT AND COMMUNICATION

Value added in this sector rose by 0.1 percent compared to a negative growth in the year 2000. This has been due to poor performance in agricultural and manufacturing sector, as well as non-completion of the rehabilitation work of the railway to the Mozambican port of Nacala.

MINING AND QUARRYING

Although only forming a small portion of the economy to date, the percent growth in this sector was high, mainly because the growth was from a small base. Value added in this sector grew by 9.7 percent in the year, compared to 10.8 percent in the previous year. The highly publicized proposed bauxite mining project on Mulanje Mountain appears to have been shelved.

OUTLOOK FOR 2002

We anticipate real GDP growth to be in the region of 2 percent which still falls short of the 6 percent growth which is necessary to make a noticeable impact in the reduction of poverty.

The performance of the tobacco sector will continue to be the main determinant of economic growth in the year. The rain pattern to date indicates a promising tobacco season. Farmers should hopefully have good quality and quantity of leaf this year. The prices are also expected to be robust in light of a predicted production shortfall in Zimbabwe.

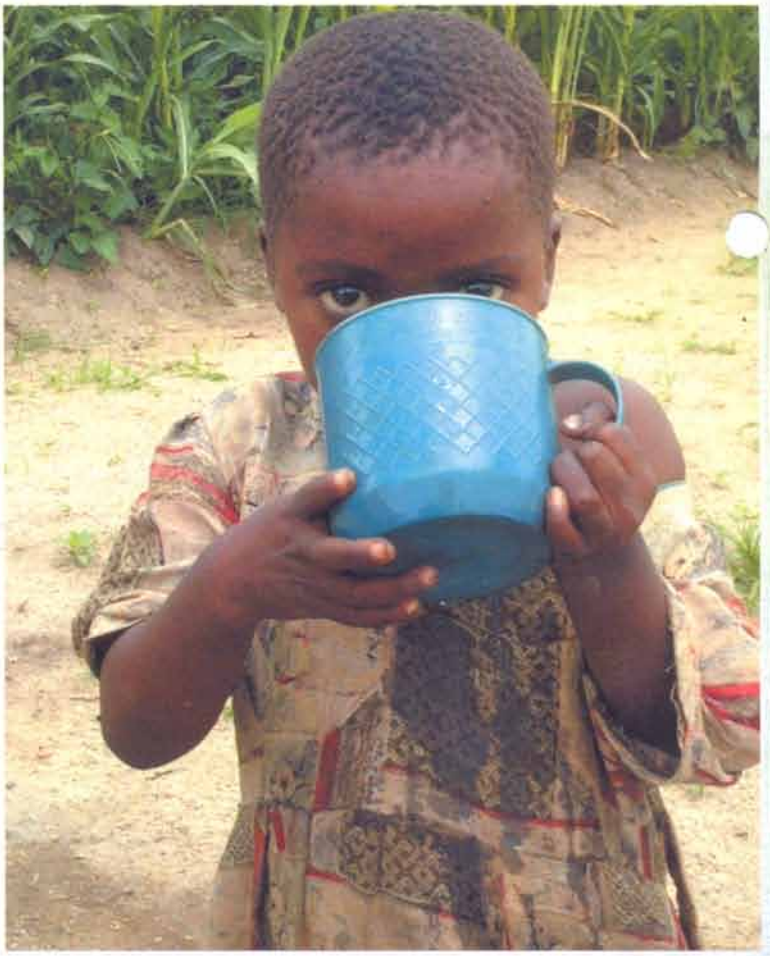
The maize crop also appears promising this year due to higher plantings and good rains.

However, Government will continue to struggle to find the revenues to meet its recurring expenditure, let alone development expenditure. The lack of growth in the economy and decline in corporate profits will adversely impact tax collections. Much will depend on the successful negotiation of continued support by the Bretton Woods Institutions for the Government's economic programmes, which should in turn lead to enhanced support by bi-lateral donor agencies.

