

2004 Annual Report



First Merchant Bank

FMB

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2003



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Malawi



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First Merchant Bank

BANK OF THE YEAR 2004 FOR

Malawi

FT Business
FINANCIAL TIMES

Stephen Timewell, Editor-in-Chief

Angus Cushley, Publishing Director

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The new First Merchant Bank Head Office in Livingstone Towers was inaugurated by His Excellency Dr. Bingu Wa Mutharika, President of the Republic of Malawi on 26th November, 2004.



LIVINGSTONE TOWERS

Head Office



Senior Management

Annual Report 2004

HEAD OFFICE

Managing Director
Kashinath Chaturvedi

General Manager
Seetharaman Srinivasan

Regional Manager (Marketing)
Kersy H. Kavina

Head, International Banking
Thomas Kadantot

Head, Information Technology
E.P. Jacob

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

Marketing Manager
George Kamvulumvulu

Audit Manager
Tiwonge Kalua



Branch Management

First Merchant Bank

BLANTYRE

Acting Chief Manager
Anna Mafuleka (Mrs)

Acting Operations Manager
Foster Sofasi

LIMBE

Chief Manager
Ravindra Kamath

Operations Manager
Montfort Masinga

LILONGWE

Chief Manager
Prakash Kamath

Acting Operations Manager
Doris Kalambo (Mrs)

CAPITAL CITY

Branch Manager
Evelyn Malongo (Ms.)

MZUZU

Branch Manager
Evance Bamusi

FIRST CORPORATE SERVICES

Chief Manager
Friday Chalamba



2004 has been another successful year for the bank with satisfactory growth in all areas of our operations. As we approach our tenth anniversary in 2005, we look forward with confidence to further sustained growth based on the strong asset and customer base already established through our reputation for customer service and innovation.

Overview of the Economy

It has been a difficult year for the Malawi economy. In the first half of the year, donor support was suspended due to concerns over governance and accountability in the run up to the presidential and parliamentary elections. The IMF programme for Malawi remains suspended until the performance of the newly elected government is assessed against agreed fiscal and monetary targets.

The first budget following the swearing in of the new government promised a return to fiscal discipline in order to re-establish the confidence of stakeholders in the ability of government to manage its resources. Preliminary data for the six months to December 2004 indicates that government expenditure has been contained within budget but two principal areas of concern remain. Firstly, the reform of civil service remuneration will likely lead to some over-expenditure in this area. However, a much greater concern is that government has been unable to significantly reduce its domestic borrowing and debt service costs now consume some 40% of government's domestic revenues.

Although the monetary authorities have largely maintained the tight monetary regime that has been in place for many years, there are indications of a possible moderation in their position in order to spur economic growth which is estimated to be a disappointing 3.2% in 2004. This is evidenced by a 10% reduction in the base rate in June 2004 and hints of further reduction when economic circumstances permit, presumably after the resumption of a full donor support programme for the economy.

Despite an overall tight monetary stance, money supply continued to grow at an annual rate of around 30% creating inflationary pressures in the economy. The national average inflation rate for the year stood at 11.5% up from 9.6% in 2003.

As could be expected, due to much lower than anticipated donor inflows and disappointing tobacco export earnings, foreign currency reserves declined further during the year. At year end, overall banking system reserves equated to 2.65 months of import cover and gross official reserves equated to 1.55 months of cover. Despite persistent foreign exchange shortages throughout the year, intervention by Reserve Bank of Malawi succeeded in maintaining the value of the Kwacha against the benchmark US dollar. However, weakness in the US dollar meant that the Kwacha depreciation against other major currencies ranged from 10% to 15%.

Performance Highlights

Despite the difficult economic conditions, the bank continues to enjoy strong growth with total group assets growing over the year by K2.6 billion to reach K8.3 billion at year end. Group profit after tax for the year was K457 million, a 31% increase over the prior year and the capital base of the group at year end was K957 million.

The financial sector remained highly competitive throughout the year and competition for deposits was particularly fierce, especially from financial institutions who enjoy a pricing advantage through not being subject to the same prudential requirements as commercial banks. Against this background, it is particularly pleasing to report that our group deposit base has grown by 42% to in excess of K6 billion.

Continued efforts to secure good quality lending opportunities have resulted in a further increase in the group's credit portfolio which increased from K1.4 billion to K2.4 billion over the course of



Chairman's Statement (Cont.)

First Merchant Bank

the year. The quality of our credit portfolio remains satisfactory and we continue to maintain a prudent provisioning policy, setting aside a further K19 million to non-specific provision which now approximates 4% of our year end advances portfolio.

Our wholly owned subsidiary, The Leasing and Finance Company of Malawi Limited, has now, following its acquisition by the group in 2002, firmly established itself as a leading player in its market segment and has become an important contributor to group profits, generating before tax profits of K55 million during the year.

The bank is now a significant way through an ambitious programme to upgrade its branch network to ensure our customers enjoy a comfortable modern environment in which to transact their business with us. Our new Lilongwe Old Town branch opened in June 2004 and our new Limbe premises is scheduled to open in February 2005 and Zomba branch shortly thereafter. The highlight of the year was undoubtedly the official opening of Livingstone Towers in Blantyre by His Excellency, The State President, Dr Bingu wa Mutharika in November 2004. Livingstone Towers houses our new head office, Corporate Services and International branches and The Leasing and Finance Company of Malawi Limited.

