

FIRST MERCHANT BANK

Annual Report 2003



The **Banker**
AWARDS 2002

FT Business
FINANCIAL TIMES

This is to certify that THE BANKER has awarded

First Merchant Bank

BANK OF THE YEAR 2002 for

Malawi

The **Banker**
awards
2003



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FINANCIAL TIMES

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First Merchant Bank

BANK OF THE YEAR 2003 FOR

Malawi



Stephen Maxwell
STEPHEN MAXWELL, EDITOR-IN-CHIEF

Angus Cushley
ANGUS CUSHLEY, PUBLISHER

Contents

INDEX	Page
Senior Management	3
Branch Management	4
Chairman's Statement	5
Bank's Progress	8
Economic Review	9
Directors' report	14
Auditor's report	16
Income Statements	17
Statements of Changes in Equity	18
Balance sheets	19
Statements of cash flows	20
Significant accounting policies	21
Notes to the financial statements	26
Addresses	36





FIRST MERCHANT BANK

Blantyre Branch with new Head Office under construction



HEAD OFFICE

Chief Executive Officer
Kashinath Chaturvedi

General Manager
Seetharaman Srinivasan

Regional Manager (Marketing)
Kersy H. Kavina

Head, International Banking
Thomas Kadantot

Head, Information Technology
E.P. Jacob

Chief Auditor
P.P. Peter

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

Senior Operations Manager
Gayatri Kamath (Mrs)

Senior Credit Control Manager
Alex Chigwale

Finance Manager
Vilipo Munthali



Branch Management

Page 4 of 4

BLANTYRE

Chief Manager
Prakash Kamath

Operations Manager
Anna Mafuleka (Mrs)

LIMBE

Chief Manager
Ravindra Kamath

Operations Manager
Montfort Masinga

LILONGWE

Chief Manager
Friday Chalamba

Operations Manager
Evince Bamusi

CAPITAL CITY

Branch Manager
Howard Chirwa

MZUZU

Branch Manager
Evelyn Malongo (Ms.)



Chairman's Statement

Annual Report 2003

Malawi's persistent macro-economic problems continue to adversely affect most of the Bank's customers and limit banking opportunities. However, I am pleased to report that the Bank enjoyed another successful year with growth in all areas exceeding expectations.

Overview of the Economy

In general the performance of the economy in 2003 has improved with an estimated growth of around 4% in real economic output compared to a marginal growth of 1.8% in 2002. In particular the small scale agricultural sector, which is the largest economic sector, enjoyed a strong recovery as a result of improved weather conditions and the provision of subsidized farm inputs to the sector. However, sustained economic growth at a much higher level will be required if any progress is to be made towards the goal of reducing poverty in Malawi.

The extent of the central government budgetary deficit has worsened in 2003 and has largely been financed through domestic borrowing. The welcome resumption of donor budgetary support in the last quarter of the year has not been sufficient to see any reduction in government borrowing. By year end outstanding treasury bill stock totalled K47 billion, a level at which the government finds itself in a vicious circle where domestic debt looks set to increase further as the debt service costs of existing debt cannot be met out of domestic revenues prompting recourse to yet more borrowing.

Despite the tight monetary stance maintained throughout the year by Reserve Bank of Malawi, money supply continued to grow at an annual rate of 30%, fuelling inflationary pressures in the economy. The national average inflation rate fell to 9.6% in 2003 from 14.6% in the preceding year largely due to a reduction in food inflation to 5% following a good cereal harvest. However, non-food

inflation remained stubbornly high, ending the year at 18.6%.

Due to much lower than anticipated donor inflows and a 10% fall in tobacco exports proceeds, there has been a decline in the level of foreign currency reserves. At the year end overall banking system reserves equated to 2.9 months import cover and gross official reserves equated to 1.8 months import cover. The Kwacha remained under pressure throughout the year, closing the year 20% down in value against the benchmark US dollar. The currency depreciation against other major currencies was more marked.

Performance Highlights

The bank has continued to enjoy strong growth with total group assets growing by K1.6 billion to K7.0 billion at the year end.

Despite the highly competitive money market, the crowding out effect of the public sector borrowing requirement and the unfair advantage enjoyed by other financial institutions who are not subject to liquidity reserve requirements the group has been able to increase its deposit base by 19% to K4.2 billion.

A concerted effort to attract good quality lending opportunities has seen the group's credit portfolio increase from K1.0 billion to K1.4 billion. This is a remarkable achievement against the background of a hostile macro economic environment for borrowers.

The overall quality of our credit portfolio remains good and provisioning in excess of the Reserve Bank guidelines have been maintained. In addition to specific provisions against identified doubtful advances, our policy remains to build up the level of non-specific provision to cater for any unidentified risks which may be present in



Chairman's Statement (cont.)

our advances portfolio. A further K12mn has been set aside during the year from profits to non-specific provision which is approximately 5 percent of our net advances portfolio.

The bank's capital to risk based asset ratio of 23 per cent comfortably exceeds the prescribed minimum of 10 per cent, thus providing ample scope for further increasing our credit portfolio.

The bank continues to seek ways to expand its range of services and sources of income. Our corporate finance and asset management divisions are now firmly established and making a respectable contribution to group profits. 2003 was a year of consolidation for our subsidiary The Leasing and Finance Company of Malawi, acquired mid-way through 2002. A new software platform has been installed, which in addition to providing real-time accountability, has greatly improved the quality of customer service. Profitability of LFC continues to improve and we are of the opinion that the company is now well placed to enjoy substantial growth in the future.

Group profit after tax for the year was K352 million (2002: K269 million) and the capital base of the group has grown to K672 million of which K58million arises as a result of revaluation of the Bank's properties during the year.

Bank of the year in Malawi

In August, 2003, 'The Banker' magazine once again selected First Merchant Bank Limited for the award of 'Bank of the Year 2003' in Malawi. Winning this award for two successive years is testimony to the professionalism and commitment of the management and staff of the Bank.



▲ Newly qualified members of The Institute of Bankers in South Africa.

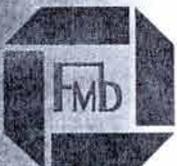
Clockwise from top left :

Ms. Mary L. Nkando, Mr. Matembo Singini,
Ms. Jane Mphande and Mr. George Jureawo.

▼ The bank has a comprehensive in-house training programme



▲ A Customer Services seminar in progress



Chairman's Statement (cont.)

Annual Report 2003

Human Resources

Staff are our most valuable asset and as such we remain fully committed to their welfare and development. We have a comprehensive in-house programme of training in various aspects of banking and we sponsor staff to attend relevant external training courses as well. We sponsor members of staff to pursue professional banking qualifications with the Institute of Bankers in South Africa and to-date four members have been admitted as Certified Associates of the Institute of Bankers in South Africa.

