RESEARCH REPORT

FirstCaribbean International Bank

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TABLE OF CONTENTS

1) Executive Summary 1

2) Company Profile 4
   a) Growth & Evolution
   b) Products & Services Offered
   c) Management Structure
   d) Ownership Structure
   e) Group Structure
   f) Management Strategy
   g) Financial Highlights

3) Caribbean Economic Environment & Outlook 11

   a) The Bahamas
   b) Belize
   c) Barbados & the Eastern Caribbean
   d) British Virgin & the Cayman Islands
   e) Jamaica

4) Caribbean Financial Services Industry Analysis 18

   a) The Bahamas
   b) Belize
   c) Barbados & the Eastern Caribbean
   d) British Virgin & the Cayman Islands
   e) Jamaica

5) Company Analysis 26

   a) Profitability
   b) Operational Efficiency
   c) Diversification
   d) Loans
   e) Deposits
   f) Liquidity
   g) Exchange Rate Risk
   h) Interest Rate Risk

6) SWOT Analysis 34

7) Share Price Valuation 38

8) Investment Conclusion 40

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1. EXECUTIVE SUMMARY

FirstCaribbean International Bank is the largest Caribbean banking entity with assets in excess of US$9.5 billion and is the second largest publicly traded financial institution in the region with a market capitalization of over US$2 billion. Established on October 11 2002 and commencing operations on October 14, FirstCaribbean was formed from the merger of the retail, corporate and offshore Caribbean operations of Barclays Bank PLC and Canadian Imperial Bank of Commerce (CIBC).

FirstCaribbean spans 15 countries across the region through its 5 major subsidiaries and has an extensive network of over 80 branches. The bank has a significant positioning in stable economies like The Bahamas, Barbados and Cayman Islands, mitigated by low exposure to the high-risk Jamaican economy. Its operations in The Bahamas, the Cayman Islands, the Eastern Caribbean, and Jamaica represent the majority of operating profit.

Standard and Poor's has rated FirstCaribbean at investment grade A-, attributing the rating and positive outlook to the bank's strong balance sheet and dominant market share. Its regional peers - RBTT Bank and Republic Bank Limited (RBL) - are rated BB+ and BBB- respectively.

FirstCaribbean also has a sound capital adequacy position, reflected in a strong Tier 1 capital ratio of 19% of assets at the end of 2003. A large US$ capital base of almost 50% of total capital minimizes the bank's exposure to exchange rate risks. The upward trend of US interest rates in the medium-term bodes well for the company's large stock of US$ denominated investments.

Relative to the capital base of its regional peers, FirstCaribbean had a lower return on assets (before goodwill and restructuring charges) of 1.3% in 2003 compared to 1.7% and 2.6%, respectively, for RBTT Bank and RBL. Its return on equity was 9.5%, much lower than that of RBTT (25.5%) and RBL, which was 18.8%.

With substantial shareholding by two international banks, localization of decision-making can be obscured. Additionally, the merger of such large entities poses the threat of anti-synergies resulting from business cultural differences, which may result in decision gridlock. Moreover, bigger is not always better. Big banks have a record of charging higher fees on their customers' accounts and are usually less responsive to small business loans. In post-merger activity, there is usually a net transfer out of the combination.

FirstCaribbean has rationalized and upgraded its communication systems but the integration of its various information technology platforms poses a tremendous challenge in terms of practicality and costs, especially given Barclay's outdated IT Infrastructure.

Goodwill arising from the excess of FirstCaribbean's fair value over the net book value of assets will be amortized over an estimated useful life of 20 years and charged to the income statement. Since inception, FirstCaribbean has amortized US$24.5 million in goodwill, which has been a significant recurring cost on the bank's income statement. At the end of April 2004, goodwill on the balance sheet stood at US$293 million.

FirstCaribbean expects to achieve cost savings from rationalization of front and back office operations and higher revenue from new products and service introductions. The company estimates synergies from the merger to be approximately US$180 million by the end of the first three years of operations in 2005. However, restructuring and integration costs are also significant and will continue to dampen reported profits until 2005. As at April 30th 2004, FirstCaribbean recognized US$48.2 million of integration and restructuring charges with another US$27.8 million to be written off for the next half of 2004 and financial year 2005.

FirstCaribbean enjoys the reputation of its heritage banks. The predecessor institutions bring various specializations to the table with some cross-operational expertise. For example, Barclays dominates market share in the Trustee services segment, especially so in Barbados where it holds a majority of the pension fund portfolios. On the other hand, CIBC has significant Merchant and Investment Banking operations in the territories while both are registered brokers on the Barbados Stock Exchange. In the offshore business, CIBC also holds the edge over Barclays, as the latter has been relatively dormant in the recent past. Together, they present a formidable combination.

FirstCaribbean has the capital base to increase market share in the region and become a dominant player. With US$ cash and short-term investments available, the bank can increase its loan portfolio within the region to achieve a higher yield on these funds. A strong regional distribution network augurs well for the company's new products and market expansion initiatives. FirstCaribbean intends to set up operations in Trinidad, which can give significant impetus to its profitability.