Human Resources

At the end of the year, our staff complement was 318. The bank invests significant resources in the welfare, training and development of its management and staff. A total of 122 staff



Blantyre Branch



The New Limbe Branch

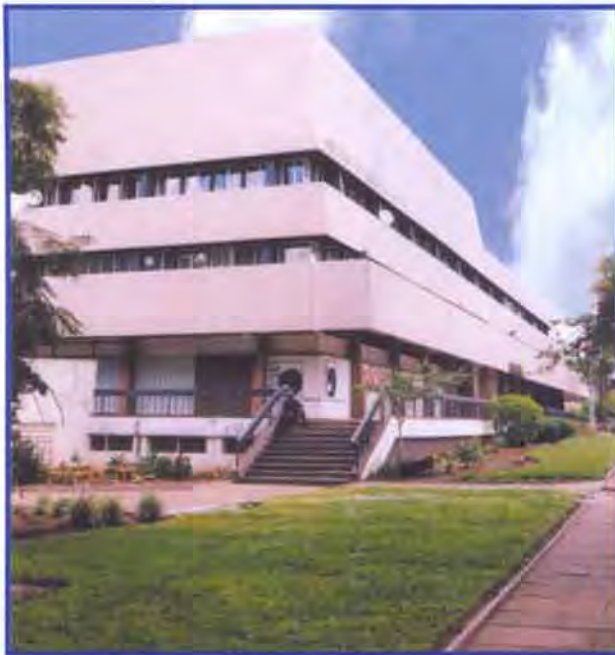


Lilongwe Branch



Chairman's Statement (Cont.)

Annual Report 2004



Chief M'belwa House, recently acquired to house the proposed Capital City Branch.



International Banking



Blantyre Branch

members are currently pursuing professional banking qualifications with the Institute of Bankers in South Africa.

The professionalism and commitment of the management and staff of the bank is evidenced by the award of 'Bank of the Year 2004' in Malawi by The Banker' magazine. We are proud to have received this award for the past three years in a row.

Donations

In recognition of its social obligations, the bank supports a wide range of worthy causes with particular focus on the areas of education and health. During the year, a forty-two-bed student hostel was handed over to the College of Medicine, the cost of which was jointly funded by the bank and one of its major shareholders, Mr N.G. Anadkat. It is hoped that this donation will prove to be of enduring benefit to the people of Malawi by assisting in the training of qualified medical personnel for generations to come.

Acknowledgements

Our customers are the foundation on which the bank's success is built. I thank all of them sincerely for their support and assure them of our commitment to continue to strive to exceed their service expectations.

I also wish to record my appreciation for the ongoing guidance of Reserve Bank of Malawi and my gratitude to our overseas correspondents and all the domestic financial institutions who have supported us during the year.

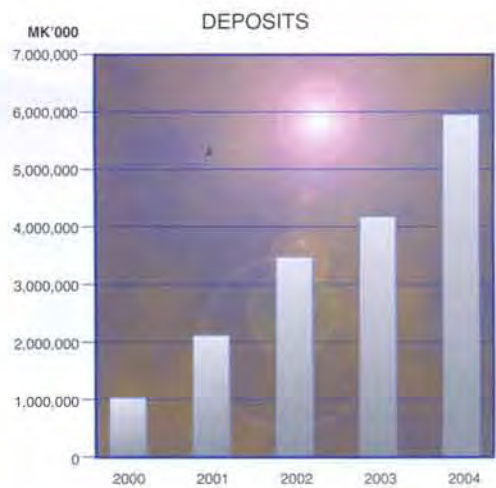
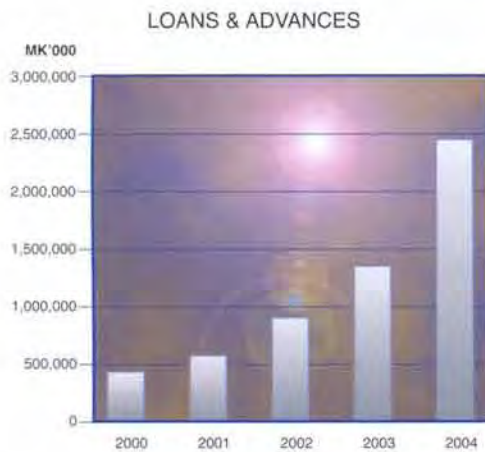
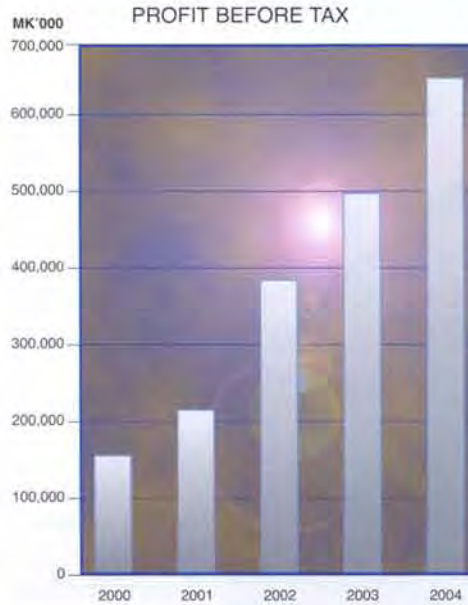
Finally, I would like to thank my fellow board members, management and staff of the bank for their continued dedication and hardwork.

**R C Kantaria
Chairman**



Five Year Performance

First Merchant Bank



2004 has been a turbulent year for the Malawi economy. The year began with the suspension of both IMF and World Bank facilities for Malawi due to Government's inability to meet agreed fiscal and monetary targets. Bi-lateral donors largely followed suit. Nevertheless, despite the absence of donor support, Government continued to spend far beyond its means in the run up to the mid year general elections resulting in a further ballooning in the already alarming level of domestic debt stock.

Following its swearing in, the new Government committed itself to the exercise of fiscal discipline and good governance. Early indications based on the budget out turn to 31 December 2004 are that the Government is delivering on its promise. Expenditure has been contained and, after grants, a modest surplus was achieved in the six months period to December. As a result, it has been possible to reduce the outstanding treasury bill stock and net domestic credit to Government.

