

# MERISTEM EQUITY RESEARCH REPORT



OCEANIC BANK INTERNATIONAL PLC

**REPORT DATE: MARCH 16, 2007**

**RECOMMENDATION: BUY**

## **EXECUTIVE SUMMARY AND INVESTMENT RATIONALE**

- Oceanic Bank International Plc is currently raising N53.17billion from the capital market through an Offer for Subscription of 3,357,993,375 ordinary shares of 50k each at N16.50k per share. The offer proceeds will be used to fund branch/subsidiary development (N26.58b or 50%), IT systems and processes (N10.63b or 20%) and increase working capital (N15.95b or 30%).
- The Bank was incorporated on March 26, 1990 as a limited liability company with 100% equity ownership by Nigerian Citizens, licensed on April 10, 1990 to carry on Commercial banking business and commenced operations on June 12, 1990 at the Waterfront Plaza, Plot 270, Ozumba Mbadiwe Avenue, Victoria Island, Lagos. It was listed on The Nigeria Stock Exchange on June 25, 2004. Its financial year spans between October 1 and September 30.
- Oceanic Bank, which is 16 years in existence, has nine Subsidiaries namely Oceanic Securities Limited, Oceanic Trustees Limited, Oceanic Registrars Limited, Oceanic Insurance Limited, Oceanic Life Assurance Limited, Oceanic Asset management Limited, Oceanic Custodian Limited, Oceanic Homes Limited and Oceanic Capital Limited and has investments in not less than 19 small and medium scale enterprise companies. It also has 191 bank branches with all branches linked on-line.
- With Consolidation in the industry, Oceanic Bank is better positioned to face the

challenges of the banking business. During the peak period of consolidation, the Bank did not merge with any bank to achieve the required minimum capital base; instead, it strategically acquired the erstwhile International Trust Bank (ITB) and raised funds from the investing public. In order to participate in the management of the country's foreign reserves, it signed an agreement with CommerzBank AG of Germany.

- Its performance has attracted awards from rating agencies abroad. This is evidenced in the Global Credit Rating of South Africa (GCR) short term rating of A1+ and Long term rating of AA for the Bank. Also rated by Reuters as one of the top 5 African stocks (outside South Africa) while the Banker Magazine rated the bank in the top 20 in Africa and awarded it Bank of the Year for the year ended 2006.
- The Bank has performed beyond expectation with good return on investment to its shareholders. It remains the fastest growing bank in Nigeria with a Compounded Average Growth Rate (CAGR) of 55.13% in gross earnings from 2002 to 2006. It also achieved 62.10% growth in PAT over 2005 PAT while gross earnings growth rate was 85.33% during the same period. Return on Asset (ROA) and Return on Equity (ROE) were 3.24% and 27.80% respectively which are above the industry averages of 2.95% and 23.73%.
- Oceanic Bank has a well diversified income stream as evidenced by its low burden ratio of 1.63%. With sustainable industry profit potential, stable political and economic environment, growth in real sector and anticipated reduction in expected cost of equity induced by company growth above the GDP, we are of the opinion that the Bank possesses a number of hidden potentials for continuous profitability.
- Risk attached to our valuation of Oceanic Bank is the effect of regulation, increase in local and international competition in the industry, volatility of interest rates, technology to back up modern banking needs and the degree of skewness of the bank's earnings. The bank's current P/E is 21.40 xs, and its forecast EPS from its

Offer document is N1.27. However, our analysis forecasts a forward EPS of N1.25 with a P/E of 15.62, relatively lower than industry P/E of 21.28 xs. We anticipate that the offer proceeds would be utilised to generate a reasonable margin to increase ROA or ROE beyond current level.

- Based on the above, we RECOMMEND a **BUY** for Oceanic Bank offer, as our analysis indicates that the current market price is trading at a discount of 22.5% to the Offer price of N16.50 and a discount of 3.4% to the market price of N19.53.