FirstCaribbean, which is currently trading at EC$2.00 on the Barbados Stock Exchange (BSE), is presently in a low growth stage and has positive medium-term prospects. The estimated 1-year share price projection ranges between EC$2.24 to EC$2.75, and accordingly the stock is recommended as a BUY.

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2. COMPANY PROFILE

First Caribbean International Bank

Snapshot	Jamaica (J$)	Trinidad (TT$)	Barbados (BD$)
Last Close	93.00	9.50	3.25
Market Cap	141.8 Billion	14.5 Billion	495.7 Million
52 Week High	96.00	9.50	3.25
52 Week Low	72.60	7.85	2.50
Dividend Paid 2003	1.52	0.16	0.05
Expected Dividend 2004	2.44	0.24	0.08
Projected Cash EPS 2004	5.49	0.57	0.18
Projected Price 2004	86.71 to 106.47	9.09 to 11.16	3.03 to 3.72

a. Growth & Evolution

FirstCaribbean International Bank is the largest Caribbean banking entity with assets in excess of US$9.5 billion and is the second largest publicly traded financial institution in the region with a market capitalization of over US$2 billion. The stock is traded on the exchanges of Barbados, Trinidad and Tobago, and Jamaica. FirstCaribbean spans 15 countries across the region through its 5 major subsidiaries and has an extensive network of over 80 branches. Its operations in The Bahamas, the Cayman Islands, the Eastern Caribbean, and Jamaica represent the majority of operating profit.

On October 11 2002, Barclays Bank PLC and Canadian Imperial Bank of Commerce (CIBC) combined their retail, corporate and offshore Caribbean operations to form FirstCaribbean, which began operations on October 14. CIBC's wealth management (approximately 9.5% of revenue) and Barclay's private banking business were not included in the merger. CIBC, which is based in Toronto, and Barclays, which is based in London, established operations in the Caribbean in 1920 and 1837, respectively.

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During its first year of operations, FirstCaribbean focused on establishing its brand as a world class banking entity and on integrating the technology platforms of its two heritage banks in order to create one unique identity. FirstCaribbean's vision is "To Create the Caribbean's Number One Financial Services Institution."

- First for Customers: Customer First
- First for Employees: Employer of Choice
- First for Shareholders: Including Employees
- First for the Caribbean: Caribbean Centric

b. Products and Services Offered

FirstCaribbean focuses its product offerings in 4 business areas, namely, Retail Banking, Corporate Banking, International Banking and Capital Markets. FirstCaribbean typically tailors its products to meet the local needs and requirements of the particular country in which it is located.

Retail Banking

Presently, Retail Banking is the largest contributor to FirstCaribbean's top line revenue accounting for more than 51% of its total loan portfolio and 43% of the deposit base. FirstCaribbean offers three core products under the umbrella of Retail banking, namely, Mortgages, Consumer Loans and Credit Cards. FirstCaribbean continues to enhance these retail products through heavy marketing and promotional efforts. During the financial year 2003, FirstCaribbean introduced several new programs aimed at satisfying customer needs. These included an aggressive "Win-Win" mortgage and loan promotion campaign, the rollout of the "Customer First" program, and the launch of the "First Customer Service Centre" in The Bahamas.

Corporate Banking

FirstCaribbean rolled out its new Corporate Banking model in 2003. The Corporate Banking category comprises 3 distinct customer sub-segments: Corporate, Commercial, and Business Banking. Corporate Banking activity accounts for just under half of total lending and almost 56% of deposits. The new model advocates personalized service with dedicated Relationship Managers. Through these initiatives FirstCaribbean hopes to target increasing numbers of corporate clients.