There are encouraging signals that the donor community are responding positively to Government's efforts. A number of bi-lateral donors have recommenced balance of payments support and there are grounds for optimism that, following reviews in early 2005, IMF and World Bank will re-instate their programmes.

Economic Output

Real growth in gross domestic product of around 4% is forecast for 2004. Whilst growth has not yet reached a level that will make any significant impact on poverty in the country, this is a respectable achievement following on from a similar rate of growth in 2003. The previous three years were characterized by economic stagnation/contraction. The growth in 2004 was achieved against the background of a disappointing maize crop which was 20% down on 2003 due to an erratic rainy

season. Growth was registered in all sectors of the economy, even the long depressed manufacturing sector, but manufacturing output still remains, in real terms, lower than that of a decade ago.

Fiscal Performance

The fiscal out-turn for year 2003/04 which ended on 30 June 2004 was little short of disastrous. Total revenues were actually in excess of budget but expenditure soared to almost 40% more than what was originally budgeted. Perhaps the most notable over expenditure was domestic interest which exceeded approved budget by more than 100%. Domestic interest payments equated to 10% of GDP and consumed 40% of total domestic revenues of government. The overall result was that, instead of achieving a small surplus as forecast, a record fiscal deficit was incurred equivalent to 8% of GDP. The deficit was financed by domestic borrowing which climbed to unprecedented levels.

The 2004/05 budget presented by the newly elected government was described as a transitional budget to provide the framework within which to eliminate obstacles to the exercise of fiscal discipline and good governance. Preliminary figures for the six months to 31 December 2004 indicate some measure of success in bringing Government finances under control with overall domestic revenues ahead of budget and overall expenditure contained well within budget with the result that a modest surplus has been achieved. As a consequence, Government has been able to effect a 10% reduction in domestic debt stock, a welcome reversal in the trend of ever escalating government borrowing over the past number of years.

Foreign Currency Market

Largely due to the suspension of donor support, foreign currency reserves remained low throughout the year. At 31st December 2004 overall banking system



gross foreign reserves were equivalent to 2.65 months of import cover (2003:2.9 months) and gross official reserves equated to 1.55 months import cover (2003:1.8 months).

During the year Reserve Bank of Malawi remained very active in the market to support the value of the currency against the benchmark U.S. dollar. Although the kwacha held firm against the dollar, weakening in the value of the dollar in international markets has seen the kwacha depreciate against all other major currencies. In particular the currency fell 16% against the South African rand, the currency of Malawi's major trading partner.

By year end pressure on the kwacha had become severe and a considerable pipeline of pending foreign remittances had built up. It will now, therefore, prove difficult for Reserve Bank to defend the currency until relief comes with the opening of the tobacco auctions and the hoped for resumption of full donor support.

Inflation

Inflationary pressures persist in the economy with broad money supply growing by 30% over the course of the year. The main driver of money supply growth is government borrowing and, as might be expected, growth in money supply was much more marked in the first half of the year slowing down in the second half when fiscal discipline was restored. On the supply side, expansion in narrow money (50% increase) has been much greater than expansion of quasi money. This may indicate that the trading environment in the country is becoming increasingly cash based and probably also reflects an increase in demand deposits as a result of the foreign remittance pipeline.

The country's annual average inflation rate for 2004 was 11.5% versus 9.6% for 2003. This increase is not in itself

particularly worrying given the poor maize harvest resulting in higher food prices. Food inflation carries a major weighting in the overall inflation index. However, inflation has been on a rising trend since mid 2003 and inflationary pressures persist, despite the stability of the Kwacha, as food and oil prices remain volatile.

Interest Rates

Following a long period of market determined high real interest rates, Reserve Bank of Malawi effected a surprise 10% reduction in the bank rate from 35% to 25% in June 2004. This reduction could not be attributed to any change in economic fundamentals but it appears that Government through Reserve Bank in now prepared to use its position as dominant borrower in the market place to drive down interest rates in the hope of stimulating economic growth. The added bonus for Government is the reduction in the interest burden on Government's domestic debt stock.

Hints of further reductions in interest rates abound, possibly following the resumption of the IMF programme. Reserve Bank have also indicated that they wish to embark on a phased reduction of the level of non interest bearing liquidity reserves required to be deposited with the central bank by commercial banks. Implementation of the reduction has already been deferred due to concerns over the possible impact on money supply. If and when implemented a reduction in liquidity reserve requirement should enable commercial banks to reduce the spread between their deposit and lending rates.

Stock Market

2004 marked a turn around in fortunes for the Malawi capital market. The reduction in money market rates resulted in comparably very attractive yields being available on listed counters. Additionally



most of the large overhangs which had plagued the market for years were eliminated. As a result the domestic share index rose by 85% over the course of the year. The market remains, however, thin and relatively illiquid, though the illiquidity is now attributable to an absence of sellers in the market rather than an absence of buyers as was hitherto the case.

Outlook

The overall objective of the Malawi Economic Growth Strategy is to achieve an economic growth target of at least 6% per annum in the medium term. However, in 2005, adverse weather conditions will again impact agricultural output and it is anticipated that growth will fall some way short of the target. Improved fiscal discipline will improve business confidence but in the interim will also dampen economic growth as government consumption is reduced.

It now seems likely that agreed fiscal and monetary targets under the IMF Staff Monitored Programme will be met and disbursements under a new Poverty Reduction and Growth Facility will resume in 2005. In the interim foreign exchange reserves will remain perilously low and the kwacha will remain under pressure. It is anticipated that Reserve Bank will, however, rigorously defend the currency until the pressure eases with the opening of the tobacco auction floors and receipt of donor inflows.

Inflationary pressures will persist in the early part of 2005 as food and oil prices remain volatile. These pressures may be partly mitigated by a slow down in money supply growth if fiscal discipline is maintained. Much also will depend on the kwacha maintaining its value which in turn depends on the resumption of the IMF programme.

