

MERISTEM EQUITY RESEARCH REPORT



**INTERCONTINENTAL
BANK PLC**

REPORT DATE: FEBRUARY 9, 2007.

RECOMMENDATION: BUY @ N17.97

EXECUTIVE SUMMARY AND INVESTMENT RATIONALE:

- Intercontinental Bank Plc has emerged as one of the most capitalized banks in Nigeria after successfully integrating and consolidating its various subsidiaries to meet CBN consolidation requirement.
- It was incorporated on March 1, 1989 as a private limited liability company under the name **Nigeria Intercontinental Merchant Bank Limited** and became a commercial bank known as **Intercontinental bank limited. It was** listed on the on the Nigerian Stock Exchange in 2002.
- The Bank went to the market in 2004 to raise funds for CBN 25billion capitalisation requirement. This was over-subscribed by 30% and the banks shareholders funds stood at N54.5billion as at year end 2006.
- Following the reforms in the banking sub-sector in 2005, the Bank merged with Equity Bank, Global Bank and Gateway Bank as part of its consolidation exercise and subsequently went back to the capital market in September 2006 to raise more funds with hybrid Offers, consisting of a Rights Issue of 1.5billion and Public Offer of 740.7million at N13.50. These offers were the part of its strategic plans of raising funds to remain competitive, dabble into new business possibilities and consolidate on its stronghold areas.
- Its subsidiaries are WAPIC Insurance Plc (59.86%) Intercontinental Capital Market Limited (75%) Intercontinental Securities Limited (55%) Intercontinental Homes (Savings & Loans) Limited (100%), Intercontinental Properties Limited (100%) and Intercontinental Finance Limited (100%) and Associated Discount House (46%).
- With a robust business model universal banking services, the bank focuses on 5 main markets, viz; **Corporate Banking (with interests on manufacturing, oil & gas, energy, aviation, maritime, real estate, hotels & tourism e.t.c.) ; Retail Banking; Corporate Finance (Financial Advisory, Structured Finance, Venture Capital, Project Management), High Net Worth Individuals and Government/Non-Governmental Organisations.**
- The bank is expanding in the financial institutions market with growing revenue from its subsidiaries in the Capital Market and Insurance sub-sector.
- Intercontinental Bank received an investor grade long term rating “A” and short term rating ‘F1’ from Fitch ratings UK, describing the Bank as ‘High credit quality, with expectations of low credit risk’ with a strong capacity for payment of financial commitments. The short term rating of ‘F1’ described as “highest credit quality, indicates the strongest capacity for timely payment of financial commitments.”

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- Risked attached to our valuation is the interest income exposure as a result of high competition in the industry coupled with regulatory effect on earnings generation potential.
- **We recommend a BUY of Intercontinental Bank at a target price of N17.97 and believe that it is presently trading at a slight premium using the review date price of N18.10 at Friday February 09, 2007.**

Future Outlook:

As the banking sub-sector of the Nigerian financial sector gets more and more competitive, the emerged banks will need to offer more services which serve the various needs of its customers. It is to this end that Intercontinental Bank has identified increased investments in **Information Communication Technology (ICT), branch development and expansion** into areas that offer opportunities and grow revenue from core-banking operations.

As the world becomes more and more technology driven, the bank has channeled resources into E-business services to offer fast, varied and diverse online real time services to meet and surpass the needs of its customers. The bank sees e-business as the next frontier capable of creating profits. This will provide a basis for the bank to operate internationally as transactions will be made over the internet.

Intercontinental Bank has set its sight on expansion of its branch network. The bank currently has 185 branches nationwide and aims at 280 by end of 2007 year end. The Bank is also looking to expanding beyond the shores of Nigeria to areas where there are heavy Nigerian business trades or populations such as the United Kingdom, United States of America, South Africa, China e.t.c. It has already obtained approval in principle to commence operations in Ghana and there are plans for more along the West African Sub region. In Nigeria branch expansion has proven to be highly successful as most branches break even 10-12 months after establishment.

The bank has its eyes on expanding its role in the financial institutions market with growing its revenue from its subsidiaries in the Capital Market and Insurance sub-sector. It also plans to increase its interest income from its loan portfolio among manufacturing companies and multinationals in Nigeria and currently looking into the funding of small and medium scale enterprises.