International Banking

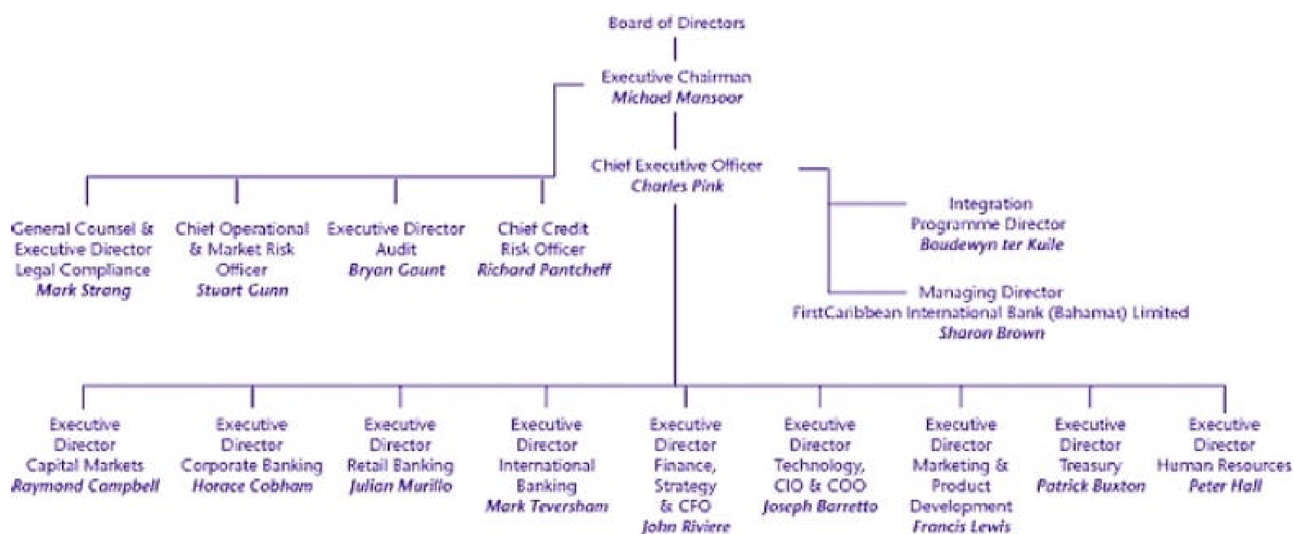
This category of products specifically targets FirstCaribbean's international clients. International Banking specializes in providing mutual funds and investment linked products. During 2003, FirstCaribbean achieved net growth in its deposit base from this source of funding and loan growth for this segment exceeded budgetary targets.

Emphasis is being placed on ensuring that the bank's databases and technology platforms are sufficiently merged so as to create value for the overseas client. To this end, FirstCaribbean will soon launch its International Mortgage Product and new self-service channels such as Telephone and Internet Banking.

Capital Markets

The Capital Markets business focuses primarily on underwriting and asset management. During 2003, FirstCaribbean was involved primarily in strategic planning for this line of business. FirstCaribbean has identified large corporations, central governments and state-owned agencies as the market players who would require the creative financing solutions that can be provided by the Capital Markets section.

c. Management Structure

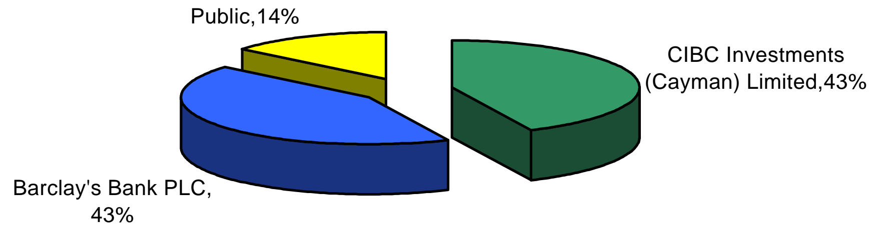


FirstCaribbean has a functional management structure with the organization divided on a departmental basis. The organizational chart depicts a fairly centralized structure with all upward communication being channeled to the Chief Executive Officer (CEO) and the Executive Chairman. The structure is fairly lean, which should encourage speedier decision-making. The emphasis on integration with single Head Office functions and harmonized policies should contribute positively to efficiency and other synergistic benefits. However, concerns about flexibility may arise as the company continues to expand within the region.

d. Ownership Structure

In 2002, Barclays Caribbean Banking Operations transferred its operating assets to CIBC Caribbean Group in return for 666,001,367 shares in the latter. CIBC Canada previously owned 470,990,742 shares (or 77% prior to restructuring) in CIBC, and purchased 195,010,625 new shares worth US$205 million (or US$1.05 each). This brought its shareholding in the newly formed entity to 666,001,367. At the time of the merger, Barclays and CIBC each had a 45% shareholding in FirstCaribbean, with the remaining 10% actively traded on the 3 Caribbean stock exchanges.