### **Risk Profile**

The increasing competition among banks and fostering of strategic alliances with international finance institutions constitutes a threat to Oceanic Bank. The bank is relatively small when compared with the top industry peers in terms of asset base, branch network and shareholders funds. The industry growing competition is the major cause of declining credit spread as well as the determination of regulatory authorities to bring down cost of fund. Profitability without adequate risk management indicates serious exposure as earnings may fall short of adequate cash backing. The Bank has to ensure that it institutes a strong risk management framework that will curtail potential increase in loan loss expenses and allowances. Foreign exchange risk is on the decline or almost negligible as the country's exchange rate is relatively stable. **One major risk associated with this is the forthcoming electioneering activities which could be mitigated if there is a free and fair election.**

### **Recent Developments**

- a. Recently, Delta State Government announced the divestment of its holdings in

eight companies including Oceanic Bank. This however is induced by the CBN's directive mandating all three tiers of governments that have stakes in banks to reduce their shareholdings to a maximum of 10 %.

- b. The Bank was recently appointed by the Central Bank of Nigeria as a settlement Bank effective February 26, 2007. This is premised more on the excellent service delivery and aggressive branch expansion.
- c. Oceanic Bank International Plc recently released its first quarter result for the period ended December 31, 2006. Gross earnings rose to N12.53 billion; an increase of 45% over the 2005 results, while pre-tax profit and after tax profit went up by 46 percent to N4.11 billion and N3.42 billion respectively. The result has been hailed by market practitioners and investors especially when compared with some of the banks in the industry that have more earning resources than Oceanic Bank.
- d. The bank, in its last financial year, declared a bonus issue of one ordinary share for every four held to all its shareholders as well as a dividend of 42 kobo per share for the year ended September 30, 2006. This implies 25 per cent instant growth in the number of shares accruing to the bank's shareholders.

