

MERISTEM EQUITY RESEARCH REPORT



FIRST BANK OF NIGERIA PLC

REPORT DATE: MARCH 02, 2007

RECOMMENDATION: BUY

EXECUTIVE SUMMARY AND INVESTMENT RATIONALE

- **First Bank of Nigeria Plc is planning to raise N100 billion from the capital market through a hybrid Offer of Rights Issue and Public Offer in equal proportion (i.e. N50 billion Rights and N50 Billion P/O). Though the price of both the Rights and Public offer are yet to be determined, It is the opinion of the market that the price would be slightly above the Offer price of UBA Plc.**
- First Bank was set up in 1894 as Bank for British West Africa (BBWA) with branches in Ghana and Sierra Leone. The bank was incorporated as Standard Bank Nigeria Limited in 1968 and was listed on the Nigerian Stock Exchange (NSE) in 1971. Name changes occurred in 1979 and 1991 to First Bank of Nigeria Limited and First Bank of Nigeria Plc respectively.
- With a branch network of over 400 and over 200 branches providing Bureau De Change services, the bank maintains the largest branch network in the Nigerian financial services industry. It has diversified into a wide range of banking activities and services which includes corporate and retail banking, agricultural finance, treasury and money market operations, equipment leasing, export banking and finance, lending products and services, loan syndication, money transfer services, small and medium-sized enterprise development project loans. The Bank also offers consumer finance products such as consumer loans, mortgage loans and First Global System for Mobile Communications (GSM) Acquisition Loans (FGAL). In addition, the Bank issues MasterCard credit cards and ValuCard banking cards. It is also engaged in the provision of Internet banking
- It has a representative office in South Africa and the United States of America, with

several other subsidiary companies namely FBN Insurance Brokers Limited, FBN Mortgages Limited, First Funds Limited, First Trustees Nigeria Limited, First Registrars Nigeria Limited, FBN Capital Limited and First Pension Custodian Nigeria Limited.

- First Bank has other associate companies and affiliates namely Kakawa Discount House, Banque International Du Benin (BIBE) Valucard, Afrexim Bank and Nigeria Interbank Settlement System.
- Its wholly owned subsidiary, FBN Bank (UK) Limited, recently signed a USD42 million syndicated term loan facility with a consortium of banks led by Standard Bank Plc which was substantially oversubscribed by 68 percent from the initial USD25 million earlier planned for. The over subscription, underlines the strong confidence of international investors in FBN UK and the First Bank of Nigeria Plc.
- The signing of an agreement (MOU) with HSBC has led to a technical partnership which would allow the bank to participate in the management of the country's foreign reserves.
- The Bank has shown impressive growth when assessed by various measures, including number of branches, growth in deposit base, asset size and size of loans and advances. Furthermore, its track record of profitability and reliability in professional banking services has continually placed the Bank in its leading position with return on equity of 31.29% and earnings per share of N1.96 (as at date) as the highest in the banking sector. It has also been highly consistent with dividend payment and bonus declaration that the market has rated its shares as both income and growth stock.
- The bank was recently rated by the foremost global rating agency, Standard & Poor's Ratings Services (S&P), which assigned the Bank the international Long-term rating of "BB-", the best rating any Nigerian company could obtain, being the sovereign rating of the country. In addition, Fitch also affirmed the Bank's National Long-term and Short term ratings at "A+ (nga)" and "F1 (nga)", respectively, the Short-term rating being the highest attainable by any institution.

- First Bank is the most capitalized bank with market capitalization of N413billion and has raised credit lines with the European Investment Bank (€50million euros) and Export Development Canada (\$25million dollars). It has a lot of growth potentials especially in an emerging market, having won over depositors' confidence with increasing focus on excellent service. Its proactive nature and availability of cheap fund has availed the bank huge opportunities to maintain a lead in an increasingly competitive banking environment. It is in the same vein that the bank is planning to respond to its growing asset and business recently via a hybrid offer.
- Risk attached to our assessment of the bank is declining credit spread of the industry and regulatory reforms that may inhibit potential profitability growth. The emerging opportunities also portend risk to existing banks as many foreign banks get attracted to share the excess income from the industry thereby increasing competition with reduction in market share.
- Given an average earnings growth of 30% in the next five years before a long term growth of 10% thereafter, a cost of equity of 16.39% and a long term sustainable return on equity of 20% after the next five years, we are of the opinion that the bank is currently trading at a discount of 12%.

