

# Bermuda Commercial Bank

June 2008

(BCB-BH)

BSX Financials – Banks

<b>Share Price (06/20/08):</b>	\$11.00
<b>Stock Rating:</b>	Hold
<b>Risk Profile:</b>	Moderate
<b>1-Year Target:</b>	\$11.00
<b>1-Year Implied ROR:</b>	7.3%

<b>Annual Dividend:</b>	\$0.80
<b>Current Yield:</b>	7.27%
<b>Payout Ratio:</b>	74%
<b>Ex-Dividend Date:</b>	12/03/08
<b>Frequency:</b>	Semi-Annual

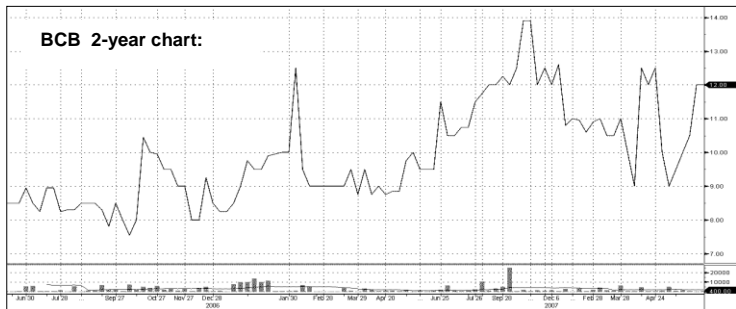
<b>Shares O/S:</b>	5.75m
<b>Market Cap:</b>	\$63.3m
<b>BSX Weight:</b>	2.46%
<b>Book Value:</b>	\$10.88
<b>Price/Book:</b>	1.01x

<b>52-Week High:</b>	\$13.90
<b>52-Week Low:</b>	\$9.00
<b>Avg. Monthly Volume:</b>	8,200

<b>Current P/E Ratio:</b>	10.19x
<b>Shareholder's Equity:</b>	\$62.6m
<b>Total Assets:</b>	\$696.5m
<b>Return on Equity:</b>	9.9%
<b>Return on Assets:</b>	1.0%

Earnings Snapshot:	2005	2006	2007	2008E
<b>EPS:</b>	\$1.04	\$1.67	\$1.08	\$1.18
<b>YoY Growth:</b>	100.0%	60.6%	(35.3%)	9.3%
<b>P/E Ratio:</b>	7.69x	5.09x	11.11x	9.00x
<b>Fiscal YE Price:</b>	\$8.00	\$8.50	\$12.00	

Notes: -on 05/31/08, BCB had 1.36 million warrants exercised, resulting in \$10.2 million in new share capital (market cap, book value, and EPS figures take this dilution into effect.)  
- BCB fiscal year end is Sept. 30<sup>th</sup>.



Price chart as of June 20, 2008. Courtesy of Bloomberg LLP.

## Fiscal 2007 Earnings Disappoint

### INVESTMENT HIGHLIGHTS

- Net operating income for fiscal 2007 came in at \$5.94 million, or \$1.08 per share – down 29% from 2006 operating income of \$8.38 million, or \$1.67 per share. BCB's operating EPS fell 16% short relative to our estimate of \$1.28. The deterioration in earnings was primarily due to a significant drop in the Bank's deposit base following the FCIB investigation of late 2006.
- Total Assets rebounded sharply year-on-year from \$464.3 million to \$621.5 million, an increase of \$150 million or 34%. Management appears to have effectively bolstered client deposit levels following the turmoil of the FCIB money-laundering charges of Sept. 2006 and the ongoing sale process of the Bank.
- Foreign exchange gains grew by \$140,000, or 21.5%, to \$790,000 due to increased turbulence in worldwide currency markets.

### OPERATIONS REMAIN CONSERVATIVE

- BCB concluded a two-year comprehensive review of its risk operations, resulting in the termination of certain client relationships which stood outside its "business strategy and conservative risk profile". Although this process led directly to lower fee and commission-based income, management was satisfied with the end result, which led to "a leaner, lower risk clientele which the Bank is better able to service."
- The Bank's 2007 earnings shortfall was due, in part, to their longstanding (and conservative) investment policy of matching client deposits with cash and cash-equivalents. Profits were vulnerable to the changing interest rate environment and fluctuations in average deposit levels. Nonetheless, BCB appears to have successfully "weathered the storm" in the financial sector, with little exposure to the worldwide "credit crunch" and no investments in U.S. mortgage-related or asset-backed securities.