Donations

The Bank recognizes its social responsibilities and supports a number of worthy causes with special focus on the areas of education and health.

Acknowledgements

The Bank owes its success and progress

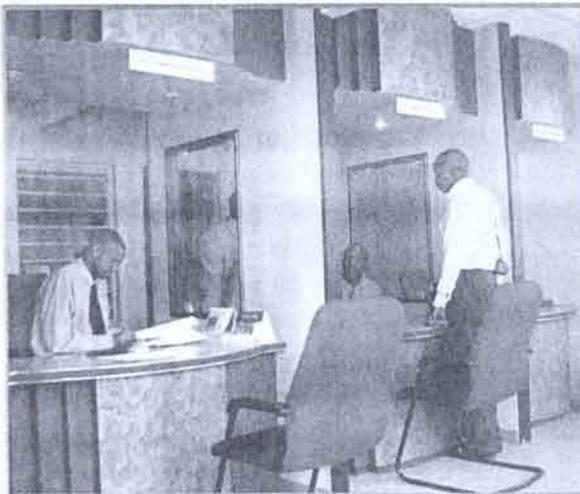
achieved so far to its customers. Therefore first and foremost, I wish to thank all our valued customers for their support during the year and assure them that we shall continue to provide excellent service based on sound banking principles.

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.

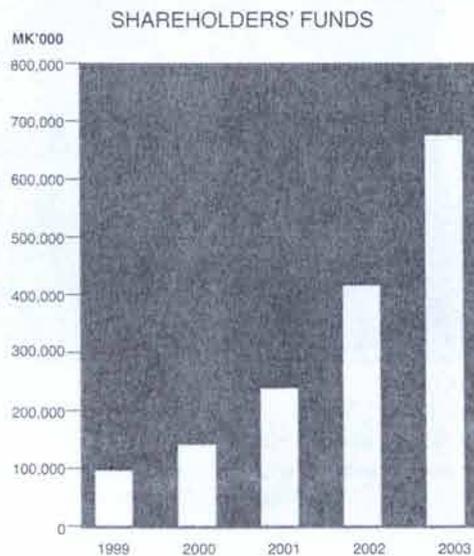
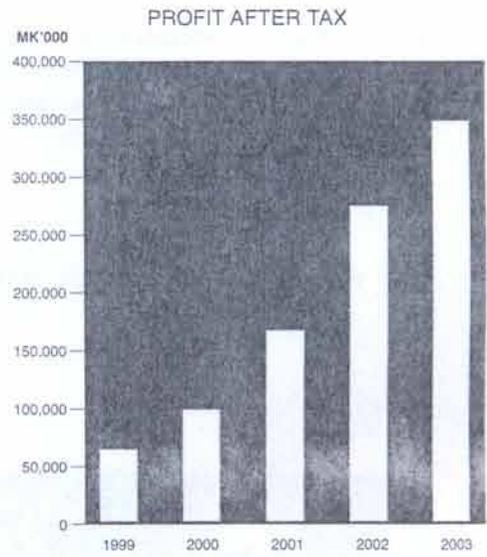
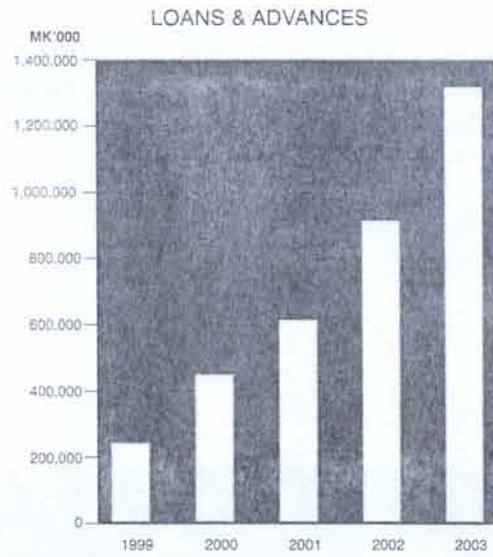
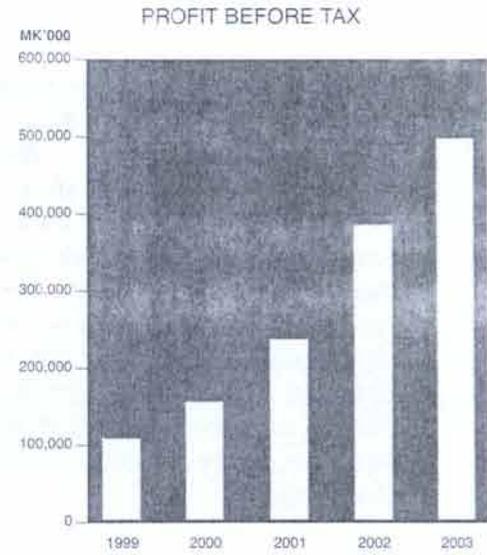
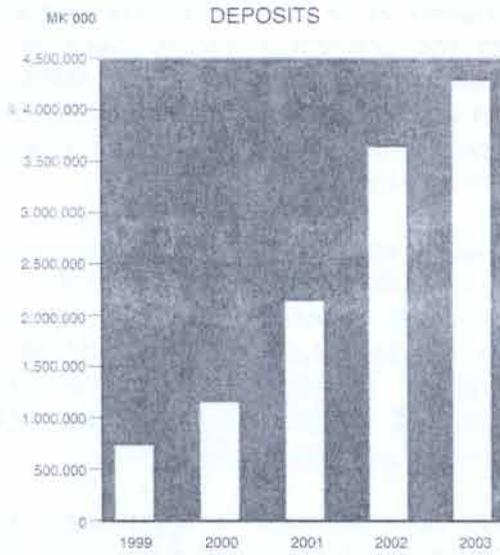
Finally, I would like to thank the management and members of staff for their continued dedication and commitment to customer service.

R. C. Kantaria
Chairman



Bank's Progress

First Merchant Bank



The world economic recovery which commenced in 2002 continued into 2003 with an expected growth in the world economy of 4% in 2003 following on from a 3% growth in 2002. Worldwide, inflationary pressures remained under control, permitting the continuance of generally benign monetary policies. As a consequence private consumer demand remained high and this has been a major factor in the continued world economic growth.

Industrial Countries

Growth in industrial countries is expected be around 2% in 2003. Among these countries, recovery continues to be led by the United States despite the costs of its war on terrorism, weak labour market and considerable excess capacity.