A tight monetary policy is likely to be maintained to guard against a further

build up of excess liquidity in the economy. Until sufficient forex reserves are available for sale to mop-up excess liquidity, the monetary authorities would be rash to effect further reductions in interest rates or any relaxation of liquidity reserve requirements.





Donations

**N.G. ANADKAT
HALLS OF RESIDENCE**
This Building was donated jointly
by Mr. N. G. Anadkat and
First Merchant Bank
JUNE 2004



The Halls of Residence shown below were donated to The Malawi College of Medicine jointly by Mr N.G. Anadkat and First Merchant Bank





Shelter at Chikapa Day Care Centre



Chikapa Day Care Centre



Mzuzu University



Donations

The First Merchant Bank continued to be involved in the community, by sponsoring students at Mzuzu University and The Malawi College of Medicine and by funding construction at Chikapa Day Care Centre, Machinjiri, Blantyre



College of Medicine, Blantyre

Directors' Report

First Merchant Bank

For the year ended 31st December 2004

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 2004.

Nature of business

First Merchant Bank Limited 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, The 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:-

Livingstone Towers
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.

Dividends

Dividends of K172 million (2003: K150 million) were declared during the year. Out of the total dividends declared K22 million were paid subsequent to year end.

Directorate and Secretary

The following directors and secretary served during the year:

Mr. R.C. Kantaria	Chairman
Mr. H.N. Anadkat	Vice Chairman
Mr. K. N. Chaturvedi	Managing Director (from 8th June 2004)
Mr. N.G. Anadkat	Director
Mr. J.M. O'Neill	Director
Mr. A. Abdallah	Director
Mr. V.K. Shetty	Director
Mr. M. Msisha	Director (from 8th June 2004)
Mr. N. Williams	Director (up to 30th September 2004)
Mrs. R. Kanyuka	Director (up to 13th February, 2004)
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.



Directors' Report (Cont.)

Annual Report 2004

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.

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 two non-executive 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 Managing Director's discretionary limits. This committee consists of two non-executive directors and one executive director.

Appointment 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 three 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 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 2005 financial statements.

K.N. Chaturvedi
MANAGING DIRECTOR

N.G. Anadkat
DIRECTOR

19th February 2005





KPMG
Public Accountants and Business Advisors
MASM House, Lower Sciater Road
P.O. Box 508,
Blantyre, Malawi

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

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 34 for the year ended 31st December 2004.

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 2004 and of the results of their operations and cash flows for the financial year ended on that date, as far as concerns the members of the Company.

KPMG
Certified Public Accountants (Malawi)
Blantyre

19th February 2005

KPMG Malawi, is a member firm of KPMG International, a Swiss cooperative. A list of the names of the partners is available for inspection at the office address.



Income Statements

Annual Report 2004

For the year ended 31st December 2004
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2004	2003	2004	2003
INCOME					
Interest on loans and advances		435,381	412,561	435,103	408,589
Interest on placements with other banks		75,801	55,116	74,777	55,116
Income from lease finance		90,051	86,914	-	-
Income from treasury bills		526,260	541,232	434,884	434,052
Income from investments	1	128,066	21,615	128,066	17,595
Interest payable on deposits and other accounts		(405,188)	(475,385)	(314,284)	(357,958)
Net interest income		850,371	642,053	758,546	557,394
Fees and commissions receivable		163,402	131,731	159,786	130,289
Other income	2	268,925	252,640	268,127	247,284
Total net income		1,282,698	1,026,424	1,186,459	934,967
EXPENDITURE					
Staff and training costs	3	293,179	229,180	280,830	216,412
Recurrent expenditure on premises and equipment		80,128	40,838	77,801	38,721
Depreciation		55,446	39,643	53,640	37,335
Other operating costs	4	174,594	199,024	158,892	150,392
Total expenditure		603,347	508,685	571,163	442,860
Profit before provision for doubtful debts		679,351	517,739	615,296	492,107
Provision for doubtful debts -Specific		(6,625)	(5,478)	(4,580)	(1,085)
-General		(19,209)	(13,225)	(12,000)	(12,000)
Profit before income tax expense		653,517	499,036	598,716	479,022
Income tax expense	5	(195,703)	(147,210)	(179,300)	(142,392)
NET PROFIT FOR THE YEAR		457,814	351,826	419,416	336,630
Basic earnings per share (MK)	6	4.58	3.52	4.19	3.36



Statements of Changes in Equity

First Merchant Bank

In thousands of Malawi Kwacha

<u>GROUP</u>	<u>Share capital</u>	<u>Property revaluation reserve</u>	<u>Investment revaluation reserve</u>	<u>Retained earnings</u>	<u>Total</u>
Balance at 1st January 2003	100,000	-	-	311,937	411,937
Surplus on revaluation of properties	-	82,729	-	-	82,729
Deferred tax on property revaluation surplus	-	(24,818)	-	-	(24,818)
Profit for the year 2003	-	-	-	351,826	351,826
Dividends paid to shareholders	-	-	-	(150,000)	(150,000)
Balance at 31st December 2003	100,000	57,911	-	513,763	671,674
Profit for the year	-	-	-	457,814	457,814
Transfer to investment revaluation reserve	-	-	85,663	(85,663)	-
Deferred tax on investment revaluation	-	-	(25,699)	25,699	-
Dividends paid to shareholders	-	-	-	(172,202)	(172,202)
Balance at 31st December 2004	100,000	57,911	59,964	739,411	957,286
<u>COMPANY</u>					
Balance at 1st January 2003	100,000	-	-	303,278	403,278
Surplus on revaluation of properties	-	82,729	-	-	82,729
Deferred tax on property revaluation surplus	-	(24,818)	-	-	(24,818)
Profit for the year 2003	-	-	-	336,630	336,630
Dividends paid to shareholders	-	-	-	(150,000)	(150,000)
Balance at 31st December 2003	100,000	57,911	-	489,908	647,819
Profit for the year 2004	-	-	-	419,416	419,416
Transfer to investment revaluation reserve	-	-	85,663	(85,663)	-
Deferred tax on investment revaluation surplus	-	-	(25,699)	25,699	-
Dividends paid to shareholders	-	-	-	(172,202)	(172,202)
Balance at 31st December 2004	100,000	57,911	59,964	677,158	895,033