Donations

Open Arms Infant Home, Blantyre

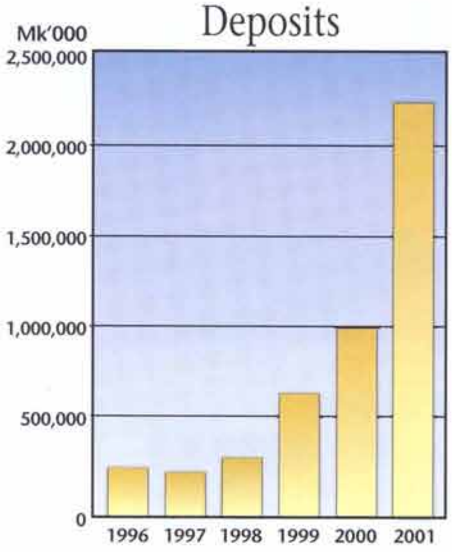
Borehole at Madalitso Orphanage site, Chiradzulu

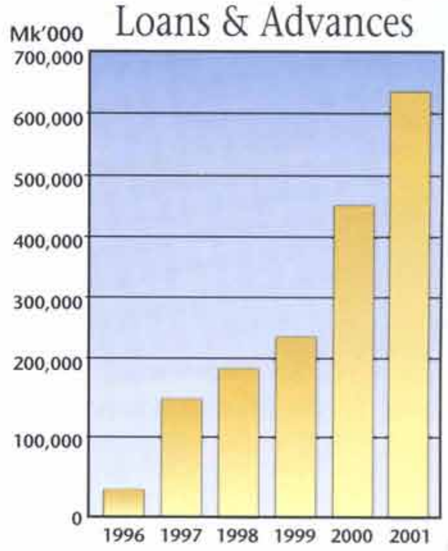


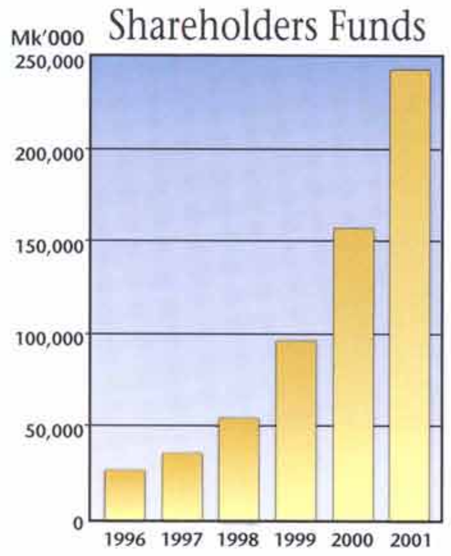
Malawi Against Polio (MAP)

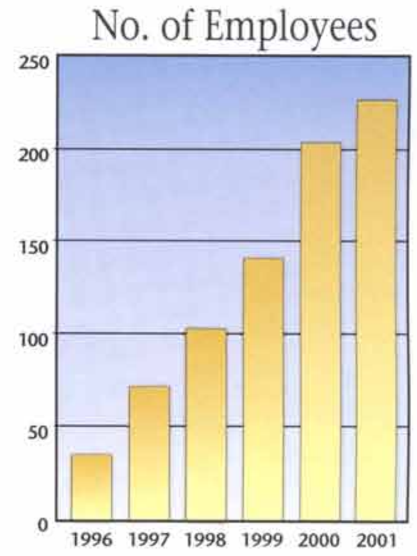
Central High/Mountview School, Limbe

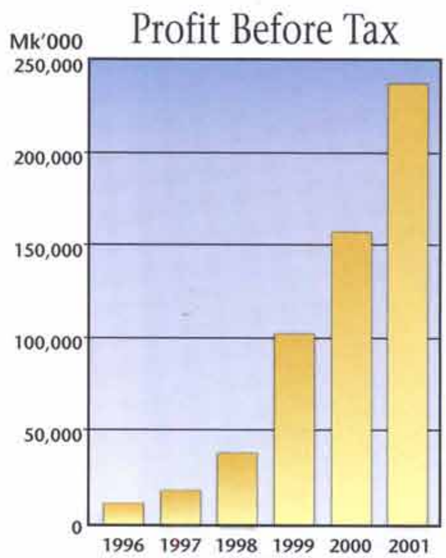
The Eye Project, Blantyre

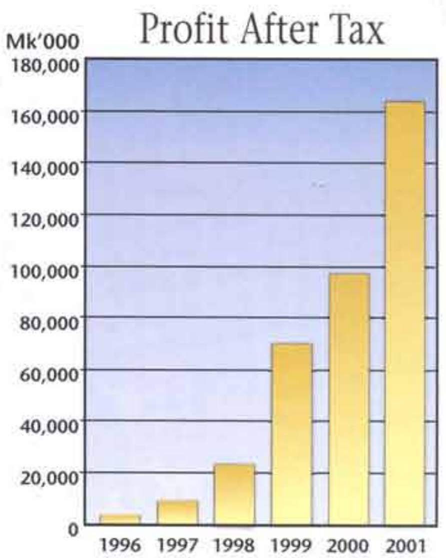

Deposits
Mk'000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
1996 1997 1998 1999 2000 2001