In the Euro area the growth estimate for 2003 has been significantly reduced to 0.5% reflecting continued disappointing private domestic demand, tight fiscal policies and the appreciation in value of the euro.

In the United Kingdom domestic demand has helped to sustain economic growth in the region of 2%.

Although deflation persists in Japan, it is easing and the broad economic indicators for the world's second largest economy are generally good. Unemployment is falling and significant increases have been recorded in Japan's export volumes and trade surplus.

Developing countries

The performance of developing countries in 2003 was somewhat of a mixed bag. On the positive side the emerging economies of Asia, despite the effects of SARS, are expected to post growth in excess of 6%,

largely driven by continued robust growth in China and India of between 8% and 10%. Growth in the transition countries in Europe remained reasonably solid with Russia leading the way with an estimated 5.7% GDP growth rate. Countries scheduled to join the expanded European Union benefited from strong direct investment inflows.

External confidence in the Latin America region, particularly Brazil, has improved but prospects for economic recovery remain fragile with a number of countries facing significant debt problems and political uncertainties. The region is extremely vulnerable to a reversal in the present bullish financial market sentiment towards emerging market bonds.

Growth performance of African economies continues to be largely determined by commodity prices, the extent of civil strife and the soundness of macroeconomic policies. In 2003 oil prices rose sharply due to the U.S. war in Iraq and then supply disruptions in Venezuela and Nigeria. Non-fuel commodity prices also rose particularly for food and agricultural raw materials. In sub-Saharan Africa (excluding South Africa) GDP growth in 2003 is expected to exceed 3% reflecting the positive impact of improved macroeconomic policies, rising commodity prices and debt relief under the HIPC initiative. However, adverse weather conditions and political instability have resulted in food shortages persisting in a number of countries. The high incidence of HIV infection also places an enormous burden on the economies of the region.

Domestic Economy

Real output of the Malawi economy is expected to recover somewhat in 2003 following a decline in real GDP in 2001 and negligible growth in 2002. Except for the



Economic Review (cont.)

Financial Review

manufacturing sector which continues to stagnate, all other sectors of the economy will show some degree of growth with the major contribution to overall growth of around 4% being the agricultural sector. In particular, small scale agriculture has benefited from improved weather conditions and the provision of free farm inputs to smallholder growers under the sponsorship of government and donors.

Donor budgetary support to Malawi resumed in the last quarter of 2003 following a prolonged period when the widening fiscal deficit was financed exclusively by domestic borrowing. The level of support was not, however, sufficient to make inroads into reducing Government domestic borrowing which has escalated to around K50 billion at 31 December 2003. Neither was there sufficient support to enable the monetary authorities halt the decline in gross official foreign exchange reserves which represented 1.8 months of import cover at 31 December 2003 compared with 2.6 months of cover at 31 December 2002.

Foreign Currency market

Foreign reserves remained low through most of the year due to the absence of donor balance of payments support and a fall of around 10% in earnings from the country's major export crop, tobacco.

As a result the Kwacha remained under pressure throughout the year and in particular over the period July to September 2003 prior to the receipt of donor budgetary support. The currency lost 20% in value against the US dollar over the course of 2003 but the US dollar itself depreciated sharply against most major currencies. As a result, the loss in value against other major currencies was more marked with, for example, a 40% depreciation in the value of the Kwacha against the South African Rand.

At 31 December 2003 overall banking system gross foreign exchange reserves were equivalent to 2.9 months of import cover (2002:3.9 months) and gross official reserves equated to 1.8 months cover (2002: 2.6 months).

Inflation

The national average inflation rate for 2003 was 9.6%, a significant drop from the 14.8% average recorded in 2002. The first half of 2003 saw a declining trend in the inflation rate with year on year inflation dropping to a low of 8.5% in June 2003 before gradually increasing over the latter half to the year to end with a year on year inflation rate of 9.8%.

The major contributory factor to the lowering of inflation rates is the very low level of food inflation following a good cereals harvest. Food costs which constitute almost 60% of the consumer price index basket rose by around 5% over the course of the year. On the other hand the year on year non-food inflation rate remained stubbornly in the range 14% to 20% throughout the year and closed at 18.6%.

Interest Rates

The Reserve Bank of Malawi maintained a tight monetary policy stance throughout the year with a view to controlling money supply through mopping up any excess liquidity in the economy. In spite of this, money supply grew by around 30% driven by net domestic borrowing by Government.

The bank rate remained at 40% from the beginning of the year until June when it was increased to 45%. In the last two months of the year the bank rate was reduced to 40% and then 35%. Money market rates broadly tracked the movement in the bank rate. For example average yields on treasury bills hovered just below 40% until June before



Economic Review (cont.)

Annual Report 2003

increasing to 44% and then falling back to end the year at 33%.

Malawi continues to face high real interest rates, though the spread between interest rates and non-food inflation is narrowing. The high real rates of interest reflect a high country risk premium and the market distortions created by the soaring public sector borrowing requirement.

Stock Market

Liquidity of the Malawi Stock Exchange improved with 182 million shares being traded for a total turnover of K808 million against total trades in 2002 of 32 million shares for a turnover of K259 million. Nevertheless the market remains depressed due to large market overhangs and the attractive yields available from relatively risk free money market investments.

Outlook

On the international economic scene America's vast current account deficit remains a major concern. At present Asian central banks continue to support the dollar through investing in low-yielding US treasury bonds. Their motivation is the promotion of Asian exports to the USA but eventually they may have to heed the risk-reward equation and this could lead to a painful correction in the form of a sharp increase in bond yields and a further decline in the value of the dollar. There is little evidence to suggest that, in an election year, the US authorities will take action to address the root causes of the current account deficit by implementing appropriate fiscal and monetary policies to reduce the government budget deficit and reverse the declining US personal savings rate.

Because of political upheaval and adverse weather conditions, the Southern African region faces widespread maize deficits in

2004 with the situation in Zimbabwe being particularly worrying. The region will be a net importer of maize in 2004 and immense logistical problems must be overcome to avoid famine.