Balance Sheets

Annual Report 2004

At 31st December 2004
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2004	2003	2004	2003
LIABILITIES AND EQUITY					
Liabilities					
Current and savings accounts		2,988,982	1,806,860	2,995,514	1,806,860
Foreign currency accounts		1,556,358	936,063	1,556,358	936,063
Term deposits accounts		1,460,590	1,483,487	919,624	1,032,025
Total liabilities to customers	7	6,005,930	4,226,410	5,471,496	3,774,948
Income tax payable		66,949	48,928	63,116	52,241
Balances due to other financial institutions		491,500	200,000	491,500	200,000
Other payables	8	701,356	466,475	701,190	463,257
Deferred tax liabilities	10	72,570	35,859	63,363	31,241
Total liabilities		7,338,305	4,977,672	6,790,665	4,521,687
Equity					
Issued capital	9	100,000	100,000	100,000	100,000
Property revaluation reserve		57,911	57,911	57,911	57,911
Investment revaluation reserve		59,964	-	59,964	-
Retained earnings		739,411	513,763	677,158	489,908
Total equity		957,286	671,674	895,033	647,819
Total equity and liabilities		8,295,591	5,649,346	7,685,698	5,169,506
ASSETS					
Cash and cash equivalents	11	4,570,565	3,639,356	4,247,794	3,241,148
Cheques in course of clearing		139,420	94,895	139,420	94,895
Other receivables	12	165,518	79,984	164,795	78,156
Loans and advances to customers	13	2,107,862	1,217,469	2,113,521	1,241,002
Finance leases	14	340,431	155,708	-	-
Quoted investments	16	322,816	45,575	322,516	45,000
Investment in subsidiary	17	-	-	65,911	65,911
		7,646,612	5,232,987	7,053,957	4,766,112
Property and equipment	18	648,979	416,359	631,741	403,394
Total assets		8,295,591	5,649,346	7,685,698	5,169,506

The financial statements of the company were approved for issue by the Board of Directors on 19th February 2005 and were signed on its behalf by:

K.N. Chaturvedi
Managing Director

N.G. Anadkat
Director



Statements of Cash Flows

First Merchant Bank

For the year ended 31st December 2004
In thousands of Malawi Kwacha

	Note	GROUP		COMPANY	
		2004	2003	2004	2003
OPERATING ACTIVITIES					
Interest and fees received		1,603,039	1,501,535	1,408,595	1,288,117
Interest paid		(429,028)	(474,730)	(330,139)	(347,413)
Cash paid to suppliers and employees		(540,021)	(391,266)	(504,641)	(305,068)
		633,990	635,539	573,815	635,636
Increase in net customer balances		1,046,305	384,269	1,175,261	139,878
Cash generated from operations		1,680,295	1,019,808	1,749,076	775,514
Income taxes paid		(138,885)	(128,524)	(136,302)	(126,147)
Cash flows from operating activities		1,541,410	891,284	1,612,774	649,367
INVESTING ACTIVITIES					
Proceeds from sale of investment		275	19,803	-	2,000
Proceeds from sale of equipment		5,141	2,089	3,120	775
Acquisition of property and equipment	18	(290,607)	(268,143)	(284,238)	(266,017)
Gross dividend received		16,843	-	16,843	-
Purchase of shares in listed companies		(191,853)	-	(191,853)	-
Cash outflows applied to investing activities		(460,201)	(246,251)	(456,128)	(263,242)
FINANCING ACTIVITIES					
Dividend paid		(150,000)	(150,000)	(150,000)	(150,000)
Net increase in cash and cash equivalents		931,209	495,033	1,006,646	236,125
Cash and cash equivalents at 1st January		3,639,356	3,144,323	3,241,148	3,005,023
Cash and cash equivalents at 31st December	11	4,570,565	3,639,356	4,247,794	3,241,148
ADDITIONAL STATUTORY INFORMATION					
Increase/(decrease) in net working capital		57,036	(651)	(259,197)	(23,320)



Significant Accounting Policies

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First Merchant Bank Limited is a private limited company incorporated in Malawi. The consolidated financial statements for the year ended 31st December 2004 comprise the bank and its subsidiary, The 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, The Leasing and Finance Company of Malawi Limited.

Consolidation is based on 31st December 2004 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.

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



Significant Accounting Policies (Cont.)

First Merchant Bank

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.

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 j).

(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.



Significant Accounting Policies (Cont.)

Annual Report 2004

(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.

(m) Pension Scheme and other post retirement benefits

The bank operates a Defined Contribution Pension Scheme. 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. Recognition of 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 and other banks, net income from foreign exchange and securities dealing and net gains on the sale of assets.



Significant Accounting Policies (Cont.)

First Merchant Bank

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.

(iv) Dividends

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

(o) Expenses

(i) Terminal benefits

Accruals made for terminal benefits and gratuities for those employees who are not covered by the Pension Fund are charged to the 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.

(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.