INDUSTRY SUMMARY

The Nigerian banking sector is vibrant and dynamic. It comprised of 89 banks in 2003 and has been streamlined to 25 as a consequence of the N25billion Capitalisation process. Industry entry barrier is prevalent especially with the N25billion shareholders funds required to commence business. This reduces the number of possible local start up bank. However, the growing profitability within the industry and burgeoning industry potentials has exposed some banks as targets of international investors such as private equity investor e.g. the recent 30% stake of Actis Group in Diamond Bank Plc as well as the on-going 51-55% tender offer between Stanbic and IBTC.

In terms of regulation, The Central Bank of Nigeria (CBN) is the supreme supervisory and regulatory body. The policy position on interest rates as part of monetary policy reforms is

creating tightening effect on credit spread within the industry. This recent emphasis on Monetary Policy rate of 10% with an allowance of 3% premium as interest rates has negative effect in interest income which constitutes between 65-80% of gross earnings. This is however forcing strategic refocusing within the industry. Competition is fierce among the banks and fight for deposits coupled with rising operating expenses are not favourable on the net interest margin. Banks are now focusing on growing their non interest/fee based banking activities. This has resulted in a renewed invigoration and expansion of investment units of many banks in the country. The industry is now customer focused as banks with good customer service continue to have an edge over their peers.

The growing need for increasing returns to their enlarged asset bases has propelled banks to venture capital business. It has also made possible funding of major initiatives such as Telecoms and Oil & Gas which would not have been possible pre-consolidation. Banks are continuing to shore up their capital bases in order to take advantage of opportunities available in the economy. Therefore, increased competition has led to a new wave of consolidation which is self or market induced and not mandated by regulation.

In the ever changing financial landscape, E-commerce and on-line banking are portals of profitability. The goal of every bank is to align its branches on its network so as to function as one branch. Information technology consultants such as Infosys have been recruited as banks expand their information system networks, upgrade software and employ more advanced servers. The set standard for a bank is better customer service delivery and this is best achieved by user friendly and convenient internet based/on line services.

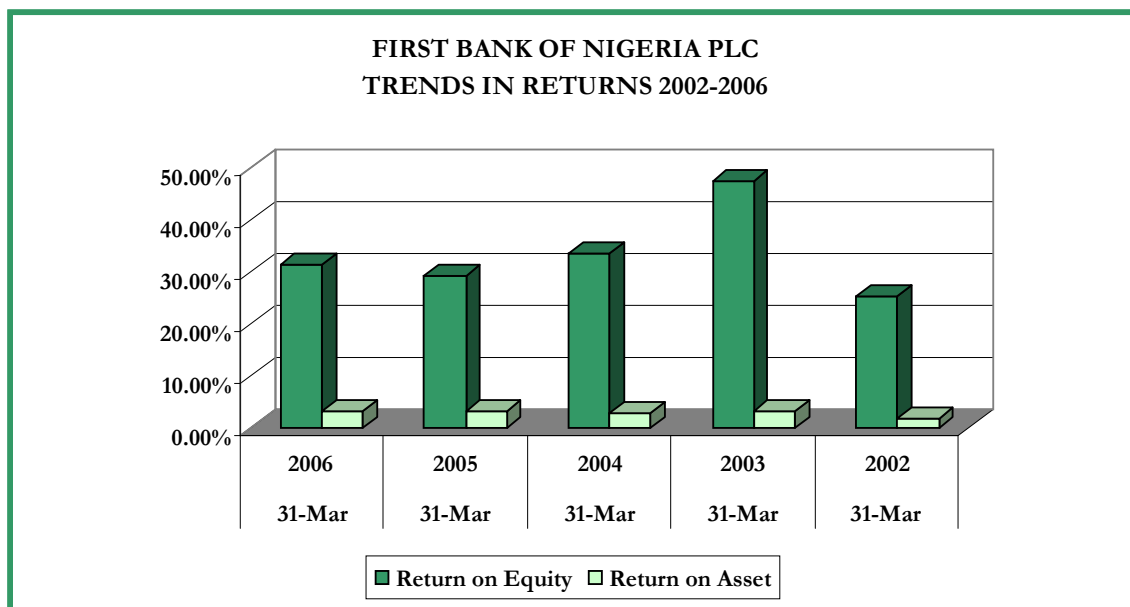
Expansion and consistent profitability portend good prospects for the future. Diversification into areas of venture capital and project funding as well as the expansion into the West African sub region (Ghana and Gambia) also suggests good potentials. However, competition between banks should be increased as this will force banks to be leaner machines providing a wider range of products and services to better suit customer needs. Corporate governance and capacity building should be improved in order to bring the sector in line with international standards. As the industry expands, greater supervision from CBN is needed as well as a much stronger deposit insurance system from the **Nigeria Deposit Insurance Corporation (NDIC)**.