ANALYSIS OF FINANCIALS:

PROFITABILITY

Intercontinental grew its Operating Income by 87.6% in 2006 to N30.87 bn from N16.45bn in 2005 which is higher than the 65% growth achieved in 2003. While Interest Income increased by 79.8% in 2006, Non-interest income grew by 93.7% as against 88.7% and 42% in 2005 respectively, meaning that the Bank focuses more on its non-interest income operations. However, the bank's ratio of operating expenses to gross earnings ratio grew from 38.8% in 2003 to 50.7% in 2006, while its gross operating margin rose from 65.9% in 2003 to 79.6% in 2006 indicating

In the same vein, return on equity (ROE) which measures return on investments to shareholders rose to 29.9% in 2003 but declined to 15.4% in 2005 after the change in its accounting year to February. However, this inched up to 15.96% in 2006 which is still relatively low when compared to the industry average of 19.9%. This could be as a result of expansion in its shareholders' base without a proportionate increase in earnings in 2006. Moreover, the Bank has the highest rate of return on assets (ROA) in the industry. Its ROA stood at 4.2% in 2006 with a 5-year average of 5.04% compared to industrial average of 2.73%. This bears credence to the fact that the Bank has a high level of risky assets relative to the industry as reflected in its asset quality ratios. Another strong index of profitability is the burden ratio. This determines the level to which Non-interest expenses could be absorbed by non interest income. Intercontinental Bank's burden ratio grew by 38% in 2006 as against 19% in 2005. This portends greater increase in Non-interest expenses than Non interest income.

However, the overall expense ratio measured by Interest expenses, Non interest expenses and loan loss provision relative to Average Total Asset has been on the decline from 20% in 2003 to 12% in 2005 and down to 11% in 2006. The decline may be a resultant effect of increasing asset base of the company and not more of any cost control strategy on the part of the Bank.

ASSET QUALITY

Intercontinental Bank's asset base grew to N360.90bn in 2006 - a quantum leap by 120% when compared to N117.89 bn in 2005. This growth in asset could be adduced to its merger

with Equity Bank of Nigeria Plc, Global Bank Plc and Gateway Bank Plc.

In terms of asset quality, the Bank has performed brilliantly well as the ratio of Loan Loss expenses to Net interest income declined significantly from 18.1% in 2003 to 3.9% in 2006. The Bank's Loan Loss provision to Non-performing Loan also increased from 81.89% in 2005 to 116.10% in 2006 while its Performing loans to Gross loans has been relatively stable at 94% between 2003 and 2006. Non-performing loans to Gross loans declined from 6.20% in 2003 to 5.62% in 2006. The growth in performing loan to gross loan represents increasing quality of risk asset while the increase in the ratio Loan Loss provision to Non-performing loan signifies adequate provision for all non performing loans. Though Intercontinental Bank has a high record of risky assets in the industry, however, its highest return on Asset in the industry has been compensating as a balance on the risk-return relationship scale.

LIQUIDITY

Liquidity is a sensitive item on the balance sheet of any bank and more often than not determines the long term sustainability of a bank. Liquidity affects profitability and therefore, it takes good management to strike a balance between the two contending forces. During our review of Intercontinental Bank's financials, we examined the relationship between its Total Loans to Total Deposit; Liquid Assets to Total Deposit as well as Demand Deposit to Total Deposit.

While the Bank's ratio of Total Loan to Total Deposit has been increasing from 40.09% in 2002 to 67.4% in 2006, its Liquid Assets to Total Deposit has been on a decline from 51.86% in 2003 to 28.12% in 2006. This exhibits a shift to profitability without necessarily putting liquidity at risk.

Customer's deposit represents 82% of the total liabilities as compared to 86% in 2002 and 83% in 2005. The bank's deposit growth has been on the increase indicating investors' growing confidence in the bank. Total Deposits grew by 41% in 2003, 119% in 2005 and 129% in 2006 while the proportion of deposits advanced to customers as loans and leases increased significantly too from 34% in 2002 to 37% in 2003, 44% in 2005 and 55% in 2006. This growth is necessary and at a reasonable level as the Bank is trying to balance the relationship between profitability and liquidity. The Bank's ability to meet customers cash demand is also reflected in its business acumen of keeping about 68% of its deposit in short term loans and advances, down from 97% in 2005. This again is necessary to maintain a reasonable profitability level for the bank while not sacrificing liquidity needs of its

customer. In this view, the bank's cash and liquid asset to its overall total asset has declined from 68% to 48% in 2006.