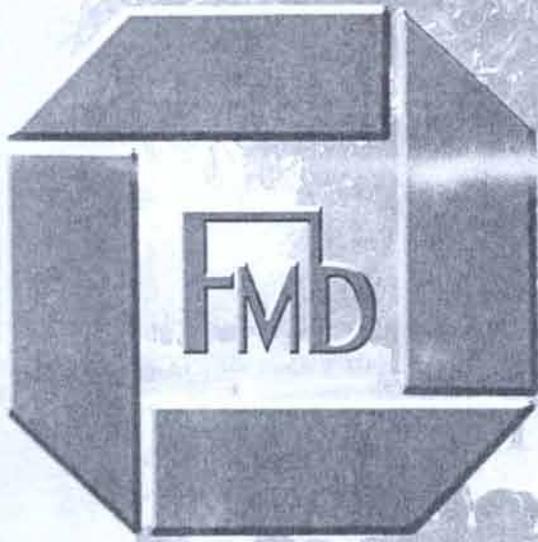
The somewhat erratic start to the rainy season in Malawi will adversely affect maize production levels, especially in the Southern Region of the country. However, overall growth in the agricultural sector is anticipated, led by an increase in large scale Virginia tobacco production. Growth is also anticipated in all other sectors of the economy though growth in the manufacturing sector will be modest and make little impact on the 20% contraction in manufacturing sector output over the last four years.

Inflationary pressures which began to build up towards the end of 2003 will continue into 2004 with food prices expected to increase in the lean season prior to the 2004 crop harvest.

There now seems little prospect of further significant donor budgetary support prior to the presidential and parliamentary elections in May 2004. The absence of donor support and a likelihood of increased government spending in the run up to the elections point to a widening fiscal deficit and a further increase in the already alarming level of government's domestic debt.

Given the low level of foreign exchange reserves at the beginning of the year, the Kwacha will remain under pressure until significant inflows of tobacco export proceeds commence in the second quarter of 2004. It is thought that the monetary authorities will wish to defend the value of the Kwacha at its present level and thus monetary policy will remain aggressive for this reason and to subdue inflationary pressures.





Pro Vice - Chancellor of the University of Malawi receiving a donation for tuition fees for sponsored students with Dr. Chokotho (far right) at the College of Medicine, Blantyre

Community Projects



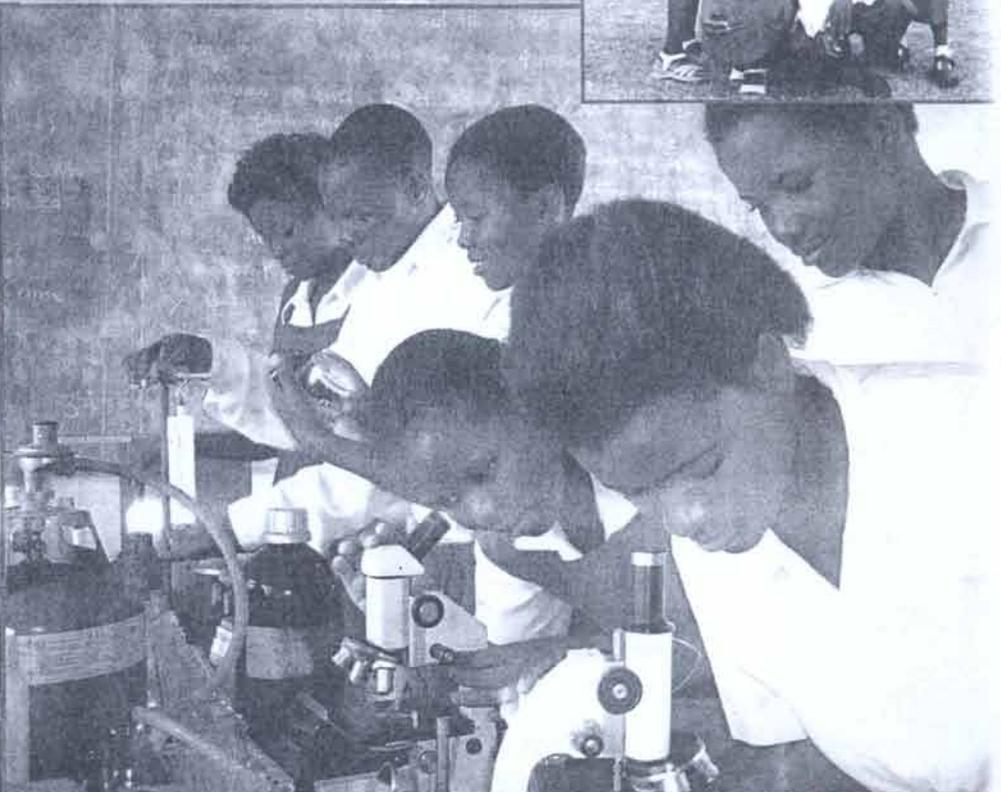
Borehole at Nancholi Primary School, Blantyre



Sponsored students at the Polytechnic, Blantyre



▼ Sponsored students at Dzukani Secondary School, Nsanama, Machinga



▼ Secondary students at Joshua Orphanage Care Centre



▼ Guardian shelter at Mzuzu Central Hospital



Director's Report

First Merchant Bank

The directors have pleasure in submitting their report together with the group financial statements of First Merchant Bank Limited for the year ended 31st December 2003.

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. Its wholly owned subsidiary, Leasing and Finance Company of Malawi Limited is engaged in the provision of lease finance.

The physical address of the holding 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 statements, statements of changes in equity, balance sheets, statements of cash flows and associated accounting policies and notes.

Dividend

A dividend of MK150 million (2002: MK100 million) was paid during the year, representing 150 tambala (2002: 100 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 have been 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.



Director's Report (cont.)

Annual Report 2003

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

Credit Committee

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

Appointments and Remuneration Committee

The committee is appointed by the Board to review the terms and conditions of service and the salaries of staff members. The committee consists of all local 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 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 responsible for establishing controls to prevent the falsification of entries in the books of account 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 2004 financial statements.

N.G. Anadkat
DIRECTOR

J.M. O'Neill
DIRECTOR

14th February 2004



Auditor's Report

First Merchant Bank



Public Accountants
and
Business Advisors

Office Address:
Able House
Hannover Avenue
Blantyre

Mail Address:
P.O. Box 508
Blantyre
Malawi

Telephone: (265) 01 620 744 / 01 620 391
Telefax: (265) 01 620 575
E-mail: kpmg@malawi.net

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

Scope

We have audited the consolidated financial statements of First Merchant Bank Limited set out on pages 17 to 35 for the year ended 31st December 2003.

Respective responsibilities of directors and auditors

These financial statements are the responsibility of the directors of the Company. 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 consolidated financial statements are properly drawn up in accordance with the provisions of the Companies Act 1984 and International Financial Reporting Standards so as to give, in all material respects, a true and fair view of the financial position of the Group and Company at 31st December 2003 and of the results of their operations and cash flows for the year then ended, as far as concerns the members of the Company.