Current Ownership Structure

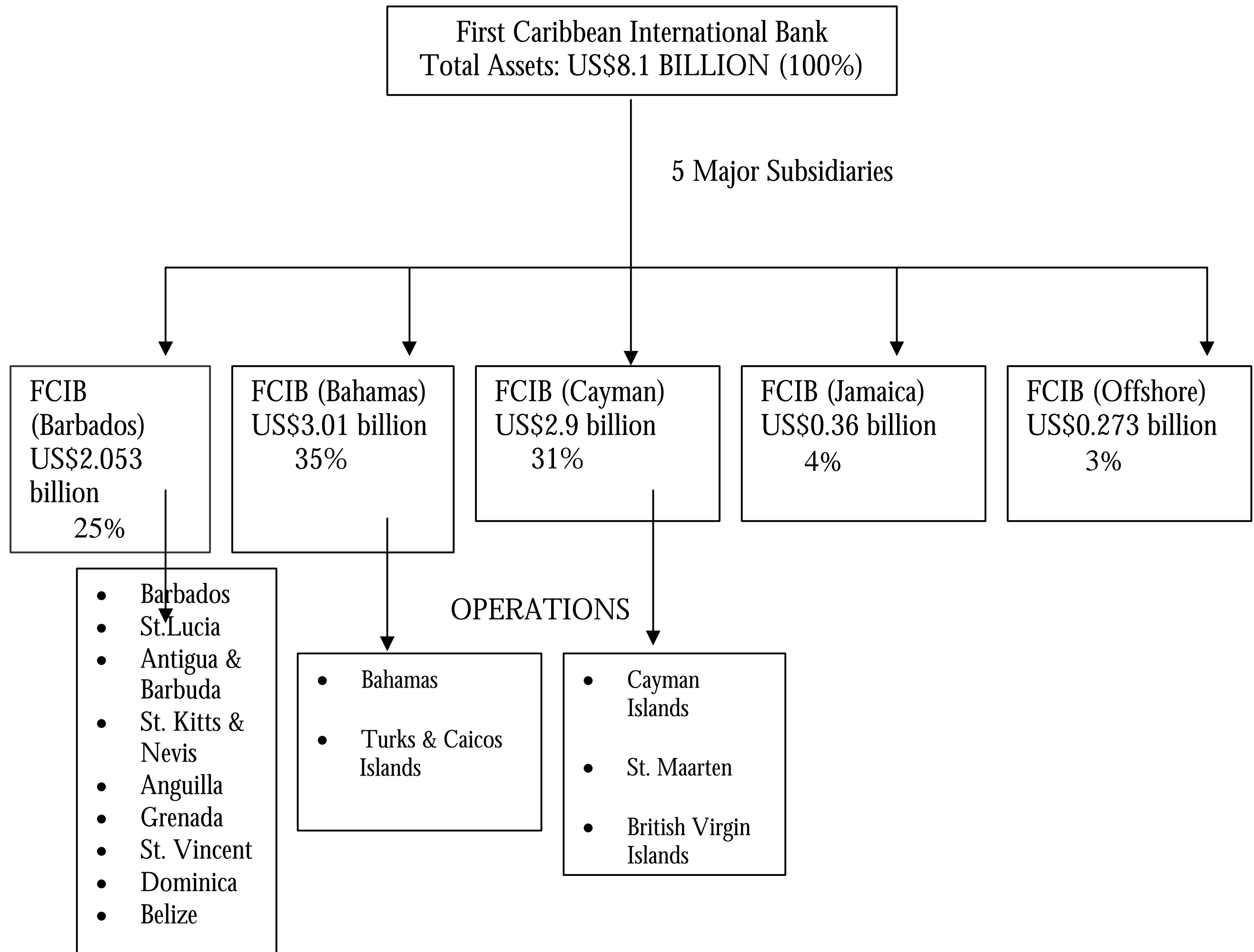


In December of 2002, FirstCaribbean completed a successful Rights Offering by which the public shareholding in the company increased to 12.5%, with CIBC and Barclays PLC each retaining a 43.75% shareholding.

e. Group Structure

The Group operates through 5 major subsidiaries, FirstCaribbean (Barbados) Limited, FirstCaribbean (Bahamas) Limited, FirstCaribbean (Cayman) Limited, FirstCaribbean (Jamaica) Limited and FirstCaribbean (Offshore) Limited.

FirstCaribbean- Subsidiaries as a Percentage of Total Group Assets as at October 31st 2003



f. Management Strategy

The management strategy for FirstCaribbean emphasizes the provision of customized products, which best meet the customers' needs. FirstCaribbean has combined the experience and skills of its two heritage banks, CIBC and Barclay's, to form a group of competent and skilled managers. Further product extensions are planned to significantly improve the bank's value proposition.

g. Financial Highlights

FIRSTCARIBBEAN: FINANCIAL HIGHLIGHTS, 2001-2003
(US'$000, unless otherwise indicated)

	2002	2003	HY 2003	HY 2004
Gross Turnover	197,390	385,436	96,874	95,100
Profit Attributable to Shareholder's	5,331	71,100	16,196	21,693
Total Assets	8,346,638	8,096,992	8,484,767	9,513,977
Total Liabilities	7,818,129	7,475,588	7,394,283	8,343,977
Shareholder's Equity	994,363	1,111,457	1,072,148	1,152,518
EPS ($)	0.01	0.05	0.01	0.01

3. CARIBBEAN ECONOMIC ENVIRONMENT & OUTLOOK

The Caribbean economies within which FirstCaribbean operates are of varying sizes, population, and historical experiences, but share many characteristics of small states. They are highly open and have limited production platforms based mainly on the exports of sugar and bananas, the exception being Jamaica (bauxite, alumina). Although many of these countries have diversified into tourism and offshore financial services, they are still vulnerable to natural disasters such as hurricanes and floods and to external shocks. These events include global recession, the September 11 terrorist attacks, erosion of preferential trade agreements, and interventions related to money laundering. The current surge in world oil prices and rising global interest rates as well as implementation of the Free Trade Areas of The Americas (FTAA) and Caribbean Single Market and Economy (CSME) will all pose challenges to the operating environment for FirstCaribbean. Despite these obstacles, social development indicators in the Caribbean are reasonably high and multi-party democracy is firmly rooted.