Loans & Advances
Mk'000
700,000
600,000
500,000
400,000
300,000
200,000
100,000
0
1996 1997 1998 1999 2000 2001


Shareholders Funds
Mk'000
250,000
200,000
150,000
100,000
50,000
0
1996 1997 1998 1999 2000 2001


No. of Employees
250
200
150
100
50
0
1996 1997 1998 1999 2000 2001


Profit Before Tax
Mk'000
250,000
200,000
150,000
100,000
50,000
0
1996 1997 1998 1999 2000 2001


Profit After Tax
Mk'000
180,000
160,000
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
1996 1997 1998 1999 2000 2001

Directors' Report

For the year ended
31st December 2001

The directors have pleasure in submitting the financial statements of the Company for the year ended 31st December 2001.

Nature of business

First Merchant Bank is a private limited company incorporated in Malawi under the Malawi Companies Act, 1984 and is registered as a Commercial Bank under the Banking Act 1989. The physical address of the company's registered office is:-

First House
Private Bag 122
Glyn Jones Road
Blantyre, Malawi.

Financial performance

The results and state of affairs of the company are set out in the accompanying income statement, balance sheet, statement of cash flows and associated accounting policies and notes.

The major trading currencies of the bank are United States Dollar, British Pound and South African Rand. The exchange rates were K67.23, K80.06 and K46.46 for the United States Dollar, K97.56, K120.63 and K76.39 for the British Pound and K6.61, K9.70 and K7.70 for South African Rand for the past three years ended 31st December 2001, 2000 and 1999.
The inflation rates were 22.1%, 35.4% and 28.3% for the last three years ended 31st December 2001, 2000 and 1999 respectively.

Dividend

A dividend of MK80 million was paid during the year, representing 266 tambala per ordinary share.

Directorate and Secretary

The following directors and secretary served during the year:

Mr. R.C. Kantaria	Chairman
Mr. H.N. Anadkat	Vice Chairman
Mr. N.G. Anadkat	Director
Mr. J.M. O'Neill	Director
Mr. A. Abdallah	Director
Mr. V.K. Shetty	Director
Mrs. R. Kanyuka	Director
Mr. N. Williams	Director
Mr. S. Srinivasan	Secretary

In accordance with the company's Articles of Association, all directors are retiring at the forthcoming Annual General Meeting, but being eligible for re-appointment, offer themselves for re-election.

Board Committees

Board Committees were established to ensure that the board discharges its duties effectively, in accordance with principles of good corporate governance. All board committees have terms of reference and report to the main board.

Audit Committee

The Audit Committee is responsible for reviewing the reports of both internal and external auditors, as well as the adequacy and effectiveness of internal and accounting controls. The committee consists of three non-executive directors.

Directors' Report (cont.)

Both internal and external auditors have unlimited access to the Audit Committee.

Standing Committee on Loans and Advances

The Committee approves all applications for loans and advances that are above the Chief Executive's discretionary limits. This committee consists of four non-executive directors.

Directors responsibility for the financial statements

The Malawi Companies Act 1984 requires the directors to ensure that for each accounting period accounts are prepared which show a true and fair view of the state of affairs of the company and of its results for that period, and which are properly prepared in accordance with the relevant provisions of the Companies Act 1984.

The directors also accept responsibility on behalf of the company for the maintenance of proper accounting records sufficient for this purpose. Accordingly the directors have:-

- selected suitable accounting policies and applied them consistently; and
- made judgements and estimates that are reasonable and prudent; and
- stated that applicable accounting standards have been followed; and
- prepared the accounts on a going concern basis having determined that the company has adequate resources to continue in operational existence for the foreseeable future.

The directors are also responsible for establishing controls to prevent the falsification of entries in the books of accounts and to facilitate the detection of inaccuracies therein.

Auditors

A resolution will be proposed at the forthcoming annual general meeting to re-appoint KPMG, Certified Public Accountants (Malawi) as auditors in respect of the company's 31st December 2002 financial statements.