ANALYSIS OF FINANCIALS:

Profitability:

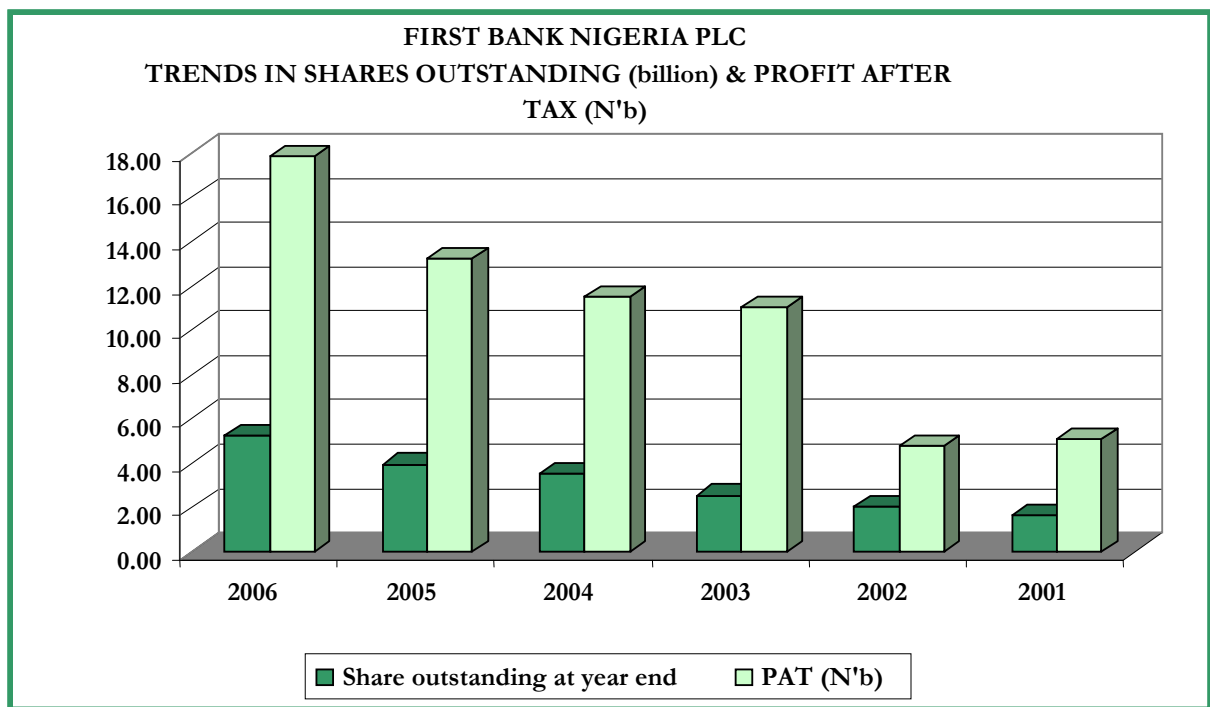
First Bank Plc has consistently clinged to the coveted position as the most profitable bank in Nigeria. Though the Bank's profitability index measured by return on average equity (ROAE) nose-dived prior to the banking consolidation in 2005, it soared again immediately after the exercise in 2006. Return on average equity fell from 47.53% in 2003 to 29.30% in 2005 while it rose again to 31.32% in 2006. Put differently, First Bank has surpassed industry average of 23.73% in terms of return to the owners of equity capital. As other banks are coming up strongly in terms of significant growth in profitability, it is expected that the bank would remain more competitive and maintain its industry status,