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) Basic earnings per share

Basic 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

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For the year ended 31st December 2004
In thousands of Malawi Kwacha

	GROUP		COMPANY	
	2004	2003	2004	2003
1. INVESTMENT INCOME				
Interest from local registered stocks	18,000	21,615	18,000	17,595
Dividend income (gross)	24,403	-	24,403	-
Increase in fair value of investments	85,663	-	85,663	-
	<u>128,066</u>	<u>21,615</u>	<u>128,066</u>	<u>17,595</u>
2. OTHER INCOME				
Profit on foreign exchange transactions	211,120	238,376	211,120	238,376
Profit on disposal of motor vehicle and equipment	2,600	1,968	869	495
Asset management income	8,269	6,368	8,269	6,368
Miscellaneous recoveries	46,936	5,928	47,869	2,045
	<u>268,925</u>	<u>252,640</u>	<u>268,127</u>	<u>247,284</u>
3. STAFF AND TRAINING COSTS				
Salaries, wages and training costs	286,479	223,997	274,573	211,866
Contributions to defined contribution plans	6,700	5,183	6,257	4,546
	<u>293,179</u>	<u>229,180</u>	<u>280,830</u>	<u>216,412</u>
The number of employees of the group at 31st December 2004 was 318 (2003: 324).				
4. OTHER OPERATING COSTS				
Auditor's remuneration - Current audit fees	4,222	3,450	2,800	2,350
-Underprovision in previous year	426	-	-	-
-Other services and surtax	943	839	620	575
Directors' fees	16,060	13,391	16,010	13,316
Telephone/telex/fax/postage	18,966	16,371	17,264	13,511
Printing and stationery	24,461	21,894	22,835	20,728
Others	109,516	143,079	99,363	99,912
	<u>174,594</u>	<u>199,024</u>	<u>158,892</u>	<u>150,392</u>
5. INCOME TAX EXPENSE				
Recognised in the income statement				
Current tax expense				
Current year at 30% (2003: 30%) based on profits	155,462	125,511	145,733	125,311
Dividend tax expense	1,445	-	1,445	-
Deferred tax credit				
Origination and reversal of timing differences	38,796	21,699	32,122	17,081
Total income tax expense in income statement	<u>195,703</u>	<u>147,210</u>	<u>179,300</u>	<u>142,392</u>



Notes to the Financial Statements (Cont.)

First Merchant Bank

For the year ended 31st December 2004
In thousands of Malawi Kwacha

6. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share at 31st December 2004 was based on the consolidated net profit attributable to ordinary shareholders of MK458 million (2003: MK352 million) and number of ordinary shares outstanding as at 31st December 2004 of 100 million (2003: 100 million).

	GROUP		COMPANY	
	2004	2003	2004	2003
7. LIABILITIES TO CUSTOMERS				
Interest bearing deposits	<u>6,005,930</u>	<u>4,226,410</u>	<u>5,471,496</u>	<u>3,774,948</u>
Payable as follows:				
Maturing within 3 months	<u>5,925,414</u>	<u>4,017,277</u>	<u>5,443,844</u>	<u>3,611,821</u>
Maturing between 3 and 12 months	<u>80,516</u>	<u>209,133</u>	<u>27,652</u>	<u>163,127</u>
	<u>6,005,930</u>	<u>4,226,410</u>	<u>5,471,496</u>	<u>3,774,948</u>
8. OTHER PAYABLES				
Interest payable	9,694	25,549	9,694	25,549
Bankers cheques issued and uncleared	99,738	64,195	99,738	64,195
Credit clearance vouchers	-	18,465	-	18,465
Dividend payable	22,202	-	22,202	-
Margins on letters of credit and forward contracts	389,738	213,437	389,738	213,437
Others	<u>179,984</u>	<u>144,829</u>	<u>179,818</u>	<u>141,611</u>
	<u>701,356</u>	<u>466,475</u>	<u>701,190</u>	<u>463,257</u>
9. SHARE CAPITAL				
Ordinary shares			2004	2003
In issue and fully paid at 31st December			<u>100,000</u>	<u>100,000</u>

At 31st December 2004 the authorised share capital comprised 100,000,000 (2003: 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.)

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For the year ended 31st December 2004
In thousands of Malawi Kwacha

10. DEFERRED TAX (ASSETS) AND LIABILITIES	Assets		Liabilities		Net	
	2004	2003	2004	2003	2004	2003
(i) GROUP						
Property and equipment	(9,342)	(9,030)	-	-	(9,342)	(9,030)
Accrued income	-	-	52,032	35,297	52,032	35,297
Revaluation surplus	-	-	51,148	27,534	51,148	27,534
General provisions	(19,300)	(15,700)	-	-	(19,300)	(15,700)
Gratuity	(1,968)	(2,242)	-	-	(1,968)	(2,242)
Tax (assets)/liabilities	<u>(30,610)</u>	<u>(26,972)</u>	<u>103,180</u>	<u>62,831</u>	<u>72,570</u>	<u>35,859</u>
(ii) COMPANY						
Property and equipment	(8,994)	(10,932)	-	-	(8,994)	(10,932)
Accrued income	-	-	43,108	35,297	43,108	35,297
Revaluation surplus	-	-	50,517	24,818	50,517	24,818
General provisions	(19,300)	(15,700)	-	-	(19,300)	(15,700)
Gratuity	(1,968)	(2,242)	-	-	(1,968)	(2,242)
Tax (assets)/liabilities	<u>(30,262)</u>	<u>(28,874)</u>	<u>93,625</u>	<u>60,115</u>	<u>63,363</u>	<u>31,241</u>

11. CASH AND CASH EQUIVALENTS	GROUP		COMPANY	
	2004	2003	2004	2003
Liquidity Reserve Deposits				
- Reserve Bank of Malawi	474,670	607,714	474,670	607,714
- Registered discount houses	129,000	190,000	129,000	190,000
	603,670	797,714	603,670	797,714
Placements with other banks	220,000	-	220,000	-
Balances with banks abroad	1,970,203	1,082,460	1,970,203	1,082,460
Malawi Government treasury bills	1,510,920	1,557,565	1,188,798	1,159,526
Balances with local banks	13,305	2,562	12,656	2,393
Cash balances	252,467	199,055	252,467	199,055
Cash and cash equivalents	<u>4,570,565</u>	<u>3,639,356</u>	<u>4,247,794</u>	<u>3,241,148</u>

12. OTHER RECEIVABLES

Dividends receivable	7,560	-	7,560	-
Items in transit	131,371	57,147	131,371	57,147
Interest receivable	10,069	12,038	10,037	11,981
Prepayments	5,607	6,908	4,916	5,137
Others	10,911	3,891	10,911	3,891
	<u>165,518</u>	<u>79,984</u>	<u>164,795</u>	<u>78,156</u>



Notes to the Financial Statements (Cont.)