KPMG
Certified Public Accountants (Malawi)
Blantyre

14th February 2004



Member firm of
KPMG International

Blantyre:
R.M. Davies
R. Harwa

Lilongwe:
V.S. Venkatesh



Income Statements

Annual Report 2003

For the year ended 31st December 2003
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2003	2002	2003	2002
INCOME					
Interest on loans and advances		412,561	294,034	408,589	290,355
Interest on placements with other banks		55,116	82,946	55,116	79,544
Income from treasury bills		541,232	379,158	434,052	351,662
Income from lease financing		86,914	64,225	-	-
Income from investments		21,615	20,636	17,595	17,565
Interest payable on deposits and other accounts		(475,385)	(357,013)	(357,958)	(289,825)
Net interest income		642,053	483,986	557,394	449,301
Fees and commissions receivable		131,731	54,695	130,289	54,695
Other income	1	252,640	184,022	247,284	181,520
Total net income		1,026,424	722,703	934,967	685,516
EXPENDITURE					
Staff and training costs	2	229,180	143,434	216,412	138,664
Recurrent expenditure on premises and equipment		40,838	31,552	38,721	30,305
Depreciation		39,643	36,747	37,335	35,175
Other operating costs	3	199,024	112,752	150,392	97,453
Total expenditure		508,685	324,485	442,860	301,597
Profit before provision for doubtful debts		517,739	398,218	492,107	383,919
Provision for doubtful debts - Specific		(5,478)	(5,669)	(1,085)	223
- General		(13,225)	(11,698)	(12,000)	(12,000)
Profit before income tax expense		499,036	380,851	479,022	372,142
Income tax expense	4	(147,210)	(111,672)	(142,392)	(111,622)
NET PROFIT FOR THE YEAR		351,826	269,179	336,630	260,520
Basic earnings per share (MK)	5	3.52	2.69		

The financial statements are to be read in conjunction with the accounting policies on pages 21 to 25 and notes on pages 26 to 35.

The auditor's report is on page 16.



Statements of Changes in Equity

First Midyear Report

For the year ended 31st December 2003
In thousands of Malawi Kwacha

GROUP	Share capital	Revaluation reserve	Retained earnings	Total
Balance at 1st January 2002	30,000	-	212,758	242,758
Bonus shares issued	70,000	-	(70,000)	-
Profit for the year 2002	-	-	269,179	269,179
Dividends to shareholders	-	-	(100,000)	(100,000)
Balance at 1st January 2003	100,000	-	311,937	411,937
Surplus on revaluation of properties	-	82,729	-	82,729
Deferred tax on revaluation surplus	-	(24,818)	-	(24,818)
Profit for the year 2003	-	-	351,826	351,826
Dividends to shareholders	-	-	(150,000)	(150,000)
Balance at 31st December 2003	100,000	57,911	513,763	671,674
COMPANY				
Balance at 1st January 2002	30,000	-	212,758	242,758
Bonus shares issued	70,000	-	(70,000)	-
Profit for the year 2002	-	-	260,520	260,520
Dividends to shareholders	-	-	(100,000)	(100,000)
Balance at 1st January 2003	100,000	-	303,278	403,278
Surplus on revaluation of properties	-	82,729	-	82,729
Deferred tax on revaluation surplus	-	(24,818)	-	(24,818)
Profit for the year 2003	-	-	336,630	336,630
Dividends to shareholders	-	-	(150,000)	(150,000)
Balance at 31st December 2003	100,000	57,911	489,908	647,819



Balance Sheets

Annual Report 2003

At 31st December 2003
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2003	2002	2003	2002
LIABILITIES AND EQUITY					
<i>Liabilities</i>					
Current and savings accounts		1,806,860	1,425,391	1,806,860	1,425,604
Foreign currency accounts		936,063	958,549	936,063	958,549
Term deposits accounts		1,483,487	1,159,308	1,032,025	836,057
Total liabilities to customers	6	4,226,410	3,543,248	3,774,948	3,220,210
Income tax payable		48,928	51,941	52,241	53,077
Balance due to other financial institutions		200,000	-	200,000	-
Other liabilities	7	466,475	412,363	463,257	385,821
		4,941,813	4,007,552	4,490,446	3,659,108
<i>Equity</i>					
Issued capital	8	100,000	100,000	100,000	100,000
Revaluation reserve		57,911	-	57,911	-
Retained earnings		513,763	311,937	489,908	303,278
Total equity		671,674	411,937	647,819	403,278
Shareholders' interests and liabilities		5,613,487	4,419,489	5,138,265	4,062,386
Deferred tax liabilities	9	35,859	-	31,241	-
Acceptances, guarantees, indemnities and credits for accounts of customers	17	1,353,697	956,946	1,353,697	956,946
Total equity and liabilities		7,003,043	5,376,435	6,523,203	5,019,332
ASSETS					
Cash and cash equivalents	10	3,639,356	3,144,323	3,241,148	3,005,023
Remittances in transit		94,895	18,772	94,895	18,772
Other assets	11	79,984	55,439	78,156	52,062
Loans and advances to customers	12	1,217,469	802,377	1,241,002	770,697
Finance leases	13	155,708	216,462	-	-
Other investments	14	45,575	63,375	45,000	47,000
Investment in subsidiary	15	-	-	65,911	65,911
		5,232,987	4,300,748	4,766,112	3,959,465
Deferred tax assets	9	-	10,658	-	10,658
Property and equipment	16	416,359	108,083	403,394	92,263
		5,649,346	4,419,489	5,169,506	4,062,386
Acceptances, guarantees, indemnities and credits for accounts of customers	17	1,353,697	956,946	1,353,697	956,946
Total assets		7,003,043	5,376,435	6,523,203	5,019,332

The financial statements of the company were approved for issue by the Board of Directors on 14th February 2004 and were signed on its behalf by:

N.G. Anadkat
Director

J.M. O'Neill
Director



Statements of Cash Flows

For the year ended 31st December 2003
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2003	2002	2003	2002
OPERATING ACTIVITIES					
Interest and fees received		1,501,535	1,073,677	1,288,117	971,557
Interest paid		(474,730)	(355,913)	(347,413)	(289,189)
Cash paid to suppliers and employees		(391,266)	(233,696)	(305,068)	(221,312)
		635,539	484,068	635,636	461,056
Increase in net customer balances		384,269	951,336	139,878	851,659
Cash generated from operations		1,019,808	1,435,404	775,514	1,312,715
Income taxes paid		(128,524)	(87,957)	(126,147)	(86,771)
Cash flows from operating activities		891,284	1,347,447	649,367	1,225,944
INVESTING ACTIVITIES					
Proceeds from sale of investment		19,803	-	2,000	-
Proceeds from sale of equipment		2,089	3,108	775	2,883
Acquisition of property and equipment	16	(268,143)	(47,060)	(266,017)	(44,632)
Acquisition of subsidiary	15	-	(45,911)	-	(45,911)
Purchase of additional shares in the subsidiary		-	-	-	(20,000)
Cash outflows from investing activities		(246,251)	(89,863)	(263,242)	(107,660)
FINANCING ACTIVITIES					
Dividend paid		(150,000)	(100,000)	(150,000)	(100,000)
Net increase in cash and cash equivalents		495,033	1,157,584	236,125	1,018,284
Cash and cash equivalents at 1st January		3,144,323	1,986,739	3,005,023	1,986,739
Cash and cash equivalents at 31st December	10	3,639,356	3,144,323	3,241,148	3,005,023
ADDITIONAL STATUTORY INFORMATION					
(Decrease)/increase in net working capital		(651)	133,771	(23,320)	140,932