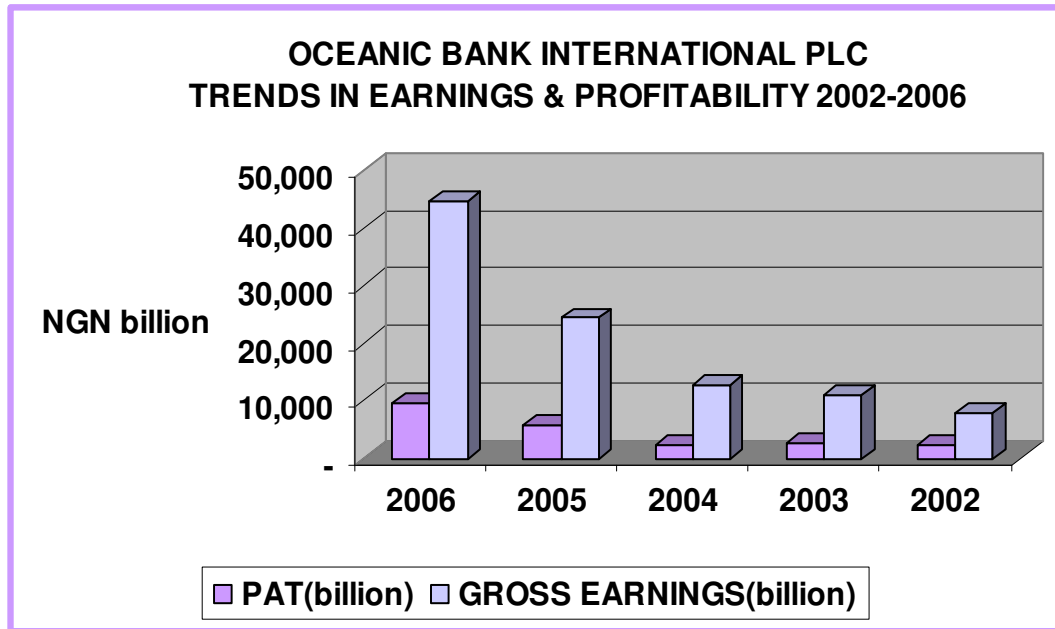
## **ANALYSIS OF FINANCIALS**

### **PROFITABILITY:**

Oceanic Bank has recorded a sterling performance in profitability among its peers as reflected in its profitability indices over the past five years. Its Profit After Tax (**PAT**) stood at N9.56bn as at its last financial year ended September 31, 2006, representing a 62.1% year-on-year growth ( higher than the industry average of 60.3%) and a 44.6% Compounded Annual Growth Rate (**CAGR**) over the past five years. Similarly, the Bank's return on average assets (**ROAA**) fell from 3.87% in 2005 (pre-consolidation era) to 3.24% in 2006.

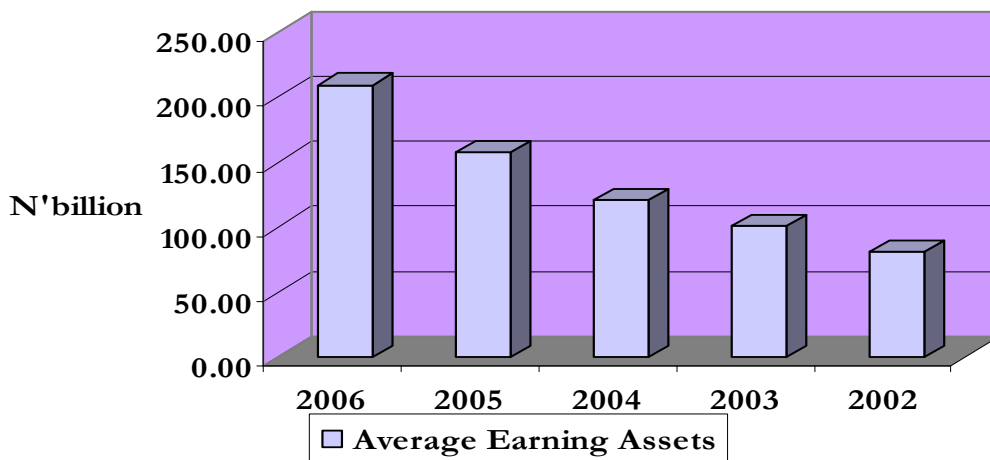
(Still above the industry average of 2.95% though low on year on year basis). Put differently, Oceanic Bank returned N3.20 per N100 worth of assets employed in 2006 higher than the industry return of N2.95 per N100 worth of assets employed.

In the same vein, the Bank's Return on Average Equity (**ROAE**) which indicates the amount returned to shareholders on their investment in the Bank stood at 27.80% as at 2006 financial year compared to the industry average of 23.73%.