The Bahamas

The Bahamas has experienced an extended period of relative prosperity due to a long track record of prudent macroeconomic management and financial stability. At US$16,600 per capita GDP is quite high compared with other investment grade rated sovereigns. The Bahamas is highly dependent on tourism, which constitutes approximately 40% of its GDP and which is closely linked to developments in the US economy, from where 80% of its tourist arrivals originate. The other mainstay is financial services (including the offshore industry), which represents approximately 15% of GDP. Inflation is low, less than 2% on average, reflecting the Bahamian dollar peg at parity to the US dollar since 1973. Public debt is moderate at around 35% of GDP, the banking system is sound, and the central bank has a reputation for cautious monetary management.

These strengths allowed the Bahamian economy to weather relatively well the impact of the global slowdown and lingering terrorism-related security concerns since 2001, unlike other Caribbean tourism destinations.

Economic growth was weak at less than 1.5% in 2002 and early 2003, but is expected to strengthen gradually to 2.5% in 2004, driven by investment inflows from the tourism sector. The economy, however, remains vulnerable to rising competition from other low-cost tourism destinations and offshore financial sectors.

Belize

Real GDP growth in Belize rebounded to 5.5% in 2003 from several exogenous shocks in recent years including hurricane damage, a shrimp virus epidemic, and the fall-out from September 11. Output in the fishing sector (including shrimp aquaculture) more than doubled, while tourism was driven by a strong increase in both stopover and cruise ship passenger arrivals. Inflation has remained low at around 2.5% due to the long-standing peg of the Belizean dollar (BZ$) to the US dollar at BZ$2 = US$1 and low global inflation.

Corrective measures undertaken in mid-2002 to avoid a balance of payments crisis arising from expansionary macroeconomic policies were short-lived in the run-up to elections in 2003. With large fiscal deficits averaging just over 9% of GDP in 2001-2003, Belize's fiscal performance has been one of the worst among its B+ rating peers. The substantial public sector borrowing requirement has led to a sharp buildup of public sector debt estimated at 106% of GDP at end- 2003, which when compared to other peers is surpassed only by that of Jamaica (145% of GDP).

This has caused difficulties for Belize to access the international capital markets. Standard and Poor's shifted its outlook on Belize to negative in late July 2004 but maintained its foreign currency credit rating at B+, while Moody's downgraded the country by two notches to B2 in early August.

Barbados & the Eastern Caribbean

Barbados

The Barbados economy exhibited a good performance in the 1990s, supported by prudent fiscal and monetary policies and a favorable external environment. The structure of the economy shifted to tourism and financial services from agriculture. Per capita GDP is about US$9,500 and Barbados is ranked 27th among 175 countries on Human Development

Index (HDI) of the United Nations Development Program (UNDP).

The negative impact of September 11 on the tourism sector and the global slowdown pushed the economy into recession. Real GDP fell by a cumulative 4% in 2001-2002, and the government engaged in counter-cyclical fiscal policy to counter the recession. However, these actions contributed to a widening of the central government deficit to 9.5% of GDP in FY 2002/03 from 2.3% of GDP in the previous year, and public sector debt rose substantially to 76% of GDP at end-March 2003, up from 63% of GDP in 2001.

Over the past year, there are signs that the Barbadian economy is recovering. Real GDP increased by about 2% in 2003 on the back of a rebound in the tourism sector. Inflation remained low at 1.5% due to the currency peg. The central government deficit narrowed to 6.5% of GDP in FY 2003/04. Proceeds from privatization financed more than half of the budget deficit, leading to a marginal fall in the public debt ratio to 75% of GDP. Although the external current account deficit widened to 7.8% of GDP in 2003, the net international reserves stood at US$751 million or equivalent to an import cover of more than 6 months.

Real GDP in Barbados grew by 2.7% in the first six months of 2004 and growth is projected at a moderate 2-2.5% for the year as whole. Off-budget spending is yet to be reduced from its current high of 4% of GDP and while fiscal performance is improving, the envisaged marginal reduction in the deficit is not as fast as desired to prevent adverse debt dynamics. Fiscal imbalances are expected to contribute to widening the external current account deficit to an estimated 7.4% of GDP in 2004. Non-residents are expected to cover half of the deficit, leaving Barbados vulnerable to external shocks.

Standard and Poor's downgraded Barbados to BBB+ with a stable outlook in early August 2004. The downgrade was not unexpected given the negative outlook on the rating and the sharp rise in public debt.