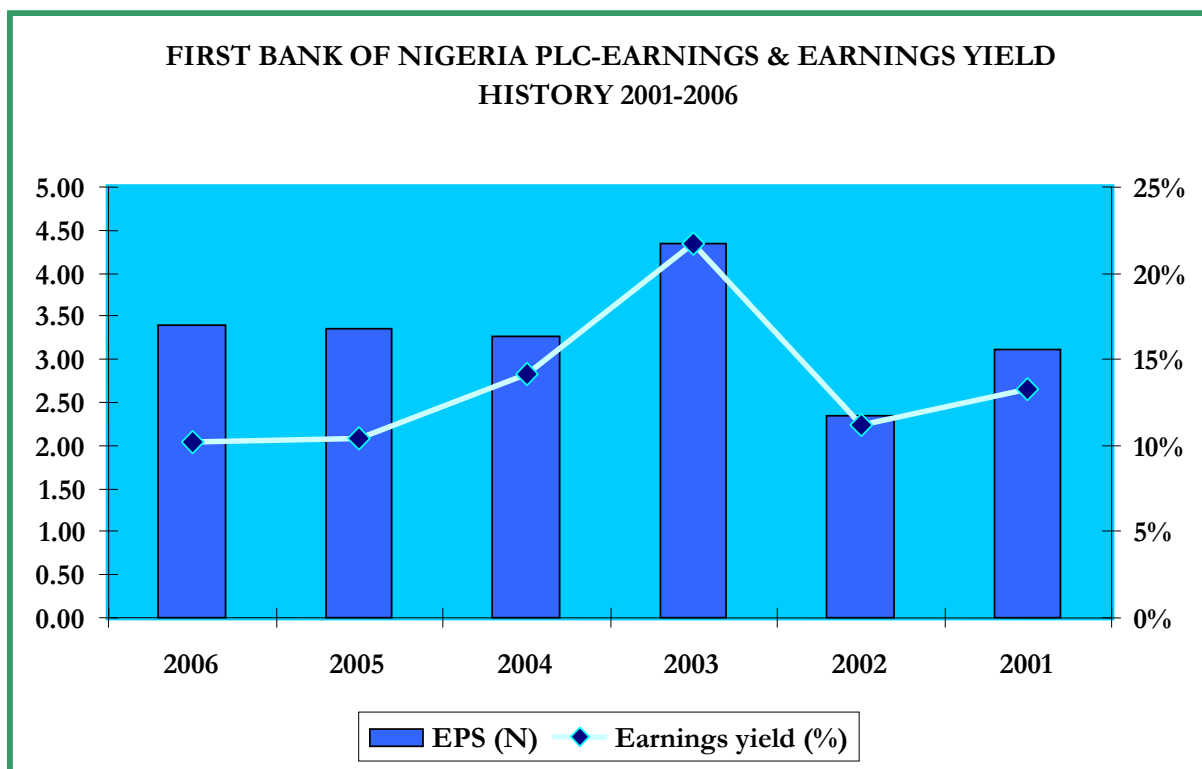
Return on average Asset (ROA), in the same vein, rose from 2.9% in 2004 to 3.20% in 2006 (though slightly below industry average of 3.24%). In other words, First Bank returned N3.20 on every N100 worth of asset employed in 2006 higher than N3.10 recorded in 2005 financial year.



The credit spread, which measures the difference between the yield on average earning assets and cost of interest-bearing liabilities increased from 8% in 2003 to 12% in 2005 while it declined by 1% to 11% in 2006 . In the same vein, Net Interest Margin (NIM) which is a