N.G. Anadkat
Director

Nigel Williams
Director

16th February 2002

Auditor's Report

Public Accountants and Business Advisors

Office Address
Able House
Hannover Avunue
Blantyre

Mail Address
P.O. Box 508
Blantyre
Malawi

Telephone: 620 744 / 620 391
Telefax: (265) 620 575
E-mail: kpmg@malawi.net

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF FIRST MERCHANT BANK LIMITED

Scope

We have audited the financial statements of First Merchant Bank Limited set out on pages 18 to 32 for the year ended 31 December 2001.

Respective responsibilities of directors and auditors

These financial statements are the responsibility of the directors. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing as promulgated by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the accounts are free from material misstatement.

An audit includes; examining, on a test basis, of evidence supporting the amounts and disclosures in the financial statements; assessing the accounting policies used and the significant estimates made by the directors in the preparation of the financial statements, and evaluating the overall presentation of the financial statements.

We believe that our audit provides a reasonable basis for our opinion.

Audit opinion

In our opinion, the financial statements of the company are properly drawn up in accordance with the provisions of the Companies Act 1984 and in conformity with International Accounting Standards so as to give, in all material respects, a true and fair view of the financial position of the Company at 31st December 2001 and of the results of operations and cash flows for the year then ended.

KPMG

KPMG
Certified Public Accountants (Malawi)
Blantyre
16th February 2002

Member firm of KPMG International

Blantyre
R.M. Davies
R. Harawa

Lilongwe
V.S. Venkatesh

Income Statement

For the year ended 31 December 2001

In thousands of Malawi Kwacha	Note	2001	2000
INCOME			
Interest receivable	1	572,159	384,580
Interest payable		(262,486)	(168,743)
Net interest income		309,673	215,837
Other income	2	188,272	95,449
Total income		497,945	311,286
EXPENDITURE			
Staff and training costs	3	104,701	64,415
Recurrent expenditure on premises and equipment		30,940	25,766
Depreciation		25,413	12,914
Other operating costs	4	75,793	46,445
Total expenditure		236,847	149,540
Profit before provision for doubtful debts		261,098	161,746
Provision for doubtful debts - Specific		(15,429)	2,114
- General		(12,000)	(8,215)
Profit before tax		233,669	155,645
Income tax expense	5	(69,450)	(57,259)
Net profit for the year		164,219	98,386
Basic earnings per share (MK)	9	5.47	3.28

Statement of Recognised Gains and Losses

For the year ended 31 December 2001

In thousands of Malawi Kwacha	Note	2001	2000
Net profit for the year		164,219	98,386
Total recognised gains and losses	8	164,219	98,386

The financial statements are to be read in conjuction with the accounting policies on pages 21 to 24 and notes on pages 25 to 32

The Auditor's report is on page 17.

Balance Sheet

As at 31 December 2001

In thousands of Malawi Kwacha	Notes	2001	2000
LIABILITIES AND EQUITY			
Liabilities			
Current and savings accounts		**1,094,910**	557,179
Foreign currency accounts		**547,665**	53,686
Term deposits accounts		**590,190**	479,794
	6	**2,232,765**	1,090,659
Income tax payable		**21,829**	11,103
Other liabilities	7	**333,464**	270,092
		2,588,058	1,371,854
Equity			
Issued capital		**30,000**	30,000
Retained earnings		**212,758**	128,539
Total equity	8	**242,758**	158,539
Deferred tax liabilities	10	**-**	3,192
		242,758	161,731
Shareholders' interests and liabilities		**2,830,816**	1,533,585
Acceptances, guarantees, indemnities and credits for accounts of customers	17	**684,056**	529,702
Total equity and liabilities		**3,514,872**	2,063,287
ASSETS			
Cash and cash equivalents	11	**1,986,739**	902,991
Remittances in transit		**63,453**	102,800
Other receivables	12	**97,675**	11,606
Loans and advances to customers	13	**548,258**	392,784
Investments	14	**47,000**	47,000
		2,743,125	1,457,181
Deferred tax assets	10	**4,261**	-
Properties, plant and equipment	15	**83,430**	76,404
		2,830,816	1,533,585
Acceptances, guarantees, indemnities and credits for accounts of customers	17	**684,056**	529,702
Total assets		**3,514,872**	2,063,287

The financial statements of the company were approved by the Board of Directors on 16th February 2002 and were signed on its behalf by:

N.G. Anadkat
Director

Nigel Williams
Director

The financial statements are to be read in conjunction with the accounting policies on pages 21 to 24 and notes on pages 25 to 32