## Where is the “White Knight” ???

### TAKEOVER DEAL SPURNED AT THE 11<sup>TH</sup> HOUR

- On February 19<sup>th</sup> 2008, BCB management released a Shareholders Letter which outlined the various details of the Bank’s lengthy sale process. A mutually-agreeable purchase arrangement had been reached with a third party and was approved by the board on Dec.7<sup>th</sup>, 2007. Despite the tacit approval of the Dutch Antilles Central Bank (acting on behalf of BCB’s main shareholder, FCIB) and after two deadline extensions, the deal was called off on Jan. 31<sup>st</sup>, 2008 due to the Central Bank/FCIB’s insistence that “more favourable terms and conditions were available”.
- We can only deduce as to what “favourable terms and conditions” might entail for the Central Bank/FCIB. Given the \$9 to \$14 trading range in BCB stock over the past year and the drawn-out pace of negotiations, we would estimate the rejected offer in the range of \$10 to \$12 per fully-diluted share. The Bank’s 3.26 million of outstanding warrants and options may have proven a significant obstacle to the negotiations.
- The Central Bank/FCIB has decided to solicit tender offers for the common shares and options of BCB, with the presumption that the result will be superior to the failed offer. BCB management may find itself in an awkward situation should this tender process fail. Over the past year they have “gone to the table” with the most suitable of candidates and may well head back to the table “hat in hand”, insistent upon better terms at the behest of their disgraced majority shareholder.

## First Half 2008 Earnings Rebound

### INVESTMENT HIGHLIGHTS

- BCB reported income for the six-month period ended March 31, 2008 of \$4.39 million, or \$0.75 per share. Removing one-time items (including \$740,000 related to the VISA and MasterCard IPO’s) net operating earnings were \$3.64 million, or \$0.63 per share – a gain of 11% on the \$0.57 per share reported in 2007.
- The Bank’s balance sheet continues to strengthen, with Total Assets growing from \$621.6 million as of fiscal YE 2007 to \$696.5 million as of March 31<sup>st</sup> 2008, a quarterly increase of 12%. Year-on-year asset growth was even more impressive at 19.4%. BCB’s recent operational efforts are to be commended, with their client base growing substantially in the face of an uncertain ownership situation and a difficult operating environment for financials. Due to the Bank’s longstanding policy of matching deposits with cash and cash-equivalents – with no direct exposure to sub-prime investments – BCB has emerged largely unscathed from the recent turmoil experienced by the global finance industry.

## The Wait Continues...Target Reduced to \$11

### FORECAST AND RECOMMENDATION

- BCB shares have declined marginally since our Blue Book report of October 2007, and would appear as a relative bargain in the range of \$10-11. However, capital markets have little patience for the drama of drawn-out sales processes, especially those involving “meddling parent” figures such as FCIB. Furthermore, BCB’s operating earnings and asset base have fluctuated wildly over their past four financial releases, raising the possibility of more client departures should the sales process drag on much further.
- On May 31<sup>st</sup> 2008, 1.36 million stock warrants were exercised at a strike price of \$7.50, resulting in \$10.23 million of new share capital. These funds will likely sit dormant in short-term investments pending the Bank sale process and a moratorium on new capital initiatives in the interim. The unfortunate result is a significantly higher price for the eventual purchaser of BCB.
- BCB has 1.8 million in options outstanding, with an average exercise price of \$5.66. Some 400,000 of these options come due upon fiscal year-end 2008, at a strike price of \$5.00. Given the near-certainty of exercise, BCB’s share capital will increase by another \$2.0 million. The dilutive effect of 6.5% on future earnings has been factored into our estimates.
- Our fiscal year 2008 operating EPS estimate stands at \$1.18. We apply a 9.00x multiple to arrive at our one-year price target of \$11.00 and a recommendation of “hold”. We would equate this \$11.00 figure to an estimated buyout figure for BCB shares (although the Central Bank/FCIB may have a significantly higher price in mind.) We would note that the Bank’s dividend yield of 8.00% remains attractive, although the next ex-dividend date is not until December 2008.

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