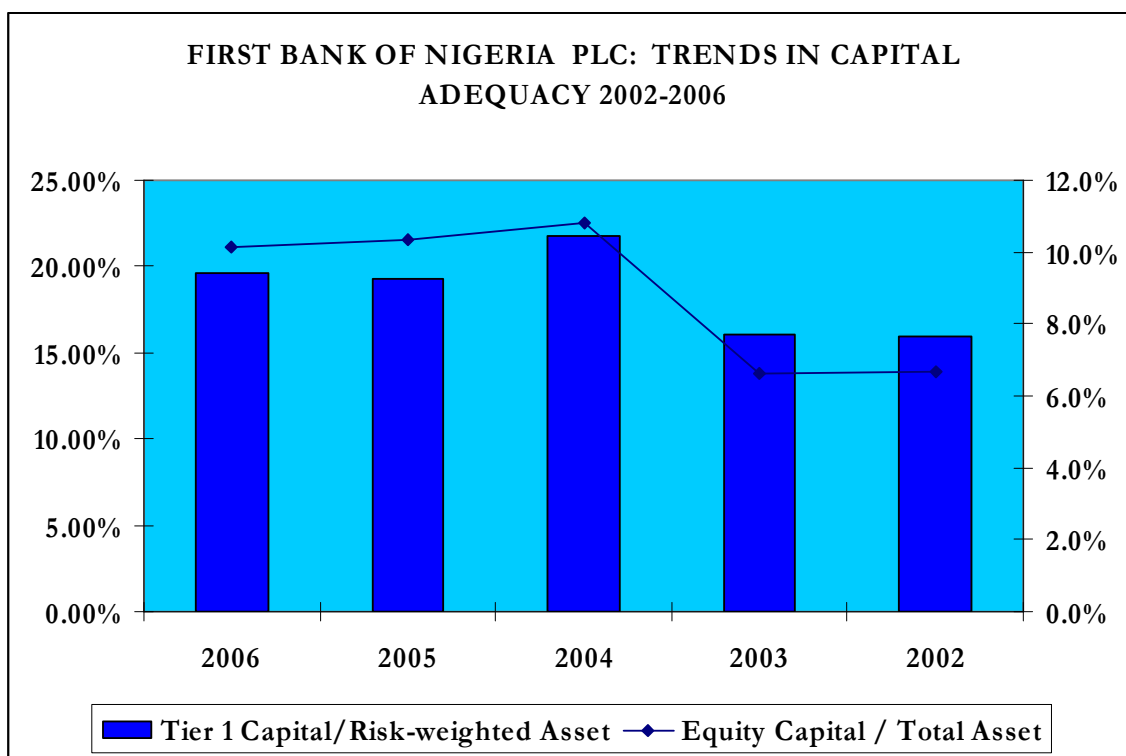
summary measure of the proportion of net interest income to interest-income generating assets fell sharply from 30% in 2004 to 15% in 2006. From the review of its financials, one can infer that First Bank interest margins (which forms over 65% of its total income) is shrinking due to downward pressure on interest rates in the face of stiffer competition amongst banks in the industry. On the other hand, efficiency ratio, a measure of a bank's ability to curtail non-interest expenses relative to adjusted operating income jumped from 59% in 2002 to 65% in 2005 and later inched to 68% in 2006. This means the bank paid non-interest expenses of N68 for every N100 operating income made in the same year. This is rather high compare to a standard benchmark of 55% for a large bank. Meanwhile, First Bank's burden ratio has consistently declined from 4.67% in 2002 to 2.32% in 2006. This ratio measures the amount of non-interest income expenses covered by fees, service charges, securities gains, and other income as a fraction of average total assets. The greater this ratio, the greater non- interest expenses exceeds non-interest income and vice versa. It therefore means that, First Bank is better off in its drive for non-interest income generation probably due to its adaptation to the dynamics of the emerging banking terrain.





Adequacy of Capital:

First Bank’s capital adequacy ratio, measured by Tier-1 Capital to Risk Weighted Assets ratio fell from 21.73% in 2004 (prior to re-capitalisation exercise) to 19.65% in 2006. The index measures the extent of cushion a bank has from its shareholders’ funds to accommodate its risky assets. Similarly, shareholders’ funds grew from N41.61bn in 2004 to N62.29bn in 2006, representing 30.8% compounded annual growth rate (CAGR). Without an iota of doubt, given the realities of the evolving financial system in Nigeria, First Bank’s capital adequacy indices suggest that there is need for the Bank to shore up its capital base as a cushion for its risky assets portfolio. This makes it more timely for the bank to raise its long awaited fund from the Capital market.



Quality of Asset:

Total Assets base of First Bank stands at N614.84bn as at 2006 up from N470.81bn in 2005 pre-consolidation. This represents 30.58% annual growth rate compared to 27.84% recorded in 2005. Similarly, further review of the Bank’s financials reveals that the quality of assets portfolio measured by the ratio of performing Loans to gross loans jerked up to 90.95% in 2006 from 75.52% in 2005, while loan loss provision to total loans dropped significantly from 33.81% in 2004 to 7.5% in 2006 (compared to industry average of 8.01%). This is quite commendable as it reflects a healthier assets portfolio showing that the Bank has feared well in managing its risky assets without unduly eating into its interest income, which grew by 46.8% during same period. In the same vein, the Bank’s ratio of loan loss expenses to total assets plummeted from 0.77% in 2004 to 0.65% in 2006 buttressing a more efficient approach of the Bank to risks management.