The Auditor's report is on page 17

FMB

Statement of Cash Flows

For the year ended 31 December 2001

In thousands of Malawi Kwacha	Notes	2001	2000
Operating activities			
Interest and fees received		761,721	470,564
Interest paid		(260,779)	(161,861)
Cash paid to suppliers and employees		(191,871)	(132,541)
		309,071	176,162
Increase in net customer balances		952,986	289,424
Cash generated from operations		1,262,057	465,586
Income taxes paid		(66,177)	(53,437)
Cash flows from operating activities		1,195,880	412,149
Investing activities			
Proceeds from sale of plant and equipment		1,019	4,747
Acquisition of property, plant and equipment		(33,151)	(51,384)
Acquisition of other investments		-	(45,000)
Cash flows from investing activities		(32,132)	(91,637)
Financing activities			
Dividend paid		(80,000)	(55,020)
Cash flows from financing activities		(80,000)	(55,020)
Net increase in cash and cash equivalents		1,083,748	265,492
Cash and cash equivalents at 1 January		902,991	637,499
Cash and cash equivalents at 31 December		1,986,739	902,991

The financial statements are to be read in conjunction with the accounting policies on pages 21 to 24 and notes on pages 25 to 32.

The Auditor's report on page 17

Significant Accounting Policies

First Merchant Bank Limited is a private limited company incorporated in Malawi. The financial statements were authorised for issue by the directors on 16th February 2002.

(a) Statement of compliance

The financial statements have been prepared in accordance with International Accounting Standards (IAS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the Standing Interpretations Committee of the IASB.

(b) Basis of preparation

The financial statements are presented in Malawi Kwacha, rounded to the nearest thousand. They are prepared on the historical cost basis except for investments held for trading which are stated at their fair value. Recognised assets and liabilities that are hedged are stated at fair value in respect of the risk that is being hedged.

The accounting policies have been consistently applied by the company and are consistent with those used in the previous year.

(c) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to Malawi Kwacha at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Malawi Kwacha at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Malawi Kwacha at foreign exchange rates ruling at the dates the values were determined.

(d) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (refer accounting policy h).

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred.

Generally, costs associated with information technology are recognised as an expense when incurred. However, information technology development costs of a strategic nature are capitalised as part of computer equipment

Significant Accounting Policies (cont.)

(iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of items of property, plant and equipment, and major components that are accounted for separately. Land is not depreciated. The following depreciation rates are in use:

▪ freehold properties	2.5%
▪ motor vehicles	25% - 50%
▪ furniture, fixtures and fittings computers, office equipment and leasehold improvements	25% - 100%

(e) Investments

Investments in debt and equity securities

The fair value of investments held for trading is their quoted bid price at the balance sheet date.

Investments held for trading are recognised/derecognised by the Company on the date it commits to purchase/sell the investments. Investments held-to-maturity are recognised/ derecognised on the day they are transferred to/by the Company.

(f) Other receivables

Other receivables comprise interbranch accounts, interest receivables, prepayments, staff advances and office assets and are stated at their cost less impairment losses (refer accounting policy h).

(g) Cash and cash equivalents

Cash and cash equivalents comprises coin and bank notes, balances with Reserve Bank, balances with other banks, registered discount houses and treasury bills.

(h) Impairment

The carrying amounts of the Company's assets are reviewed at each balance sheet date tc determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

(i) Provisions for credit losses

Advances and other assets are stated in the balance sheet after the deduction of provisions for credit losses.

Appropriate provisions are made against advances based upon the directors assessment of the quality of the portfolio.

Specific provisions, covering identified doubtful debts, are based on specific evaluations of advances and take account of past loss experience, economic conditions and changes in the nature and level of risk exposure.

In addition, a general provision is also made to cover potential losses which although not specifically identified may be present in any portfolio of loans and advances.

The amounts required to fund the assessed level of provision for credit losses are charged to the Income statement.

Interest on advances is accrued to income until such times as reasonable doubt exists with regards to recovery, thereafter further interest is not included in income.

Advances are written off once the probability of recovery becomes remote.

(j) Provisions and other liabilities

A provision is recognised in the balance sheet when the Company has a legal or constructive obligation as result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

(k) Pension Scheme and other post retirement benefits

The bank operates a Defined Contribution Pension Scheme administered by the National Insurance Company Limited, the assets of which are held in separate trustee administered fund. Contributions to this fund which are based on pensionable earnings are charged to income statement as they fall due.

(l) Revenue recognition

(i) Net interest income

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis, using the effective yield method. Interest income is suspended when the collection of loans becomes doubtful. Such income is excluded from income until received.