CAPITAL ADEQUACY:

This is a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposure. It is a measure of how far a bank can absorb shock arising from credit exposure. It is determined by comparing Tier-1 Capital to Risk weighted assets. The higher the ratio, the better it is for a Bank.

From our review of the Financials of Intercontinental Bank, its Tier-1 Capital to Risk weighted assets rose from 13.6% in 2003 to 23.1% in 2006. Put differently, it indicates that the Bank's financial muscle has increased in order to be able to absorb more shocks from its risky assets. This could be attributed to further injection of fresh capital from the last Offer in November 2006. Furthermore, the Bank's Risk weighted assets to Total assets and contingencies which measures the proportion of the Bank's assets exposed to credit risks increased significantly from 11.1% in 2003 to 59% in 2006. This is relatively high compared to the industrial average of 28.8%.

RISK ANALYSIS:

Intercontinental Bank like any other banks is exposed to high level of competition both within and outside the country. As many local banks are struggling for more market shares locally, a number of foreign banks are strategizing towards establishing a foreign subsidiary in the country. Since the economy is opened to the class of investors, it poses a greater risk. In the same vein, since interest come constitutes the bulk of bank's gross earnings, intercontinental is exposed to interest rate volatility as regulatory authorities put more pressures on interest rate reduction.

The challenge to meet up with an average expected return on investment post consolidation is a challenge on the bank since given an expanded equity base, generating enough returns in term of increased earnings constitutes a serious threat to the bank in a highly competitive environment.

Intercontinental Bank's liquidity **risk** has been measured by a couple of indices. Its Total Deposit to Total Liabilities grew from 80% in 2003 to 82% in 2006 while its short-term investment to Average Total Assets rose from 1.35% in 2003 to stand at 5.31% in 2006. Similarly, loan losses to Total Deposits declined significantly from 8.28% in 2003 to 0.26% in 2006, implying that the Bank' has put in place a more effective and strict credit policy.

Equally important is **capital risk** in the banking industry. As earlier mentioned, Intercontinental Bank is adequately capitalised with equity to asset ratio averaged 14.2% over five year's period (2001-2006). Its Equity capital grew by 15.2% in 2003 pre-consolidation era, 280% immediately after merger and by 66% in 2006 post-consolidation.

HIGHLIGHTS OF QUARTERLY PERFORMANCE / FORECASTS:

Intercontinental Bank's half-year 2006 results re-affirmed not only its ability to grow earnings but also earnings sustainability. Its half-year gross earnings grew by 149% from N13.62 bn in the corresponding period in 2005 to N33.93 bn in Q2-2006 while profit after tax rose to N6.34bn from N3.32 bn in Q2-2005, an increase of 91%. Furthermore, to demonstrate its commitments to shareholders, it declared an interim dividend of 30k per share for the current year (as a way of fulfilling its promise during the last offer). Soon after this, the third quarter (Q3-2006) result was released with more promising future as gross earnings stands at N59.1bn and profit after tax equals to N10.1 bn, translating to a quarter-on-quarter growth of 94% & 84% respectively over the corresponding period in 2005.

Given this trend in performance and barring all unforeseen contingencies, the Bank should be able to surpass its forecasts for earnings and profit after tax for years 2007-2009 as contained in its offer prospectus in 2006. As stated in the document, forecast gross earnings for years 2007-2009 are N66.02 bn; N84.35 bn and N111.056 bn in that order while profit after tax is projected as N12.97bn; N18.06bn and N24.11bn.