Significant Accounting Policies

Annual Report 2003

First Merchant Bank Limited is a private limited company incorporated in Malawi. The consolidated financial statements for the year ended 31st December 2003 comprise the bank and its subsidiary, Leasing and Finance Company of Malawi Limited, (together referred to as the "Group")

(a) Statement of compliance

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

(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 fixed assets which are revalued and certain 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) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the bank and its subsidiary, Leasing and Finance Company of Malawi Limited.

Consolidation is based on 31st December 2003 audited financial statements. Inter-group balances and transactions and any unrealised gains arising from intra-group transactions other than arm's length transactions in the normal course of business are eliminated in preparing the consolidated financial statements.

(d) 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.

(e) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost or latest valuation and subsequent costs less accumulated depreciation (see below) and impairment losses (refer accounting policy (j).)

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



Significant Accounting Policies (cont.)

First Merchant Bank

All properties are subject to revaluation every two years.

(ii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property 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 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.

(iii) Depreciation

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

• leasehold properties	2.5% (or period of lease the shorter of)
• freehold properties	2.5%
• motor vehicles	25%-50%
• furniture, fixtures and fittings, computers, office equipment and leasehold improvements	25%-100%

(f) 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 in equity are recognised at cost.

Investments held for trading are recognised/derecognised by the Group 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 Group.

(g) Finance leases

Lease and instalment sale contracts are regarded as financing transactions and rentals and instalments receivable there under, less unearned finance charges, are not capitalised as fixed assets, but are shown as lease debtors at amounts equal to the net investment in the leases.



Significant Accounting Policies (cont.)

Annual Report 2003

Known bad debts are written off and specific provision made for those considered to be doubtful.

(h) 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 i).

(i) Cash and cash equivalents

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

(j) Impairment

The carrying amounts of the Group's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

(k) 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.

(l) Provisions and other liabilities

A provision is recognised in the balance sheet when the Group 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.



Significant Accounting Policies (cont.)

First Merchant Bank

(m) Pension Schemes and other post retirement benefits

The bank operates a Defined Contribution Pension Scheme administered by the NICO Life 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.

(n) 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.

(iii) Lease income

Income from leases is accounted for on the actuarial method so as to produce a constant periodic rate of return on the net investment outstanding.

(o) Expenses

(i) Terminal benefits

Accruals are made for terminal benefits and gratuities for those employees who are not covered by the Pension Fund and are charged to income statement up to the date of balance sheet.

(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.

(p) 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.



Significant Accounting Policies (cont.)

Annual Report 2003

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.

(q) Dividends

Dividends are recognised in the income statement when the company has unconditional rights to receiving them.

(r) Goodwill

Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired.

Goodwill is written off in the year of acquisition.

(s) Earnings per share

Earnings per share is calculated by dividing net profit attributable to ordinary shareholders by the number of ordinary shares outstanding at year-end.



Notes to the Financial Statements

First Merchant Bank

For the year ended 31st December 2003
In thousands of Malawi Kwacha

	GROUP		COMPANY	
	2003	2002	2003	2002
1. Other income				
Profit on foreign exchange transactions	238,376	177,959	238,376	177,959
Profit on disposal of fixed assets	1,968	2,484	495	2,259
Other sundry income	12,296	3,579	8,413	1,302
	<u>252,640</u>	<u>184,022</u>	<u>247,284</u>	<u>181,520</u>
2. Staff and training costs				
Salaries, wages and training costs	223,997	138,260	211,866	135,612
Contributions to defined contribution plans	5,183	5,174	4,546	3,052
	<u>229,180</u>	<u>143,434</u>	<u>216,412</u>	<u>138,664</u>
The number of employees of the group at 31st December 2003 was 324 (2002: 304).				
3. Other operating costs				
Auditor's remuneration - current audit fees (before surtax)	3,714	2,838	2,350	1,800
Directors' fees	13,391	8,848	13,316	8,848
Goodwill written off	-	7,115	-	-
Telephone/telex/fax/postage	16,371	12,279	13,511	11,545
Printing and stationery	21,894	14,562	20,728	13,889
Others	143,654	67,110	100,487	61,371
	<u>199,024</u>	<u>112,752</u>	<u>150,392</u>	<u>97,453</u>
4. Income tax expense				
Recognised in the income statement				
Current tax expense				
Current year at 30% (2002: 30%) based on profits	125,511	118,069	125,311	118,019
Deferred tax				
Origination and reversal of timing differences	21,699	(6,397)	17,081	(6,397)
Total income tax expense in income statement	<u>147,210</u>	<u>111,672</u>	<u>142,392</u>	<u>111,622</u>



Notes to the Financial Statements (cont.)

Annual Report 2003

5. Earnings per share

The calculation of basic earnings per share at 31st December 2003 was based on the consolidated net profit attributable to ordinary shareholders of MK352 million (2002: MK269 million) and number of ordinary shares outstanding as at 31st December 2003 of 100 million (2002: 100 million).

For the year ended 31st December 2003
In thousands of Malawi Kwacha

6. Liabilities to customers

	GROUP		COMPANY	
	2003	2002	2003	2002
Interest bearing deposits	4,226,410	3,543,248	3,774,948	3,220,210
Payable as follows:				
Maturing within 3 months	4,017,277	2,925,577	3,611,821	2,633,508
Maturing between 3 and 12 months	209,133	617,671	163,127	586,702
	4,226,410	3,543,248	3,774,948	3,220,210

7. Other liabilities

Interest payable	25,549	15,004	25,549	15,004
Bankers cheques issued and uncleared	64,195	35,789	64,195	35,789
Credit clearance vouchers	18,465	31,266	18,465	31,266
Margins on letters of credit and forward contracts	213,437	258,559	213,437	258,559
Others	144,829	71,743	141,611	45,203
	466,475	412,363	463,257	385,821

8. Share capital

In thousands	Ordinary shares	
	2003	2002
In issue at 1 January	100,000	30,000
Issued during the year	-	70,000
In issue at 31st December – fully paid	100,000	100,000

At 31 December 2003 the authorised share capital comprised 100,000,000 (2002:100,000,000) ordinary shares of K1 each and the issued and fully paid share capital totalled 100,000,000 (2002:100,000,000) ordinary shares 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.