(ii) Other non-interest income

Other non-interest income includes, fees and commissions from customers, other banks and related transactions, net income from exchange and securities dealing and net gains on the sale of assets.

Fees and commissions are recognised when the related service is performed.

(m) Expenses

(i) Terminal benefits

The actual amounts paid as pension and retirement gratuities to those employees who are not covered by the Pension Fund are charged to income statement.

(ii) Off balance sheet transactions

The bank enters into off -balance sheet transactions such as forward exchange contracts and currency swaps. At the year end, unrealised gains and losses are dealt with through the income statement.

Significant Accounting Policies (cont.)

(n) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(o) Dividends

Dividends are recognised in the income statement in the period paid.

Notes to the Financial Statements

For the year ended 31 December 2001

In thousands of Malawi Kwacha	2001	2000
1. Interest receivable		
Customer loans and advances	216,424	164,742
Treasury bills	299,857	174,026
Financial Institutions	38,313	39,497
Local Registered Government Stocks	17,565	6,315
	572,159	384,580
2. Other income		
Profit on disposal of fixed assets	307	1,539
Revenue from fees and commissions	32,853	25,671
Profit on foreign exchange transactions	147,351	61,200
Other sundry income	7,761	7,039
	188,272	95,449
3. Staff and training costs		
Salaries, wages and training costs	102,349	63,366
Contributions to defined contribution plans	2,352	1,049
	104,701	64,415

The number of employees at 31 December 2001 was 222 (2000: 208).

	2001	2000
4. Other operating costs		
Auditor's remuneration -current audit fees	1,500	1,100
Directors' fees	5,143	3,003
Others	69,150	42,342
	75,793	46,445
Others include:		
Computer costs	15,271	4,727
Telephone/telex/fax	8,546	4,107
Printing and stationery	7,425	5,579
Others	37,908	27,934
	69,150	42,342

Notes to the Financial Statements (cont.)

For the year ended 31 December 2001

In thousands of Malawi Kwacha	2001	2000
5. Income tax expense		
Recognised in the income statement		
Current tax expense		
Current year at 30%(2000: 35%) based on profits	**76,903**	54,067
Deferred tax (credit)/expense		
Origination and reversal of timing differences	**(7,453)**	3,192
Total income tax expense in income statement	**69,450**	57,259
6. Liabilities to customers		
Interest bearing deposits	**2,232,765**	1,090,659
Payable as follows:		
Maturing within 3 months	**1,428,519**	364,701
Maturing between 3 and 12 months	**804,246**	725,958
	2,232,765	1,090,659
7. Other liabilities		
Interest payable	**14,368**	12,661
Bankers cheques issued and uncleared	**15,943**	16,637
Credit clearance vouchers	**48,030**	145,417
Items in transit	**-**	47,060
Other sundry payables	**255,123**	48,317
	333,464	270,092
Other sundry payables comprise:		
Margins on letters of credit and the foreign exchange purchases	**228,576**	41,785
Others	**26,547**	6,532
	255,123	48,317

In thousands of Malawi Kwacha	Share capital	Retained earnings	Total
8. Capital and reserves			
Reconciliation of movement in capital and reserves			
Balance at 1 January 2001	30,000	128,539	**158,539**
Total recognised gains and losses	-	164,219	**164,219**
Dividends to shareholders	-	(80,000)	**(80,000)**
Balance at 31 December 2001	30,000	212,758	**242,758**

Share capital

Ordinary shares

In thousands of shares	2001	2000
In issue at 1 January and 31 December-fully paid	**30,000**	30,000

At 31 December 2001 the authorised share capital comprised 50,000,000 ordinary shares (2000: 50,000,000) of K1 each and the issued and fully paid ordinary shares were 30,000,000 (2000: 30,000,000) of K1 each.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

In thousands of Malawi Kwacha	2001	2000
9. Earnings per share		

Basic earnings per share

The calculation of basic earnings per share at 31 December 2001 was based on the net profit attributable to ordinary shareholders of MK164 million (2000:MK98 million) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2001 of 30 million (2000: 30 million), calculated as follows:

	2001	2000
Net profit attributable to ordinary shareholders (K'000)	**164,219**	98,386
Weighted average number of ordinary shares ('000)	**30,000**	30,000
Basic earnings per share (MK)	**5.47**	3.28

Notes to the Financial Statements (cont.)