The Caribbean : Macroeconomic Indicators, 1990-2003

Countries	Public Debt (% of GDP)		Overall Balance (% of GDP)		Primary Balance (% of GDP)		Inflation (%)		GDP Growth (%)	
	1997	2003	1990-97	1998-03	1990-97	1998-03	1990-97	1998-03	1990-97	1998-03
Antigua & Barbuda	102	114	-5.2	-7.9	2.4	-3.4	3.7	1.8	3	3.3
Bahamas, The	46	48	-1.7	-1.8	1.5	0.8	3.2	1.9	0.9	2.2
Barbados	62	84	-2.8	-5	1.5	-0.2	3.5	1	0.1	1.4
Belize	41	93	-5.6	-10.9	-4	-7.9	2.9	0.8	5.7	7.2
Dominica	61	122	-3.4	-8.2	-1.1	-3.5	2.6	-0.3	2.7	-0.5
Grenada	42	109	-3.9	-7.1	-1.3	-4	2.6	2.1	2.8	3.9
Jamaica	103	142	0.2	-8.5	8.7	8.3	32.6	7.3	0.2	1
St Kitts and Nevis	86	160	-1.7	-11.2	1	-5.9	3.5	2.5	4.5	2.3
St Lucia	36	66	-1	-2.5	0.3	0	3.1	2.1	2.7	0.8
St Vincent & the Grenadines	48	71	-0.6	-3.5	1.9	0.1	3.6	0.9	3.3	2.7
T"dad and Tobago	52	54	0.2	-2.2	6.7	4.8	6.3	3.3	2	4.2
Caribbean 6/	**56**	**92**	**-2.6**	**-5.9**	**1.1**	**-1.2**	**16.3**	**6.5**	**2.4**	**2.5**

Eastern Caribbean

The Organization of Eastern Caribbean States (OECS) comprises Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, Anguilla and Montserrat. All 8 member states belong to the Eastern Caribbean Currency Union (ECCU), with an independent central Bank (Eastern Caribbean Central Bank) responsible for monetary policy and issuing the Eastern Caribbean (EC) dollar, which has been pegged to the US dollar at EC$ 2.70 = US$1 since 1976.

Since the mid-1990s, the Eastern Caribbean has experienced weak economic growth associated with a series of negative shocks, including weather-related disasters, the dismantling of preferential trade

agreements for sugar and bananas, competitive pressures from lower-priced tourism destinations, the effects of September 11, closures of offshore banks, and weaknesses in the global economy. Real GDP growth slowed from nearly 5% a year during 1985-1995 to about 2.25% over 1996-2003.

Responding to these shocks, the countries pursued expansionary fiscal policies in an attempt to sustain employment and growth and to meet disaster-related spending. However, these policies also led to the rapid accumulation of public debt and deterioration in fiscal balances. Public debt reached 103% of GDP at end-2003 compared with 60% at end-1997. In four countries – Antigua & Barbuda, Dominica, Grenada, and St. Kitts & Nevis – existing public sector debt levels are now in excess of 100% of GDP. Acute financing constraints in Dominica have led to IMF-supported programs since August 2002. The overall fiscal deficit weakened from about 2% of GDP in 1990-1997 to more than 6% in 1998-2003.

The economies in the Eastern Caribbean are likely to grow between 2.5-3.5% in 2004, driven by the revival of tourism and tourism-related services as the global economy strengthens. Even though the overall fiscal balance for the region is expected to improve only modestly to about 5.5% in 2004, structural deficits remain large, with the exception of St. Vincent and the Grenadines. Public debt-to-GDP ratios are not expected to substantially decline in the immediate period ahead. Such an environment puts at risk the viability of the quasi-currency board arrangement, which has been integral to maintaining macroeconomic stability in the region.

British Virgin Islands (BVI) & the Cayman Islands

British Virgin Islands

The British Virgin Islands (BVI) is a small British Overseas Territory of 153 square kilometers with a small population of around 21,000. Annual per capita GDP is about US$37,000. Real GDP growth in the BVI has remained buoyant, ranging between 3-5% in recent years. About 40% of the labor force comes from outside the territory, which has virtually no unemployment, and is highly dependent on tourism and offshore finance, which together account for 40-45% of GDP. The high return rate of visitors emphasize the quality of the tourism product, while the offshore financial sector is also performing relatively well, recording increases in the registrations of companies and mutual funds.

Cayman Islands

With a GDP per capita of nearly US$50,000, the Cayman Islands remain one of the wealthiest countries in the Caribbean due to successful tourism and offshore financial sectors, which together account for almost 50% of GDP. The Cayman Islands' economy is also highly dependent on trade, particularly with the US. About 80% of tourists arrive from the US and about 70% of imports come from the US.

Real GDP growth has slowed to around 1.5% on average in 2000-2003 from the buoyant rates of 6-8% in the 1990s. The economy should continue to expand during 2004 and 2005, benefiting from the continued strengthening of the US economy in the form of inward investments and visitor spending. The level of tourism expenditure remains a source of concern, however, with the continued shift from air arrivals, which have visitors with higher per diem expenditures and longer stays, to cruise ship arrivals. Inflation in the Cayman Islands was less than 1% in 2003. The unemployment rate is currently at 3.6% compared with 7.5% following the September 11 attacks in 2001.

The Cayman Islands retains its position as a leading international financial center. In 2003, growth in financial services was broad-based with the exception of the fall in the number of banks and trust licenses resulting from consolidations within the industry and the cost of establishing a physical presence as required by tighter regulations. Nevertheless, the banking sector remained healthy, as external assets of banks stood at just over US$1 trillion in June 2003, up from US$5.4 billion from December 2002.