First Merchant Bank

For the year ended 31st December 2004
In thousands of Malawi Kwacha

	GROUP		COMPANY	
13. LOANS AND ADVANCES TO CUSTOMERS	2004	2003	2004	2003
Maturing within 3 months	734,947	428,794	726,579	461,989
Maturing between 3 and 12 months	1,506,638	893,347	1,522,748	883,360
Maturing after 12 months	2,598	-	-	-
	<u>2,244,183</u>	<u>1,322,141</u>	<u>2,249,327</u>	<u>1,345,349</u>
Segmental analysis industry:				
Agriculture	404,695	139,496	404,695	123,069
Finance and insurance	62,819	206,070	81,285	205,486
Government accounts	256,454	9,265	256,454	9,265
Individuals	95,709	316,921	95,709	304,231
Manufacturing	178,302	227,325	178,302	211,207
Wholesale and retail	271,196	177,426	271,196	159,129
Others	975,008	245,638	961,686	332,962
	<u>2,244,183</u>	<u>1,322,141</u>	<u>2,249,327</u>	<u>1,345,349</u>
Provision for losses:				
Specific Provision				
- At 1st January	(19,606)	(21,343)	(19,606)	(18,521)
New provision	(10,310)	(18,282)	(10,310)	(18,282)
Write offs	1,682	802	1,682	-
Recoveries	5,730	19,217	5,730	17,197
-At 31st December	<u>(22,504)</u>	<u>(19,606)</u>	<u>(22,504)</u>	<u>(19,606)</u>
Interest in suspense:				
At 1st January	(32,407)	(29,816)	(32,407)	(29,816)
New provision	(16,561)	(2,591)	(16,561)	(2,591)
At 31st December	<u>(48,968)</u>	<u>(32,407)</u>	<u>(48,968)</u>	<u>(32,407)</u>
General provision:				
At 1st January	(52,659)	(40,659)	(52,334)	(40,334)
New provision	(12,190)	(12,000)	(12,000)	(12,000)
At 31st December	<u>(64,849)</u>	<u>(52,659)</u>	<u>(64,334)</u>	<u>(52,334)</u>
Net loans and advances	<u>2,107,862</u>	<u>1,217,469</u>	<u>2,113,521</u>	<u>1,241,002</u>

The directors consider that the carrying amount of loans and advances approximates to their fair value.



Notes to the Financial Statements (Cont.)

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For the year ended 31st December 2004

In thousands of Malawi Kwacha

14. FINANCE LEASES

Lease debtors, which are secured over the relevant assets, are receivable as follows:-

	GROUP	
	2004	2003
Maturing within 3 months	66,611	63,688
Maturing between 3 and 12 months	90,188	65,871
Maturing after 12 months	237,780	74,578
	<u>394,579</u>	<u>204,137</u>
Specific provision at 1st January	(27,570)	(22,589)
New provision	(2,045)	(6,413)
Write offs	2,047	1,432
At 31st December	<u>(27,568)</u>	<u>(27,570)</u>
Interest in suspense at 1st January	(12,174)	(13,216)
New provision	(3,459)	1,042
Recoveries	2,667	-
At 31st December	<u>(12,966)</u>	<u>(12,174)</u>
General provision at 1st January	(3,785)	(2,560)
New provision	(7,019)	(1,225)
At 31st December	<u>(10,804)</u>	<u>(3,785)</u>
Interest on overdue debts at 1st January	(4,900)	(6,160)
New provision	-	1,260
Recoveries	2,090	-
At 31st December	<u>(2,810)</u>	<u>(4,900)</u>
Net finance leases	340,431	155,708
Government sub-lease debtors	18,446	18,446
Rural motorised project	(18,446)	(18,446)
Total finance leases	<u>340,431</u>	<u>155,708</u>

The directors consider that the carrying amount of lease debtors approximates to their fair value.

15. GOVERNMENT OF MALAWI LEASES

The group is party to an agreement with the Government of Malawi in respect of vehicles which were leased from the Government and sublet to transporters. Under the terms of the lease agreements, the obligations of the group are restricted to payment to the Government of instalments received by the group from the sub-lessees and no liability exists in respect of unpaid instalments. Consequently, the balance sheet reflects only those instalments currently due from the lessees and due to the Malawi Government.

At the balance sheet date, the amount due to the Government was K18.4 million (2003: K18.4 million).



Notes to the Financial Statements (Cont.)

First Merchant Bank

For the year ended 31st December 2004
In thousands of Malawi Kwacha

16. QUOTED INVESTMENTS

	GROUP				COMPANY			
	2004		2003		2004		2003	
	<u>Cost</u>	<u>Valuation</u>	<u>Cost</u>	<u>Valuation</u>	<u>Cost</u>	<u>Valuation</u>	<u>Cost</u>	<u>Valuation</u>
Investments in quoted companies	191,853	277,516	-	-	191,853	277,516	-	-
Local registered stocks	45,300	45,300	45,575	45,575	45,000	45,000	45,000	45,000
	<u>237,153</u>	<u>322,816</u>	<u>45,575</u>	<u>45,575</u>	<u>236,853</u>	<u>322,516</u>	<u>45,000</u>	<u>45,000</u>

All investments in quoted companies are held for trading. The increase/(decrease) in fair value is taken to income statement.