For the year ended 31 December 2001

In thousands of Malawi Kwacha	Assets		Liabilities		Net	
	2001	2000	2001	2000	**2001**	2000
10. Deferred tax assets and liabilities						
Property, plant and equipment	2,361	-	-	185	**(2,361)**	185
Accrued income	-	-	6,600	8,724	**6,600**	8,724
General provisions	8,500	5,717	-	-	**(8,500)**	(5,717)
Tax (assets)/liabilities	10,861	5,717	6,600	8,909	**(4,261)**	3,192
Net (assets)/liabilities	-	-	-	-	**(4,261)**	3,192

In thousands of Malawi Kwacha	**2001**	**2000**
11. Cash and cash equivalents		
Liquidity Reserve deposits		
-Reserve Bank of Malawi	**364,878**	109,194
-Registered discount house	**116,000**	64,000
	480,878	173,194
Balances with banks abroad	**977,206**	130,356
Malawi Government treasury bills	**243,531**	544,892
Reserve Bank of Malawi bills	**179,363**	-
Commercial Paper	**18,749**	-
Cash balances	**87,012**	64,549
	1,986,739	912,991
Less: Balances due to other financial institutions	**-**	(10,000)
Cash and cash equivalents in the statement of cash flows	**1,986,739**	902,991
12. Other receivables		
Items in transit	**87,214**	-
Interest receivable	**6,418**	8,085
Prepayments	**2,603**	1,540
Others	**1,440**	1,981
	97,675	11,606

In thousands of Malawi Kwacha

		2001	2000
13.	**Loans and advances to customers**		
	Maturing within 3 months	**526,539**	349,199
	Maturing between 3 and 12 months	**93,383**	81,793
		619,922	430,992
	Provision for losses:		
	Specific Provision - At 1 January	**(6,807)**	(9,426)
	Write offs	**3,020**	505
	New provision	**(26,829)**	(1,014)
	Recoveries	**11,400**	3,128
	- At 31 December	**(19,216)**	(6,807)
	Interest in suspense: At 1 January	**(15,067)**	(9,007)
	New provision	**(9,047)**	(6,060)
	At 31 December	**(24,114)**	(15,067)
	General provision: At 1 January	**(16,334)**	(8,119)
	New provision	**(12,000)**	(8,215)
	At 31 December	**(28,334)**	(16,334)
	Net advances and loans to customers	**548,258**	392,784
14.	**Investments**		
	Local registered Government stocks (at cost)	**47,000**	47,000

Accrued interest has been included under other receivables

Notes to the Financial Statements (cont.)

For the year ended 31 December 2001

In thousands of Malawi Kwacha	Freehold property	Lease-hold improve-ments	Motor Vehicles	Equip-ment Fixture & fittings	Under con-struction	Total
15. Property, plant and equipment						
Cost or valuation						
Balance at 1 January 2001	34,927	2,668	9,313	52,008	4,358	**103,274**
Additions	-	-	1,881	31,270	-	**33,151**
Transfers	-	-	-	4,358	(4,358)	-
Disposals	-	(1,283)	(535)	-	-	**(1,818)**
Balance at 31 December 2001	34,927	1,385	10,659	87,636	-	**134,607**
Depreciation and impairment losses						
Balance at 1 January 2001	528	1,717	4,916	19,709	-	**26,870**
Charge for the year	874	164	2,935	21,440	-	**25,413**
Released on disposal	-	(571)	(535)	-	-	**(1,106)**
Balance at 31 December 2001	1,402	1,310	7,316	41,149	-	**51,177**
Carrying amount						
At 1 January 2000	34,399	951	4,397	32,299	4,358	**76,404**
At 31 December 2001	33,525	75	3,343	46,487	-	**83,430**

Registers of land and building giving details as required under the Companies Act 1984, Schedule 3, Section 16 are maintained at the registered office of the company and are open for inspection by members or their duly authorised agents.

In thousands of Malawi Kwacha	2001	2000
16. Employee benefits		
Expense recognised in the income statement		
Pension contributions	2,352	1,049

This is recognised under staff costs in the income statement.

The Company Pension Scheme is First Merchant Bank Limited Group Pension and Life Assurance Scheme covering all employees in the permanent service of the company. The trustees of this scheme have effected a Deposit Administration Contract with National Insurance Company Limited with effect from 1st April 1999. Members and employers contribute to a Deposit Fund established thereunder.