Notes to the Financial Statements (cont.)

FMB Merchant Bank

9. Deferred tax assets and liabilities

	Assets		Liabilities		Net	
	2003	2002	2003	2002	2003	2002
GROUP						
Property and equipment	(9,030)	(7,835)	-	-	(9,030)	(7,835)
Accrued income	-	-	35,297	9,277	35,297	9,277
Revaluation surplus	-	-	27,534	-	27,534	-
General provisions	(15,700)	(12,100)	-	-	(15,700)	(12,100)
Gratuity	(2,242)	-	-	-	(2,242)	-
Tax (assets)/liabilities	(26,972)	(19,935)	62,831	9,277	35,859	(10,658)
COMPANY						
Property and equipment	(10,932)	(7,835)	-	-	(10,932)	(7,835)
Accrued income	-	-	35,297	9,277	35,297	9,277
Revaluation surplus	-	-	24,818	-	24,818	-
General provisions	(15,700)	(12,100)	-	-	(15,700)	(12,100)
Gratuity	(2,242)	-	-	-	(2,242)	-
Tax (assets)/liabilities	(28,874)	(19,935)	60,115	9,277	31,241	(10,658)

10. Cash and cash equivalents

	GROUP		COMPANY	
	2003	2002	2003	2002
Liquidity Reserve Deposits				
- Reserve Bank of Malawi	607,714	457,591	607,714	457,591
- Registered discount houses	190,000	161,250	190,000	161,250
	797,714	618,841	797,714	618,841
Balances with banks abroad	1,082,460	235,581	1,082,460	235,581
Malawi Government treasury bills	1,557,565	1,550,049	1,159,526	1,411,397
Balances with local banks	2,562	561,013	2,393	560,365
Cash balances	199,055	178,839	199,055	178,839
Cash and cash equivalents	3,639,356	3,144,323	3,241,148	3,005,023

11. Other assets

Items in transit	57,147	31,317	57,147	31,317
Interest receivable	12,038	10,003	11,981	7,943
Prepayments	6,908	11,320	5,137	10,003
Others	3,891	2,799	3,891	2,799
	79,984	55,439	78,156	52,062



Notes to the Financial Statements (cont.)

Annual Report 2003

For the year ended 31st December 2003
In thousands of Malawi Kwacha

	GROUP		COMPANY	
	2003	2002	2003	2002
12. Loans and advances to customers				
Maturing within 3 months	428,794	791,471	461,989	756,644
Maturing between 3 and 12 months	893,347	102,724	883,360	102,724
	<u>1,322,141</u>	<u>894,195</u>	<u>1,345,349</u>	<u>859,368</u>
Segmental analysis industry:				
Agriculture	139,496	101,170	123,069	101,170
Finance and insurance	206,070	45,026	205,486	45,026
Government accounts	9,265	6,786	9,265	6,786
Individuals	316,921	58,874	304,231	58,874
Manufacturing	227,325	287,854	211,207	287,854
Wholesale and retail	177,426	256,528	159,129	256,528
Other	245,638	137,957	332,962	103,130
	<u>1,322,141</u>	<u>894,195</u>	<u>1,345,349</u>	<u>859,368</u>
Provision for losses:				
Specific Provision : At 1st January	(21,343)	(20,018)	(18,521)	(19,216)
Write offs	802	472	-	472
New provision	(18,282)	(12,461)	(18,282)	(10,441)
Recoveries	19,217	10,664	17,197	10,664
-At 31st December	<u>(19,606)</u>	<u>(21,343)</u>	<u>(19,606)</u>	<u>(18,521)</u>
Interest in suspense: At 1st January	(29,816)	(24,114)	(29,816)	(24,114)
New provision	(2,591)	(5,702)	(2,591)	(5,702)
At 31st December	<u>(32,407)</u>	<u>(29,816)</u>	<u>(32,407)</u>	<u>(29,816)</u>
General provision: At 1st January	(40,659)	(28,659)	(40,334)	(28,334)
New provision	(12,000)	(12,000)	(12,000)	(12,000)
At 31st December	<u>(52,659)</u>	<u>(40,659)</u>	<u>(52,334)</u>	<u>(40,334)</u>
Net loans and advances	<u>1,217,469</u>	<u>802,377</u>	<u>1,241,002</u>	<u>770,697</u>



Notes to the Financial Statements (cont.)

First Merchant Bank

For the year ended 31st December 2003

In thousands of Malawi Kwacha

13. Finance leases

	GROUP	
	2003	2002
Maturing within 3 months	63,688	55,744
Maturing between 3 and 12 months	65,871	102,623
Maturing after 12 months	74,578	103,266
	<u>204,137</u>	<u>261,633</u>
Specific provision at 1st January	(22,589)	(18,717)
New provision	(6,413)	(3,872)
Write offs	1,432	-
At 31st December	<u>(27,570)</u>	<u>(22,589)</u>
Interest in suspense at 1st January	(13,216)	(17,302)
New provision	1,042	4,086
At 31st December	<u>(12,174)</u>	<u>(13,216)</u>
General provision at 1st January	(2,560)	(2,862)
New provision	(1,225)	302
At 31st December	<u>(3,785)</u>	<u>(2,560)</u>
Interest on overdue debts at 1st January	(6,160)	-
New provision	1,260	(6,160)
At 31st December	<u>(4,900)</u>	<u>(6,160)</u>
Net finance leases	<u>155,708</u>	<u>217,108</u>
Government sub-lease debtors	18,446	17,664
Rural motorised project	(18,446)	(18,310)
Total finance leases	<u>155,708</u>	<u>216,462</u>

14. Other investments

Local registered Government stocks (at cost)
Accrued interest has been included under other assets.

	GROUP		COMPANY	
	2003	2002	2003	2002
	45,575	63,375	45,000	47,000

15. Investments in subsidiary (at cost)

Leasing and Finance Company of Malawi Limited

	SHAREHOLDING		COMPANY	
	2003	2002	2003	2002
	100%	100%	65,911	65,911



Notes to the Financial Statements (cont.)