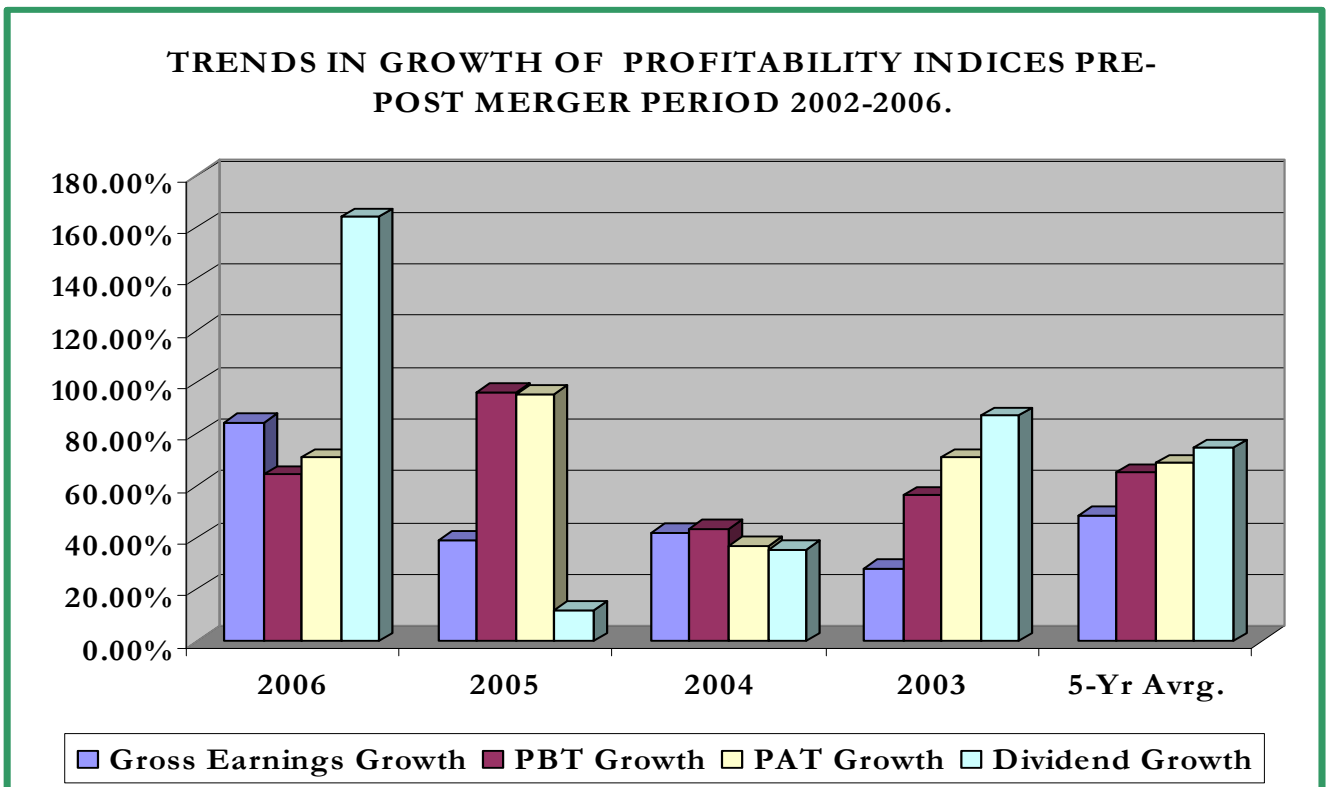
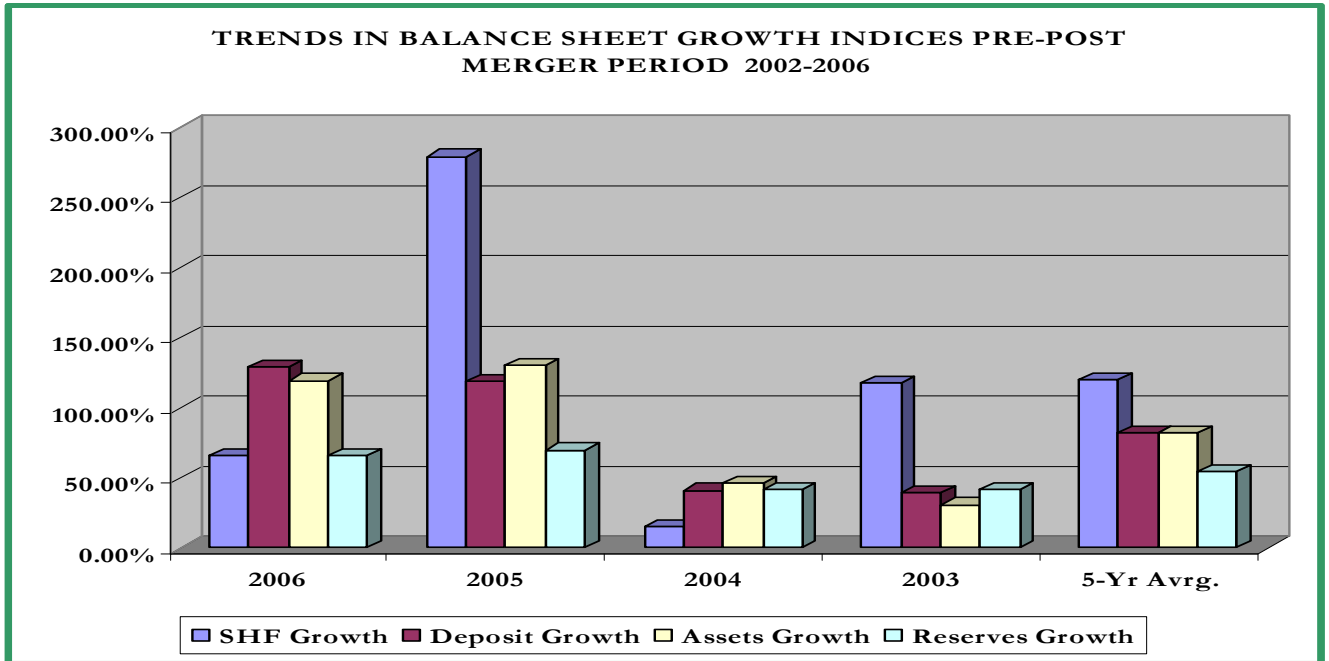
Going by the Bank's performance in the third quarter, the estimates for gross earnings and profit after tax will definitely be exceeded. With conservative earnings' and profit after tax growth rates of 78% and 68%, the Bank's gross earnings and profit after tax for year end February 2007 should be in the neighborhood of N69.05bn and N14.2bn respectively.