In thousands of Malawi Kwacha

	2001	2000
17. Contingent Assets/Liabilities		
Letters of credit	194,889	61,159
Guarantees	161,090	100,534
Travellers cheques	111,603	237,465
Foreign bills lodged	77,860	130,433
Forward sale contracts	138,614	111
	684,056	529,702

18. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the company's business. Financial instruments are used to reduce exposure to fluctuations in foreign exchange rates and interest rates. While these are subject to the risk of market rates changing subsequent to acquisition, such changes are generally offset by opposite effects on the items being hedged.

Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit revaluations are performed on all customers requiring credit over a certain amount.

Investments are allowed only in liquid securities and only with well known counterparties.

On the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

Foreign currency risk

The Company incurs foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than Malawi Kwacha. The currencies giving rise to this risk are primarily Pounds Sterling, US Dollars, and South African Rand.

All the transactions entered into during the year were within the foreign currency exposure and foreign currency lending directives of Reserve Bank of Malawi.

19. Related parties

Identity of related parties

The bank has a related party relationship with its directors and shareholders.

The bank transacts part of its business on an arms length basis with companies affiliated to the shareholders. As at 31st December 2001 the total loans and advances to related parties amounted to K5.6 million which is 0.90% of the total advances (2000: K2.2 million which was 0.51% of the total advances). Of this total, K2.9 million (2000: K0.9 million) was fully secured by fixed and/or floating charges. All advances to related parties carry interest above the bank's base lending rate.

20. Statutory requirement

In accordance with Section 27 of the Banking Act 1989, the Reserve Bank of Malawi has established the following requirements as at the balance sheet date:

(i) Liquidity Reserve Requirement

The Bank is required to maintain liquidity reserve ratio, calculated on a weekly average basis, of not less than 30 percent of the preceding month's total deposit liabilities. In the last week of December 2001, the liquidity reserve was 31.8% (2000: 31.8%) of total customer deposits.

(ii) Capital Adequacy Requirement

The Bank's available capital is required to be a minimum of 10% of its risk bearing assets and contingent liabilities. At 31 December 2001, the Bank's available capital was 21% (2000:23%) of its risk bearing assets and contingent liabilities

21. Prudential Aspects of Bank Liquidity

The Reserve Bank of Malawi has issued the following guidelines on the management of liquidity:

-Liquidity Ratio 1: Net liquidity (total liquid assets less suspense account in foreign currency) divided by total deposits must be at least 30%

-Liquidity Ratio 11 : Net liquidity (total liquid assets less suspense account in foreign currency and cheques in the course of collection) divided by total deposits must be at least 20%.

As at 31 December 2001, the Bank's Liquidity Ratio 1 was 94% (2000: 97%) and Liquidity Ratio 11 was 91% (2000: 87%)

22. Subsequent events

Subsequent to the Balance Sheet date no events have occurred necessitating adjustments to or disclosures in the financial statements.

Addresses

HEAD OFFICE

First House, Glyn Jones Road,
Private Bag 122, Blantyre, Malawi
Tel.: (265) 621955 / 621942 / 621943 / 624840 / 624889
Fax: (265) 621978
Telex:45313 FMBMALAWI
e-mail address: fmbhq@malawi.net

Blantyre Branch

First House, Glyn Jones Road,
Private Bag 122, Blantyre, Malawi
Tel.: (265) 624594 / 624886 / 622759 / 622686
Fax: (265) 622737
Telex: 43170 FMBMALAWI
e-mail address:fmbt@malawi.net

Limbe Branch

Janoo House, Livingstone Avenue,
P.O. Box 51938, Limbe, Malawi
Tel.: (265) 642324 / 642418 / 642396 / 642425
Fax: (265) 642458
e-mail address: fmblimbe@malawi.net

Lilongwe Branch

NICO Centre, Kamuzu Procession Road,
Private Bag 85, Lilongwe, Malawi.
Tel.: (265) 755388 / 755851 / 753729 / 753570 / 753470
Fax: (265) 753830
Telex: 43099 FMBMALAWI
e-mail address: fmbll@malawi.net

Mzuzu Branch

Old Malawi Savings Bank Building,
Orton Chirwa Avenue, Private Bag 158,
Mzuzu, Malawi
Tel.: (265) 334214 / 332964 / 334455
Fax: (265) 333891
Telex: 44615 FMBMALAWI
e-mail address: fmbmz@malawi.net

Capital City

Casa-De-Shez, Robert Mugabe Crecent,
P.O. Box 30890, Capital City, Lilongwe 3, Malawi
Tel.: (265) 775081 / 775082 / 772606 / 772693
Fax: (265) 774490

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