Annual Report 2003

16. Property and equipment

GROUP	Freehold property	Leasehold improvements	Motor Vehicles	Equipment Fixture & fittings	Capital work in progress	Total
Cost or valuation						
Balance at 1st January 2003	44,416	1,385	30,494	137,315	-	213,610
Additions	63,460	-	4,933	19,972	179,778	268,143
Revaluation surplus	80,960	-	-	-	-	80,960
Disposals	-	-	(4,752)	(1,582)	-	(6,334)
Balance at 31st December 2003	188,836	1,385	30,675	155,705	179,778	556,379
Depreciation and impairment losses						
Balance at 1st January 2003	2,259	1,310	17,846	84,112	-	105,527
Charge for the year	1,995	-	4,368	33,280	-	39,643
Eliminated on revaluation	(1,769)	-	-	-	-	(1,769)
Released on disposal	-	-	(1,995)	(1,386)	-	(3,381)
Balance at 31st December 2003	2,485	1,310	20,219	116,006	-	140,020
Carrying amount At 31st December 2003	186,351	75	10,456	39,699	179,778	416,359
At 31st December 2002	42,156	75	12,648	53,204	-	108,083
COMPANY						
Cost or valuation						
Balance at 1st January 2003	34,226	1,385	19,854	122,781	-	178,246
Additions	63,460	-	4,933	17,846	179,778	266,017
Revaluation surplus	80,960	-	-	-	-	80,960
Disposals	-	-	(1,140)	-	-	(1,140)
Balance at 31st December 2003	178,646	1,385	23,647	140,627	179,778	524,083
Depreciation and impairment losses						
Balance at 1st January 2003	2,146	1,310	10,101	72,426	-	85,983
Charge for the year	1,769	-	3,950	31,616	-	37,335
Eliminated on revaluation	(1,769)	-	-	-	-	(1,769)
Released on disposal	-	-	(860)	-	-	(860)
Balance at 31st December 2003	2,146	1,310	13,191	104,042	-	120,689
Carrying amount At 31st December 2003	176,500	75	10,456	36,585	179,778	403,394
At 31st December 2002	32,080	75	9,753	50,355	-	92,263



Notes to the Financial Statements (cont.)

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.

The freehold properties were last revalued on 31st December 2003 by Francis R. Chaloza MSC Pg Dip of Knight Frank, on market value basis.

Capital work in progress represents development costs on the bank's various branches and administration properties.

For the year ended 31st December 2003
In thousands of Malawi Kwacha

17. Contingent Assets/Liabilities	GROUP		COMPANY	
	2003	2002	2003	2002
Letters of credit	377,465	286,033	377,465	286,033
Guarantees	506,813	250,354	506,813	250,354
Travellers cheques	220,013	311,602	220,013	311,602
Foreign bills lodged	249,406	108,957	249,406	108,957
	<u>1,353,697</u>	<u>956,946</u>	<u>1,353,697</u>	<u>956,946</u>

18. Employee benefits

Expense recognised in the income statement

Contributions to defined contribution plans

This is recognised under staff costs in the income statement.

	5,183	5,174	4,546	3,052
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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 NICO Life Insurance Company Limited with effect from 1st April 1999. The company and employees contribute to a Deposit Fund established thereunder.

The subsidiary company's pension scheme is The Leasing and Finance Company of Malawi Limited Pension Fund covering all employees in the permanent service of the company. The trustees of this scheme have effected a deposit administration contract with Old Mutual Life Assurance Company Limited with effect from 1st March 1987. The company and employees contribute to a Deposit Fund established thereunder.



Notes to the Financial Statements (cont.)

Annual Report 2003

19. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the group'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 evaluations 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. Throughout the year the bank complied with the Reserve Bank of Malawi directive on credit concentration.

Foreign exchange risk

The Group 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, South African Rand and Euro. All the transactions entered into during the year were within the foreign currency exposure and foreign currency lending directives of Reserve Bank of Malawi.

Liquidity risk

Liquidity risk arises where the operations of the Bank cannot be funded due to mismatches in the cash flows of assets and liabilities within the balance sheet. The bank has an Asset and Liability Committee (ALCO) which reviews the potential for these mismatches, takes measures to alter certain maturity profiles where necessary with a view to minimising the impact of such mismatches.

Interest rate risk

Interest rate risk is generally referred to as the exposure of the Bank's net interest income to adverse movements in interest rates as a result of assets and liabilities re-pricing at different times and using different bases. The risk therefore has a direct impact on the bank's net interest margin. ALCO reviews the re-pricing gap periodically and appropriate action is taken to reduce the effect of the risk.

Operational risk

This is the risk of losses arising from the operations of the Bank. Losses can occur due to system malfunctioning or failure to follow procedures. Operational risk manifests itself in losses, customer complaints and claims. To mitigate the risk, management continuously reviews the controls and procedures in place. Branches and Head Office departments employ internal audit which, periodically, determine whether the controls in place are commensurate with the risk involved.



Notes to the Financial Statements (cont.)

First Merchant Bank

20. Related parties

The bank transacts part of its business on an arm's length basis with related parties. As on 31st December 2003, advances to the bank's subsidiary company, Leasing and Finance Company of Malawi Limited totalled K40.4 million (2002: K5.8 million) which was fully secured by Treasury bills. Loans and advances to other related parties totalled K1.9 million (2002: K3.8 million) of which K1.5 million (2002: K3.8 million) was secured by fixed and floating charges.

During the year the group made payments of K11.65 million to companies affiliated to its shareholders comprising K9.0 million for acquisition of leasehold property and K2.65 million as rental payments for properties occupied by the group.

21. Statutory requirements

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 weeks total deposit liabilities. In the last week of December 2003, the liquidity reserve was 32% (2002: 33%) 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 31st December 2003, the Bank's available capital was 23% (2002: 28%) of its risk bearing assets and contingent liabilities.

23. 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 2: 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 31st December 2003, the Bank's Liquidity Ratio 1 was 85% (2002: 95%) and Liquidity Ratio 2 was 83% (2002: 94%)



Notes to the Financial Statements (cont.)

Annual Report 2003

24. Incorporation

First Merchant Bank Limited is a private company incorporated in Malawi under the Malawi Companies Act 1984 and is registered as a commercial bank under the Banking Act (1989).

25. Exchange rates and inflation

The average of the year-end buying and selling rates of the major foreign currencies affecting the performance of the Bank are stated below, together with the increase in the National Consumer Price Index, which represent an official measure of inflation.

Exchange rates	2003 MK	2002 MK	2001 MK
Kwacha/GBP	193.7	140.2	98.4
Kwacha/Rand	16.7	10.2	5.7
Kwacha/US Dollar	108.4	87.1	67.3
Kwacha/Euro	136.7	91.3	30.7
Inflation rate %	9.6%	14.8%	22.1%

26. Subsequent events

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



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First Merchant Bank's
new building is scheduled to
be completed in May 2004