INTERCONTINENTAL BANK PLC: TRENDS IN PERFORMANCE 2001-2006

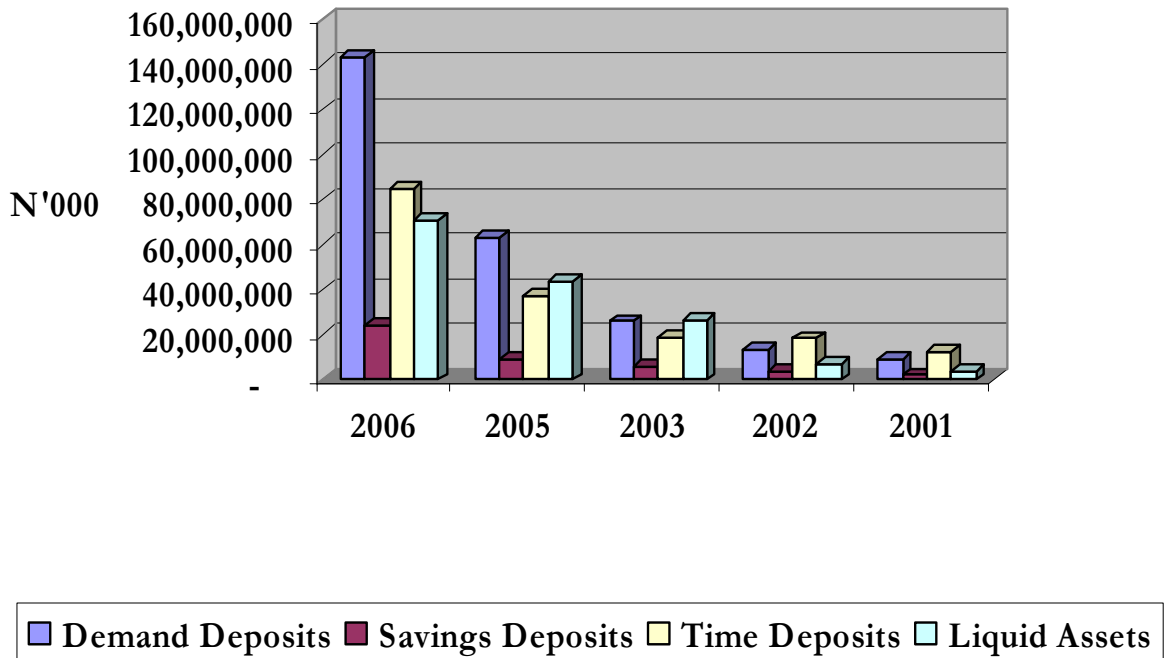
Profitability Ratios:	Post-merger	14-				5Yr Avg.
	Year-ended	months Ended	Dec-03	Dec-02	Dec-01	
	Feb-06	Feb-05				
OPEX / Gross Earnings	50.65%	41.93%	38.82%	34.89%	32.46%	39.75%
Gross Earnings/ Total Assets & Conting. Liab.	9.81%	11.42%	19.54%	6.93%	5.41%	10.62%
Profit After Tax/ Gross Earnings	22.16%	23.89%	17.00%	17.66%	13.22%	18.79%
Gross Operating Margin	79.57%	78.25%	65.99%	64.62%	60.35%	69.76%
Net Interest Margin	27.21%	30.45%	21.23%	20.48%	16.95%	23.26%