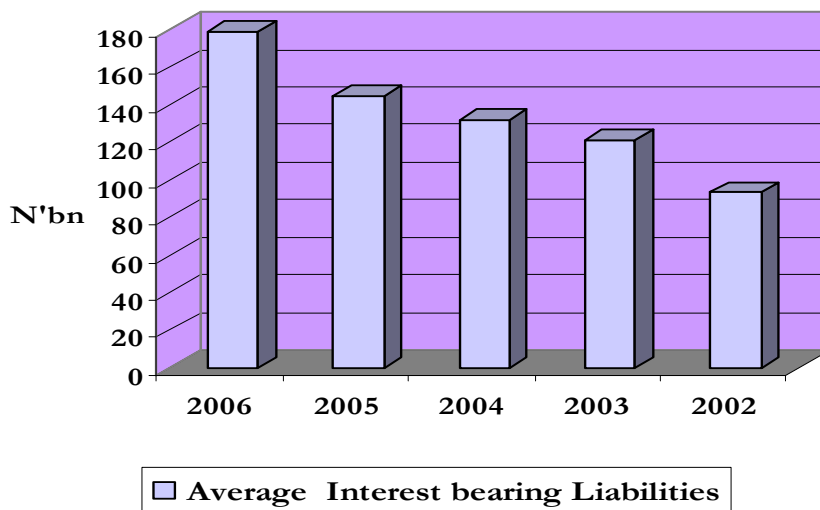


Similarly, it has also recorded high feat in generating appreciable earnings from its total assets. Gross earnings grew to N44.68bn in 2006 from N24.31bn recorded in the previous year, translating to 83.8% year-on-year growth while the industry average is 77.8 %. Its credit spread, a measure of the difference between the yield on average earnings assets and cost of interest-bearing liabilities soared from 21.8% in 2005 to 25.0% in 2006 while its Net Interest Margin (NIM), which indicates the Bank's proportion of net interest incomes to its interest-income generating assets rose marginally from 17.25% to 17.34% during the same period. This is evidenced by a 77.98% growth in its interest earning assets outpaced by a 78.9% leap in its net interest incomes over the same period.

**OCEANIC BANK INTERNATIONAL PLC  
GROWTH IN EARNING ASSETS 2002-2007**



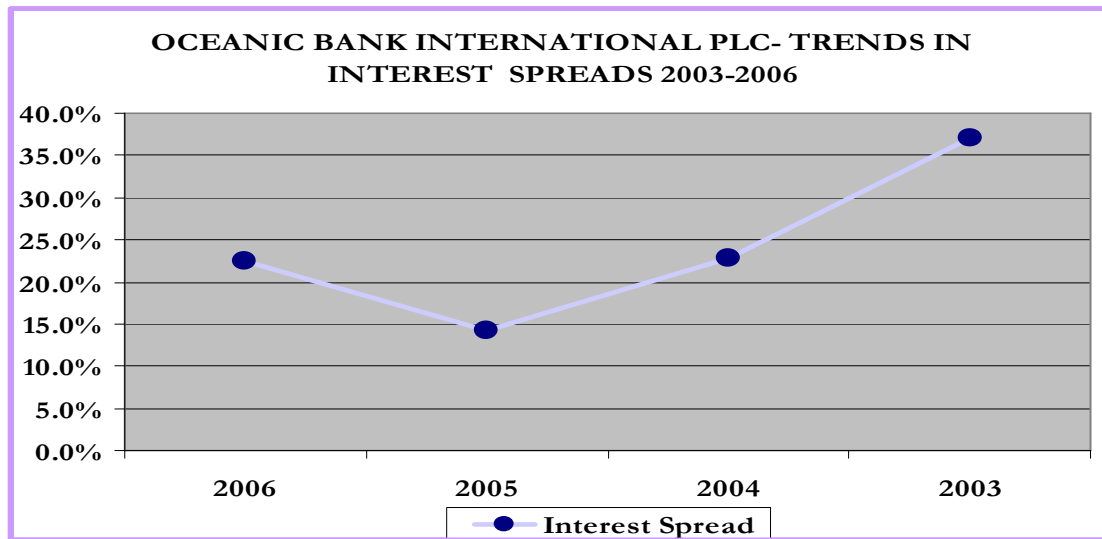
**OCEANIC BANK INTERNATIONAL PLC- TRENDS IN  
INTEREST-BEARING LIABILITIES 2002-2006**



The Bank's efficiency ratio, which is a measure of its ability to curtail non-interest expenses in relation to adjusted operating income declined from 78.44% in 2004 to 62.95% in 2005 before a marginal rise to 63.89% in 2006. In other words, the Bank incurred N63.89 in

interest expense for every N100 income generated as operating income in 2006. This is relatively high when compared to 55% set aside as benchmark for a typical big bank.\*

Burden ratio, which determines the extent to which non-interest expenses are covered by non-interest incomes such as fees, service charges, investment gains and other incomes, dropped sharply from 3.26% in 2004 to 1.25% in 2005 and inched up again to 1.63% in 2006. Impliedly, the Bank has recorded a significant improvement in its non-interest income generating efforts in a swift response to heap of challenges posed by the evolving financial market in Nigeria.