Jamaica

Concerns over fiscal slippages and a worsening external current account deficit triggered a near crisis in Jamaica's foreign exchange market in the first half of 2003. International reserves fell by a cumulative US$800 million while the Jamaican dollar depreciated against the US dollar by 24% from March 2002 to June 2003. The Bank of Jamaica's (BOJ's) response was to more than double interest rates on its open market instruments to around 35%. The government renewed its fiscal adjustment effort and contained the budget deficit to just below 9% of GDP in fiscal 2003/04. These policies, supported by an improving international environment, helped to stabilize the Jamaican economy and

restore investor confidence.

Real GDP growth reached 2% in fiscal 2003/04 after disappointing growth at less than 1% for over a decade. Strong performances in the key tourism and mining sectors supported the resumption of growth. Social problems such as a persistently high unemployment rate of more than 15% of the labor force and high crime rates, nevertheless, continued to discourage private sector initiatives. Reflecting the steep depreciation of the Jamaican dollar in late 2002 and early 2003, inflation increased to almost 17% in 2003/04, from just over 6% in the previous year.

As conditions began to stabilize in the foreign exchange market, the BOJ started reducing interest rates, which fell to14-17% by end-June 2004, less than half the March 2003 peak. The Jamaican dollar has remained around J$60 per US dollar over the past year. Recent bond issues, including the successful GOJ 2017 Eurobond, have boosted international reserves to a healthy position of over US$1.5 billion. Jamaica's gross external financing needs, however, remain high, at more than 250% of reserves.

Much of the fiscal adjustment undertaken in recent years has seen the government often cut critical capital expenditure and raise taxes in order to generate a primary surplus (11% of GDP in 2003) necessary to stabilize the public debt stock. At 145% of GDP in 2003, Jamaica's public sector debt is one of the highest among rated sovereigns, and has heavily burdened the public finances, limiting the room for counter-cyclical fiscal policy.

The macroeconomic situation in Jamaica remains difficult, with the small open economy still vulnerable to negative external developments and a general shift in investor confidence. The government has limited room for maneuver, given the high public debt levels, which have been worsened by exchange rate depreciation and sustained high interest rates. On February 5, 2004, Standard & Poor's affirmed its 'B' long-term foreign sovereign credit ratings on Jamaica, but revised its outlook to negative from stable.

4. CARIBBEAN FINANCIAL SERVICES INDUSTRY

The international financial services industry is undergoing rapid and far-reaching change. The boundaries separating banks, trust companies, finance houses, insurance firms and securities dealers are gone or fast disappearing. Technological advances, cross-border trading, deregulation, and the consolidation of financial business into large, global and fully diversified conglomerates have all served to dramatically alter the global financial services landscape.

The financial services industry in the Caribbean has also been experiencing similar changes, albeit at a much slower pace. A brief profile reveals the following:

- Capital is still largely controlled by commercial banks, which account for between 45-75% of total financial system assets. Three or four of the largest banks typically hold the lion's share of these assets. Banks lend mainly short-term to finance firms' working capital and households' acquisition of assets (houses, motor vehicles, and personal loans). Banks also provide finance to governments. The major regional players include FirstCaribbean, RBTT Bank, and Republic Bank Limited (RBL).

- Non-banks have a strong institutional presence comprising finance companies, mortgage banks, development banks, pension schemes, insurance companies, credit unions and building societies, usually commanding a share of system assets ranging from 1- 28%.

- Equity markets are quite shallow with a small base of about 100 listed corporates. Total market capitalization is about less than half of 1% of global stock market capitalization. New issues are rare in the region. Government securities dominate debt markets and secondary market trading is limited.

- Offshore financial centres are prevalent in the smaller

Caribbean countries, offering financial services exclusively to non-residents. The major centers are The Bahamas, Bermuda, Cayman Islands, the Netherlands Antilles, Barbados, and the British Virgin Islands. FirstCaribbean operates in 4 of these 6 jurisdictions. Offshore financial centers have recently faced increased concerns about tax evasion, money laundering, and terrorism financing.

❖ Venture capital funds and advanced mechanisms of financing small and medium enterprises and higher risk companies are virtually non-existent.

The Bahamas

Economic and political stability, low taxation, and a largely deregulated environment have all helped to stimulate the growth and development of The Bahamas' international financial sector. Nearly 35 of the top 100 global banks operate in The Bahamas, originating from 24 countries. The offshore financial sector, one of the largest in the Caribbean, comprises 276 banks and trust companies managing US$280 billion in assets. U.S banks hold 10% of active licenses and 70% of assets.

The domestic financial sector is much smaller, comprising 9 banks and trust companies, of which 6 are subsidiaries of foreign banks, and provide most employment opportunities and more than half of local lending. Strict regulations and foreign exchange controls constrain transactions between offshore and domestic banks. Though there is a significant exposure to non-resident deposits - approximately four times more than that of resident deposits - these funds come from sound and observably stable depositor bases such as Europe and Canada.