Return On Average Assets(Pre-tax)	4.20%	5.69%	5.69%	5.54%	4.09%	<i>5.04%</i>
Return on Equity	15.96%	15.40%	29.90%	25.30%	27.50%	<i>22.81%</i>
Liquidity Ratios	Feb-06	Feb-05	Dec-03	Dec-02	Dec-01	5Yr Avg.
Demand Deposits/ Total Deposits	56.90%	57.6%	51.1%	38.6%	36.3%	<i>48.10%</i>
Savings Deposit/Total Deposits	9.59%	8.37%	11.13%	10.25%	7.9%	<i>9.45%</i>
Time Deposit/ Total Deposits	33.50%	34.04%	36.85%	51.12%	47.3%	<i>40.57%</i>
Liquid Asset/ Total Deposits	28.12%	39.56%	51.86%	18.6%	14.4%	<i>30.50%</i>
Total Loans/Total Deposits	67.40%	50.27%	46.15%	40.9%	47.4%	<i>50.42%</i>
Asset Quality Ratios	Feb-06	Feb-05	Dec-03	Dec-02	Dec-01	5Yr Avg.
Perf Loans / Total Loans(gross)	94.38%	94.02%	93.80%	80.10%	82.87%	<i>89.03%</i>
Non-perf Loans / Total Loans(gross)	5.62%	5.98%	6.20%	19.90%	17.13%	<i>10.97%</i>
Loan Loss Prov/Total Non-perf. Loans	116.10%	81.89%	106.59%	67.44%	57.80%	<i>85.96%</i>
Loan Loss Prov/Total Loans	6.53%	4.89%	6.61%	13.42%	9.90%	<i>8.27%</i>
Loan Loss Exp/Net Int Inc.	3.87%	13.21%	18.08%	24.25%	39.94%	<i>19.87%</i>
Capitalisation Ratio	Feb-06	Feb-05	Dec-03	Dec-02	Dec-01	5Yr Avg.
Equity /Total Assets	14.93%	19.80%	12.00%	15.27%	9.17%	<i>14.23%</i>
Capital Adequacy Ratio	Feb-06	Feb-05	Dec-03	Dec-02	Dec-01	5Yr Avg.
Risk Weighted Assets/Total Assets & Conting.	59.0%	17.7%	11.1%	4.8%	2.2%	<i>19.0%</i>
RISKS RATIOS/ Liquidity Risks	Feb-06	Feb-05	Dec-03	Dec-02	Dec-01	5Yr Avg.
Loan Losses /Total Deposit	0.26%	2.46%	8.28%	5.49%	4.69%	<i>4.2%</i>
Total Deposit/Total Liabilities	82.2%	83.5%	80.0%	86.3%	75.5%	<i>81.5%</i>
Short Term Investment/Avrq Total Assets	5.31%	0.98%	1.35%	7.15%	1.35%	<i>3.2%</i>
Capital Risks						
Tier 1 Capital/Risk-Weighted Assets	23.1%	32.7%	13.6%	11.8%	6.6%	<i>17.6%</i>
Equity /Total Assets	14.9%	19.8%	12.0%	15.3%	9.2%	<i>14.2%</i>
Growth rate in Total Equity Capital	65.6%	279.7%	15.2%	118.0%	119.6%	<i>119.6%</i>
Equity Growth less Assets Growth	-54.0%	149.5%	-31.4%	87.1%	37.8%	<i>37.8%</i>
Operational Risks						
Non-Int Exp/Net Int Inc +Non-int.Inc.	63.7%	53.6%	58.8%	54.0%	53.8%	<i>56.8%</i>
Total Expenses/Gross Income	71.1%	63.7%	72.8%	70.3%	72.1%	<i>70.0%</i>