### ASSET QUALITY:

A review of Oceanic Bank's financials reveals a more efficient risk management strategy by the Bank given the amount of existing credit risk associated with loans and investment portfolio as well as off- balance sheet activities.

The Bank's total equity and liabilities stood at N371.59bn as at its financial year ended September 31 2006, a quantum leap by 71% from N217.80bn in 2005 before the consolidation deadline date. (5-year CAGR is 62.5%). Similarly, the Bank's quality of assets determined by the ratio of its performing loans to total loans increased marginally again to

another comfort level of 95.9% in 2006 from 94.7% in 2005 while its loan loss provision to total loan ratio expectedly rose from 1.97% to 3.43%. Loan and advances however grew by 27.3% in 2006 to N99.92bn from N77.72bn in 2005. As a further confirmation of careful risk management, the Bank's ratio of non-performing loans to total loans declined from 5.3% in 2005 to 4.10% in 2006 (below the industry average of 7.83%) while its loan loss expenses to total assets nose-dived from 0.77% in 2004 to 0.45% in 2005 with a marginal rise to 0.47% in 2006. By and large, we may objectively deduce that the Bank deserves its GCR rating based on strong risk management process.

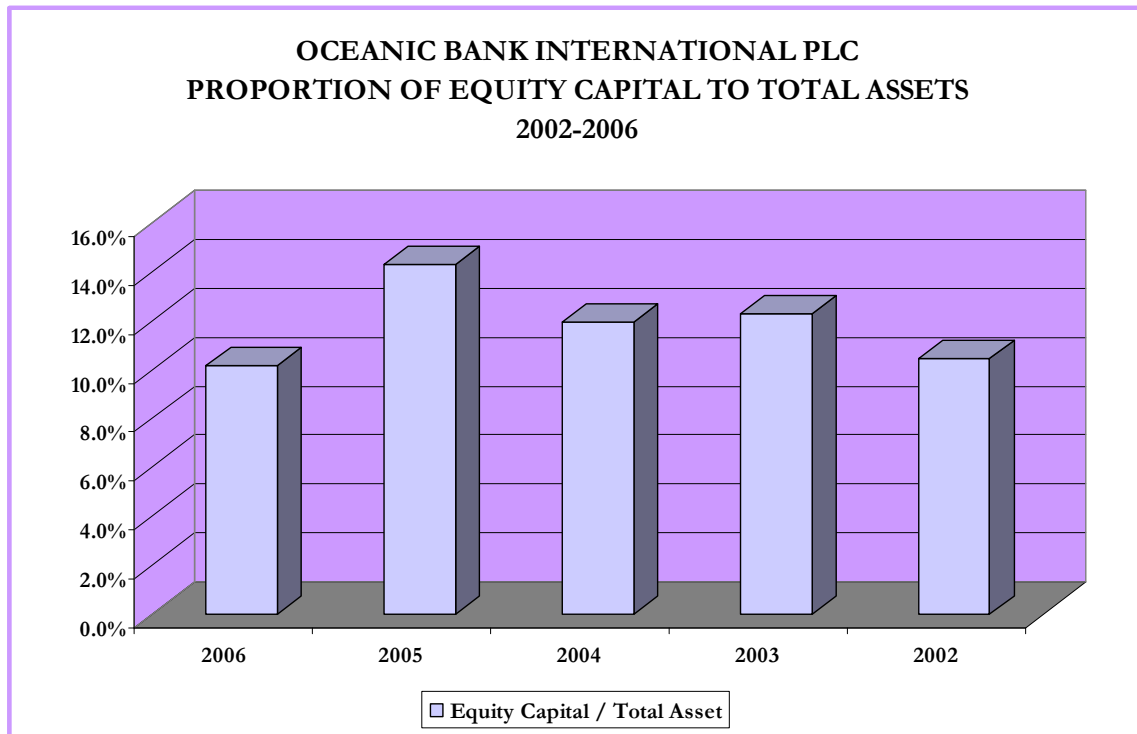
### **LIQUIDITY:**

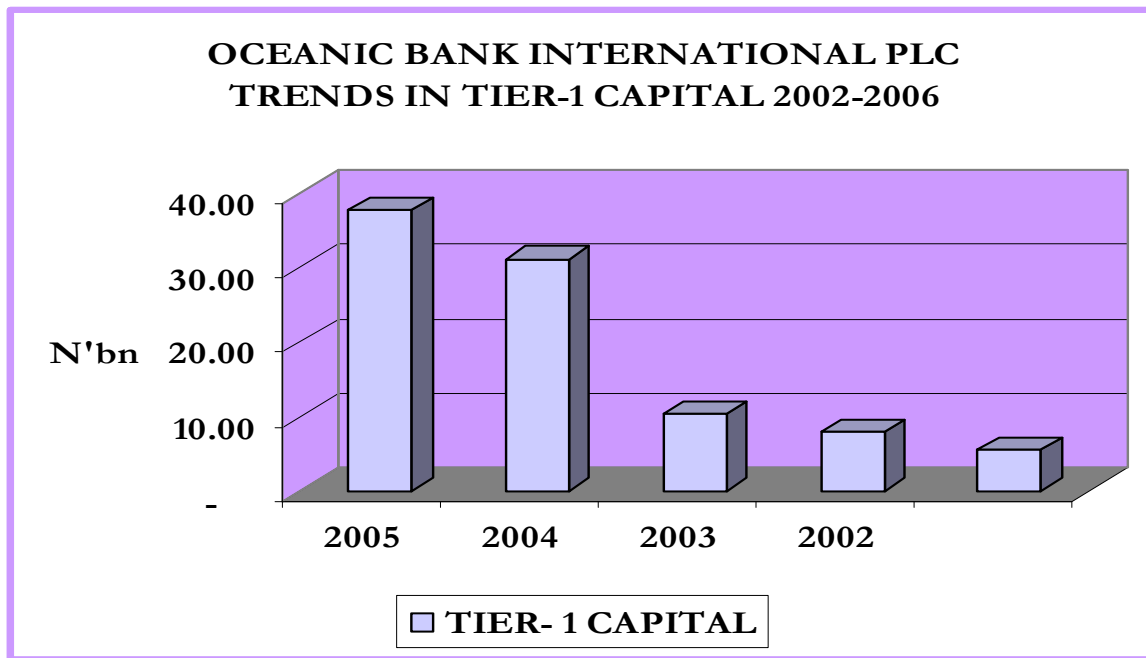
An analysis of Oceanic Bank's liquidity position reveals a healthy trend for the past three years 2004-2006. The Bank has maintained a consistent ratio of over 70% cash and short term funds to total deposits (74.55%, 71.41% & 71.11% for 2004, 2005 and 2006 respectively). This is well above the benchmark of 40% minimum set by the apex regulatory authority, the Central Bank of Nigeria (CBN). Its loans and advances to total deposits rose from 35.17% in 2004 to 46.42% in 2005 and later declined to 31.87% in 2006. This trend is also replicated in the behaviour of demand deposit to total deposit ratio which increased from 62.7% in 2004 to 65.57% in 2005 and fell thereafter to 60.94% in 2006. By and large, Oceanic Bank has been able to strike a reasonable balance between profitability and liquidity.