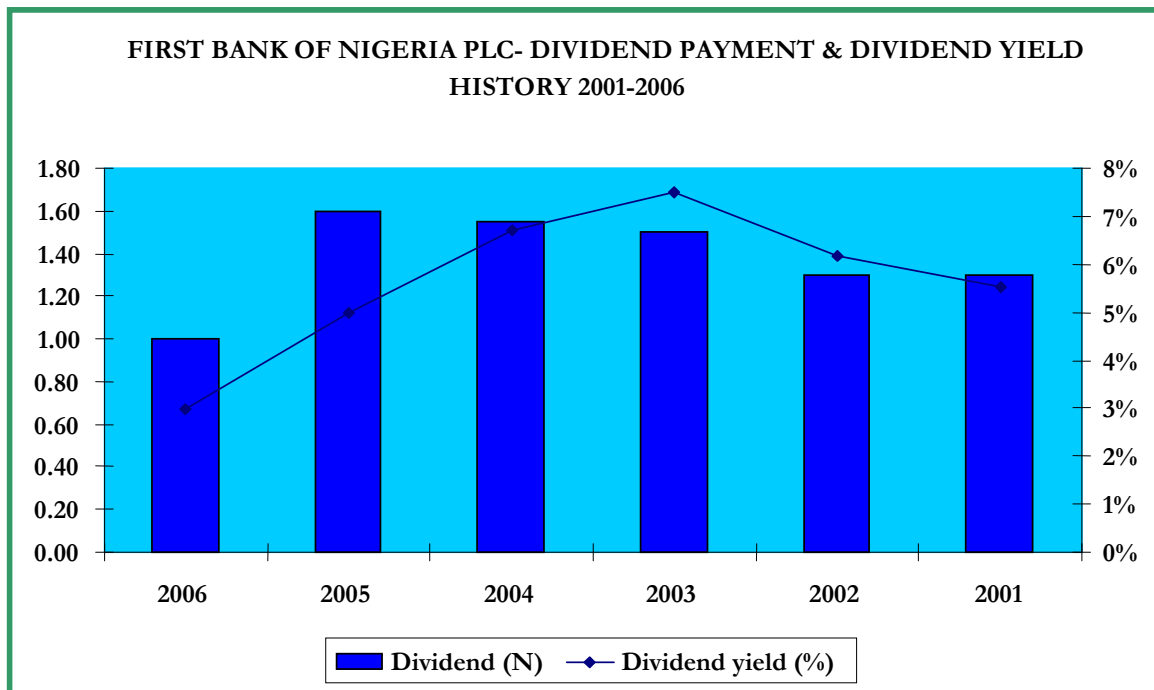
Liquidity:

The Bank’s liquidity structure changed in 2006 after maintaining a continuous decline in the prior years. Liquid asset to total deposit that nose-dived earlier from 76.69% in 2003 to 9.9% in 2005 had a marginal increase to 11.36% in 2006. In the same vein, loans and advances to

total deposits ratio declined from 48.73% to 42.70 in 2006. This may be a response to the increase in the proportion demand deposit to total deposit which increased from 34.92% to 44.66%.

Earnings:

First Bank earnings growth is relatively below industry average. The Bank grew its earnings by 1.42%, 11.57% and 17.79% in 2004, 2005 and 2006 respectively. Though this follows an upward pattern, **it still falls below industry statistics of 77.8% in 2006.** In 2006, gross earnings totaled N67.44bn compared to N57.23bn recorded in the previous year. Out of this, interest income accounted for 67% while non-interest income represented 33% compared to the previous year of 60% to 40% respectively. This clearly reveals that interest income still commands a large proportion of the Bank’s gross earnings. To affirm its position in the market as the most profitable bank in the country, First Bank profit after tax (PAT) soared by 35% in 2006 from N13.23bn in 2005 to N17.38bn compared to the previous year’s record of 15.25% growth. This was evidenced by the Bank’s unprecedented mixed-benefits of N1.00 dividend per share and a scrip issue of 1 for 1.



HIGHLIGHTS OF Q3-2007 RESULTS.

First Bank recorded a profit before tax (PBT) of N19.2 bn for its nine months financial result for period ended December 2006. This figure is 27.15% higher than N15.15 bn

recorded during the same period in 2005. However, adjusting the result by the extraordinary income of N3.72 bn included in last year's PBT figures; the bank grew its PBT figure in the review period by 68.55%. In the same vein, gross earnings rose by 27.67% to N64.53 bn during the period under review as against the N50.55 billion recorded during the same period in 2005.