PERFORMANCE CHARTS



**TRENDS ANALYSIS OF DEPOSIT & LIQUID ASSETS PRE-
POST MERGER PERIOD 2001-2006.**



PEER REVIEW ANALYSIS OF BANKING INDUSTRY

As Nigerian economy has undergone a number of reforms recently, one other sector that has witnessed a lot of transformation during the reforms is the banking industry. Post consolidation, there has been drastic reduction in the number of banks in the economy to 25 with each surviving bank having a shareholders Funds of not less than N25 billion.

Aftermath of consolidation process has generated a multiplier effect on the overall economic performance. Furthermore, competition in the industry has risen and the banks are still raising funds from the capital market to shore up their capital base for mega business opportunities.

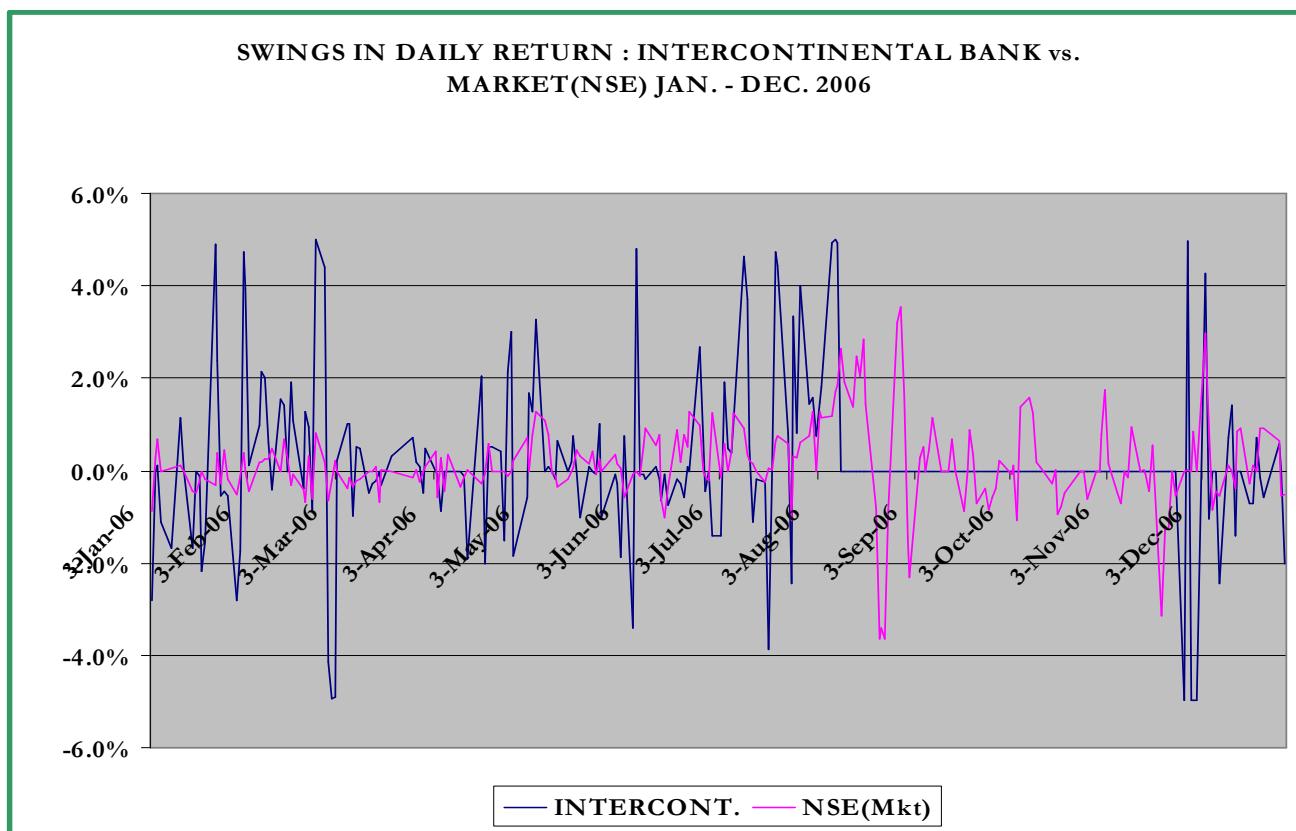
Below is a summary statistics for the banks in the industry.