17. INVESTMENTS IN SUBSIDIARY (AT COST) SHAREHOLDING COMPANY

	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
The Leasing and Finance Company of Malawi Limited	100%	100%	65,911	65,911



Notes to the Financial Statements (Cont.)

Annual Report 2004

For the year ended 31st December 2004

In thousands of Malawi Kwacha

18. PROPERTY AND EQUIPMENT

GROUP	Freehold property	Leasehold improvements	Motor Vehicles	Equipment Fixture & fittings	Capital work in progress	2004 Total	2003 Total
Cost or valuation							
Balance at 1st January	188,836	1,385	30,675	155,705	179,778	556,379	213,610
Additions	27,409	16,191	6,175	120,127	120,705	290,607	268,143
Transfers	17,423	128,232	-	33,137	(178,792)	-	-
Revaluation surplus	-	-	-	-	-	-	80,960
Disposals	-	-	(6,712)	(5,342)	-	(12,054)	(6,334)
Balance at 31st December	233,668	145,808	30,138	303,627	121,691	834,932	556,379
Depreciation and impairment losses							
Balance at 1st January	2,485	1,310	20,219	116,006	-	140,020	105,527
Charge for the year	4,628	1,203	3,615	4,600	-	55,446	39,643
Eliminated on revaluation	-	-	-	-	-	-	(1,769)
Released on disposal	-	-	(5,298)	(4,215)	-	(9,513)	(3,381)
Balance at 31st December	7,113	2,513	18,536	157,791	-	185,953	140,020
Carrying amount At 31st December	226,555	143,295	11,602	145,836	121,691	648,979	416,359
COMPANY							
Cost or valuation							
Balance at 1st January	178,646	1,385	23,647	140,627	179,778	524,083	178,246
Additions	27,409	16,191	2,936	116,997	120,705	284,238	266,017
Transfers	17,423	128,232	-	33,137	(178,792)	-	-
Revaluation surplus	-	-	-	-	-	-	80,960
Disposals	-	-	(3,120)	(4,684)	-	(7,804)	(1,140)
Balance at 31st December	223,478	145,808	23,463	286,077	121,691	800,517	524,083
Depreciation and impairment losses							
Balance at 1st January	2,146	1,310	13,191	104,042	-	120,689	85,983
Charge for the year	4,402	1,203	3,278	44,757	-	53,640	37,335
Eliminated on revaluation	-	-	-	-	-	-	(1,769)
Released on disposal	-	-	(1,707)	(3,846)	-	(5,553)	(860)
Balance at 31st December	6,548	2,513	14,762	144,953	-	168,776	120,689
Carrying amount At 31st December	216,930	143,295	8,701	141,124	121,691	631,741	403,394

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. Chalozza MSC Pg Dip of Knight Frank, on a market value basis.

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



Notes to the Financial Statements (Cont.)

First Merchant Bank

For the year ended 31st December 2004

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19. CONTINGENT ASSETS/LIABILITIES	GROUP		COMPANY	
	2004	2003	2004	2003
Letters of credit	471,015	377,465	471,015	377,465
Guarantees	742,312	506,813	742,312	506,813
Travellers cheques	382,986	220,013	382,986	220,013
Foreign bills lodged	518,956	249,406	518,956	249,406
	<u>2,115,269</u>	<u>1,353,697</u>	<u>2,115,269</u>	<u>1,353,697</u>
20. EMPLOYEE BENEFITS				
Expense recognised in the income statement				
Contributions to defined contribution plans	6,700	5,183	6,257	4,546

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.

21. 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.



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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. The Bank's 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 reviews and determines whether the controls in place are commensurate with the risk involved.

22. RELATED PARTY TRANSACTIONS

The bank transacts part of its business on an arm's length basis with related parties. As on 31st December 2004, advances to the bank's subsidiary company, Leasing and Finance Company of Malawi Limited totalled K1.3 million (2003: K40.4 million) which were fully secured by Treasury bills. Loans and advances to other related parties totalled K7.2 million (2003: K1.9 million) of which K6.3 million (2003: K1.5 million) was secured by fixed and floating charges.

During the year the group made payments of K1.6 million (2003:2.6m) to companies affiliated to its shareholders in respect of rental payments for properties occupied by the group.

	GROUP		COMPANY	
	2004	2003	2004	2003
23. CAPITAL COMMITMENTS				
Capital expenditure				
Authorised and contracted	140,039	261,408	140,039	261,408
Authorised but not contracted	59,569	183,379	58,689	175,979
	<u>199,608</u>	<u>444,787</u>	<u>198,728</u>	<u>437,387</u>

24. 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



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First Merchant Bank

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In thousands of Malawi Kwacha

average basis, of not less than 27.5 percent (2003:30%) of the preceding weeks total deposit liabilities. In the last week of December 2004, the liquidity reserve was 28% (2003: 32%) 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 2004, the Bank's available capital was 19% (2003: 23%) of its risk bearing assets and contingent liabilities.

24. 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 2004, the Bank's Liquidity Ratio 1 was 79% (2003: 85%) and Liquidity Ratio 2 was 77% (2003: 83%)

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	<u>2004</u>	<u>2003</u>	<u>2002</u>
	MK	MK	MK
Kwacha/GBP	210.6	193.7	140.2
Kwacha/Rand	19.9	16.7	10.2
Kwacha/US Dollar	108.9	108.4	87.1
Kwacha/Euro	148.8	136.7	91.3
Inflation rate %	<u>11.5%</u>	<u>9.6%</u>	<u>14.8%</u>

At the time of signing these financial statements the exchange rates had moved to:

Kwacha/GBP	206.9
Kwacha/Rand	18.9
Kwacha/US Dollar	108.9
Kwacha/Euro	142.7

26. 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).

27. 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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