The company currently enjoys the highest EPS of N1.96 as at Q3-2006 from its previous N1.76 for Q2-2006 before the release of its third quarter results. This indicates 11.4% growth in earnings. It is expected that there would be more growth in earning in the last quarter of its financial year. From our analysis, we expect next quarter EPS to grow by 24%.

INTERNATIONAL RATINGS

First Bank reaffirmed its leadership position post-consolidation, with a rating from foremost global rating agency, Standard & Poor's Ratings Services (S&P), which assigned the Bank the international Long-term rating of "BB-", the best rating any Nigerian company could obtain, being the sovereign rating of the country. The ratings, in which the bank was also assigned a Short-term rating of "B" and a stable outlook, reflect the Bank's strong market position as Nigeria's leading financial services provider with robust funding and liquidity profile, sound risk governance, and the benefits derived from its expansion into the fast-developing retail banking market. S&P maintained that the bank has extensive branch network and strong franchise, which has also afforded it a robust funding and liquidity profile".

In the same vein, Fitch Ratings, one of the world's foremost rating agencies, assigned the Bank the international Long-term and Short-term ratings of "B+" and "B" respectively. In addition, Fitch also affirmed the Bank's National Long-term and Short term ratings at "A+ (nga)" and "F1 (nga)", respectively, the Short-term rating being the highest attainable by any institution. These ratings are coming on the heels of the National Long-term and Short-term ratings of AA and A1+ assigned the Bank by Global Credit Rating Company Limited, one of the Securities and Exchange Commission's licensed rating agencies. The Short-term rating is also the highest attainable by any institution.

VALUATION:

We have employed a number of valuation metrics in arriving at an appropriate intrinsic value for First Bank. We used Discounted Cash Flow (DCF)/ Residual Income Approach, Dividend Growth Valuation Method and a couple of relative valuation metrics such as Price to Book Value (P/B), Price to Gross Earnings (P/GE), and Price to Earnings (P/E) ratios.

Meanwhile, after attaching appropriate weights to each valuation metric, we are more over weight on residual income approach (DCF), P/B and dividend valuation method as we believe they are better measures of the Bank's intrinsic value. Subsequently, we arrived at fair price of N40.41.

Technical Analysis of First Bank Share Price Behaviour 2002-2007.

First Bank Share price exhibited a bullish long term trend (primary trend) which is in line with the overall trend of the market. On the other hand, it exhibited a bearish secondary trend in 2004 with each successive share price peak being lower than preceding ones. During this period, the resistance level was N32.66 while the support level was N20. At this interval, the rate of change indicates that First Bank the shares were overbought with the implication that a rally was imminent.

The stock began a homeward run soon after March 2005, riding strongly on a bullish trend which culminated in an all-time high of N72.76 before it was marked down for twin benefits of 1 for 1 bonus and dividend for the financial year end 31 March 2006.

The stock rallied up after bonus/dividend adjustment before responding to temporary bearish market when it traded again at N31.9 before it was taken up to oscillate between N36 and N39.

First Bank's 4-year price volatility (β) is 0.73. Put differently, a 1% rise (fall) in the market transcends into 0.73% rise (fall) in the share price of First Bank.

FIGURE 1:

FIRST BANK OF NIGERIA PLC: TRENDS IN SHARE PRICE-VOLUME 2004-2007



FIRST BANK OF NIGERIA PLC						
EARNINGS, DIVIDEND & BONUS HISTORY						
	2006	2005	2004	2003	2002	2001
Dividend (N)	1.00	1.60	1.55	1.50	1.30	1.30
Bonus	1 for 1	1 for 4	1 for 8	1 for 5	1 for 4	1 for 4
Market price at year end	33.50	32.00	23.10	20.00	21.05	23.55
Share outstanding at year end	5.24	3.95	3.50	2.54	2.03	1.63
PAT (N'bn)	17.83	13.23	11.48	11.01	4.78	5.07
Dividend declared (N'bn)	5.24	6.33	5.43	3.81	2.64	2.11
EPS (N)	3.40	3.35	3.28	4.33	2.35	3.12
DPS (N)	1.00	1.60	1.55	1.50	1.30	1.30
Earnings yield (%)	10%	10%	14%	22%	11%	13%
Dividend yield (%)	3%	5%	7%	8%	6%	6%
Dividend growth rate (%)	-38%	3%	3%	15%	0%	4%

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