*** BANKS' PEER PERFORMANCE REVIEW 2006 FYE**

	AV	FBN	GTBANK	INTERCONT.	OCEANIC	UBA	UBN	ZENITH
Shares Outstanding(bn)	9.76	10.48	8.00	10.72	9.31	8.47	12.07	9.27
Mkt. Capt.(Ngn)	272.72	389.64	206.32	194.10	164.97	321.85	337.33	294.84
Market Price as at Date- (N'bn)	28.08	37.19	25.79	18.1	17.72	37.99	27.95	31.82
Shareholders' Funds- (N'bn)*	61.94	62.29	36.35	54.47	37.67	48.54	100.50	93.80
EPS(N)	1.41	1.76	1.50	1.11	0.82	1.68	1.38	1.59
DPS(N)	0.81	1.00	0.70	0.45	0.42	1.00	1.10	1.00
ROE (%)	19.92	27.9	23.51	15.83	25.4	23.78	10.75	12.25
ROA (%)	2.73	2.83	3.40	4.20	3.13	1.45	1.63	2.49
Book Value Per Share(BVPS)N	6.05	5.95	4.54	3.44	4.04	4.63	9.59	10.13
Earnings Yield (%)	4.86%	4.73%	5.24%	5.60%	4.97%	4.41%	4.60%	4.50%
Div. Yield (%)	2.85%	2.7%	2.7%	2.5%	2.4%	2.6%	3.9%	3.1%
Div. Pay-out (%)	56.83%	56.8%	46.7%	41.0%	51.2%	59.5%	79.7%	62.9%
Price/Earnings(P/E) ratio	20.87	22.41	19.09	17.87	20.14	22.67	21.72	22.22
Price-to-Book Value	5.12	6.25	5.68	5.26	4.39	8.21	2.91	3.14
Price-to-Gross Earnings	0.51	0.55	0.77	0.44	0.40	0.42	0.42	0.55
Gross Earnings Per Share(N'b)	57.44	67.44	33.62	41.04	44.69	90.48	66.58	58.22
Tier Capital/Risk Weighted Assets	39.56	29.71	50.41	23.10	30.88	27.20	58.55	57.04
Risk Weighted Assets/Total Assets	28.81	28.69	18.91	59.00	26.15	16.97	24.92	27.03

* As at last financial year

STOCK MARKET PERFORMANCE



VALUATION:

We have employed both relative valuation bases and dividend growth valuation metrics in arriving at our valuation for Intercontinental Bank.

Using a projected EPS of N1.32 and a trailing P/E ratio of 17.87, we estimated a target price of N23.58. However, given the Industry Average P/E multiple of 20.39, the Bank should be trading at a N26.91.

Further on a relative valuation basis, at an average P/B multiple of 5.12 for the industry, we arrived at N17.61. However, our dividend valuations approach assumes that the current payout ratio would be sustained and given a dividend growth rate of 20% in the first three years and a long term dividend growth of 12% thereafter, we arrived at N16.5 as the Bank's fair value.

With an appropriate blend of values from different valuation approaches, we arrived at N17.97 as a fair value of Intercontinental Bank Plc. This indicates that the Bank is currently trading at a premium and probably riding on the bullish effect of the market trend.

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