### **CAPITAL ADEQUACY:**

The Bank has recorded an impressive growth in assets base in the last three years (2004-2006) pre-and-post consolidation exercise. Its total assets plus contingent liabilities grew by 65.91% in 2006 to N466.45bn from N281.14bn in 2005, while its shareholders' funds rose to N37.67bn in 2006, 21.7% above the N31.09bn level as at September 2005 before the banking consolidation deadline. The Bank's Tier-1 Capital to risk weighted assets ratio, which is a capital adequacy index, declined from 18.06% in 2004 to 13.11% in 2006. Put differently, the extent of its cushion from its shareholders' funds to absorb its risky assets has been on decrease. This became more pronounced between 2005 and 2006. Meanwhile,

this signifies that the Bank needs to increase its capital base in order to be at pace with its growing assets and increasing potential exposure.





## VALUATION.

In determining a fair value for Oceanic Bank, we assume a growth in Profit After Tax (PAT) of 12.06% and a decline in Return on equity (ROE) to 17% as a result of increased competition in the industry. In the same vein, we anticipate reduction in cost of equity as the Bank's growth rate increases.

We adopted Residual Income /Discounted Cash Flow (DCF) Valuation metric, Dividend Growth Method (DGM) and Relative Valuation Multiples. Our DCF method gave an intrinsic value of N20.70 while DGM produced N10.31 as a fair value. However, with price multiples; we obtained N20.77, N19.50 and N30.50 as fair values using Price to Gross Earnings, Price to Book Value and Price to Earnings ratios respectively. Given proper weighting and more emphasis on Residual Income and Price/Book Value metrics, we obtained an estimate fair value of N20.20.

## OCEANIC BANK INTERNATIONAL PLC : KEY STATISTICS-2006 FINANCIALS

VALUATION METRICS		TRADING INFORMATION	
Market Cap(N'bn)	227.33	<b>Stock price history</b>	
Trailing P/E	21.40	Volatility - Beta ( $\beta$ )	0.58
PEG Ratio (5 yr expected) (%)	1.77	52-Week High (13-02-07) (Ngn)	19.53
Price/Gross earnings	3.84	52-Week Low (04-04-06) (Ngn)	5.90
Price/Book value	5.68		
Projected Growth Rate in (%)	12.06	<b>Share statistics</b>	
		Average Volume Traded (1 month)	500,735
		Average Volume Traded (5 days)	518,679
<b>FINANCIAL HIGHLIGHTS</b>		Shares outstanding(bn)	11.64
Fiscal Year End	30-Sep	Float	46.60
Most Recent Quarter (mrq)	Dec-06	% held by insiders	42.70
<b>Profitability</b>		% held by institutions	10.70
Net Interest Margin(NIM) %	17.34	<b>Dividend and Bonus History</b>	
Credit Spread %	25.01	Last Paid Dividend (Ngn)	0.42
Burden Ratio	1.63	Trailing Dividend Yield (%)	2.15
Asset Utilisation Ratio	15.16	Trailing Earnings Per Share(Ngn)	0.91
Tax Expense Ratio	11.22	Trailing Earnings Yield (%)	4.67
Equity Multiplier Ratio	8.57	Last Script Issue	1 for 4
<b>Management Effectiveness</b>		Payout Ratio (%)	41
Return on Average Asset (ROAA)	3.24%	Ex-dividend Date	17-Jan-07
Return on Average Equity (ROAE)	27.80%	<b>Balance Sheet</b>	
<b>Income Statement</b>		Shareholders Fund(Nbn)	37.67
Gross Earning (Nbn)	44.68	Loans and Advances(Nbn)	10.58
Gross Earnings Per Share	5.09	Total Assets & Contingent Liabilities(Nbn)	466.46
PBT(Nbn)	11.61	Tier-1 Capital/Risk Weighted Assets(%)	13.11
PAT(Nbn)	9.56	Book Value Per Share (Ngn)	3.44
Total Expenses(Nbn)	33.1	Shareholders Fund Growth (%)	21.2
		Deposit Growth (%)	85.38
		Reserves Growth (%)	21.16
		Total Assets Growth (%)	70.61

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