Since late 2000, the Central Bank of the Bahamas has been strengthening financial supervision and regulation, including introducing legislation to bring the regimes for combating money laundering and terrorism financing into compliance with international standards. Key aspects of the tighter regulatory framework include the following:

❖ Establishment of new physical presence licensing requirements with a view to eliminating "shell" banks by June 2004. Over 100 banking licenses have been revoked or terminated.

- ❖ Transformation of ad hoc prudential norms into transparent regulations and guidelines.
- ❖ Expansion of on-site supervision activities to assess risk management and corporate governance practices.
- ❖ Strengthened regulations on customer identification, creation of a Financial Intelligence Unit to monitor and investigate suspicious transactions, and greater cooperation with regulatory agencies in other jurisdictions.

Enhanced financial regulation appears to have only modestly affected the volume of business of offshore and domestic financial institutions. The closing of "shell" banks did not appreciably affect employment or assets.

Barbados & the Eastern Caribbean

Barbados

The financial system in Barbados is quite sophisticated, comprising both onshore and offshore activities. The onshore financial sector consists of a wide range of financial institutions including banks, which are largely foreign-owned and which command assets of over 100% of GDP and over 80% of all deposit-taking institutions. FirstCaribbean, which is headquartered in Barbados, accounts for about one-third of total assets. Capital adequacy in the banking system is relatively high at over 18% of risk-weighted assets and non-performing loans rose to about 9% of total loans, with about half fully provisioned. The banking sector has relatively high exposure to the tourism industry (18.6% of total loans at end-2002) and to entertainment (21.6%); it seems likely that these are related risks, because tourists are presumably large consumers of entertainment.

Credit unions have expanded rapidly in recent years with total assets in the range of 10% of GDP. The largest credit unions are almost as large as the smallest bank and are competing with banks in consumer lending. Insurance companies, of which Sagicor Financial Corporation is the largest with 65% of the market, account for most non-bank onshore financial activities.

The offshore financial sector in Barbados is second only to tourism in terms of foreign exchange earnings, generating inflows of around US$110 million annually, and contributing almost 40% to corporate tax revenue.

The eight largest offshore banks account for nearly 90% of total assets. To a large extent, offshore banks are insulated from the onshore sector, although the importance of wealth management and treasury services expose offshore banks to considerable market and transfer risks.

Both onshore and offshore banking sectors demonstrate a high compliance with international supervisory standards, which helps to limit systemic risks. The government has implemented most of the recommendations in the 2002 Financial Sector Assessment Program (FSAP), including strengthening the framework to aid in the fight against money laundering and the financing of terrorism.

The onshore financial sector has been very liquid partly on account of the government's use of foreign loans and privatization proceeds as well as conservative lending policies on the part of commercial banks. To remove some of the liquidity overhang, the Central Bank of Barbados reduced the government securities ratio to 16% in November 2002; in 2002 it lowered the administered interest rate on time and savings deposits, from 3% to 2.5%, and stopped setting maximum indicative lending rates for banks on selected loans. While credit has begun to pick up, excess liquidity still prevails. This resulted in a further decline in the Treasury bill rate, which moved from 0.94% in September 2003 to 0.28% in mid-2004. Credit is expected to rise in response to the reduction in lending rates, particularly a declining mortgage rate. Nevertheless, liquidity in the banking system is expected to remain high in the medium term.

Caribbean Financial Sector: Summary Data

	Bahamas	Bdos	Belize	Jamaica	OECS	T&T
GDP, US$ mn.	4,497	2,490	687	6,788	na	6,789
GDP per capita, US$	15,070	9,500	2,827	2,660	na	5,281
Quasi-Liquid						
Liabilities/GDP, %	55	74	61	35	70	54
Market Share, %						
Banks	53	62	74	65	72	46
Near-Banks	9	8	na	28	na	25
Dev. Banks	1		8	5	3	1
Credit Unions	2	5	12	2	5	5
Insurance Com.	12	11	5	na	4	15
Soc. Security	19	15	na	na	16	8
No./Banks	9	7	4	9	24	5
Local	2	2	2	6	18	3
Foreign	7	5	2	3	6	2
Concentration						
3 Largest Banks, %	56	60	na	64	na	55
Banks						
ROE, %	24.5	13	61.1	19.6		17.6
ROA,%	3	1.8	4.7	0.8		1.7
Capital Adequacy,%	10	14.9	12.5	20.8		17.5

Source: Worrell et. al. (2001), Financial System Soundness in the Caribbean: An Initial Assessment IMF Working Paper #123

Eastern Caribbean

The financial system in the Eastern Caribbean is relatively well developed, offering a diversified range of financial services. Commercial banks, most of which are foreign-owned, dominate the industry, although the structure is changing with the entry of more aggressive regional banks. A total of 39 banks manage assets equivalent to about 156% of GDP. A large number of near banks, the most important of which are 71 credit unions, manage about 24% of GDP in assets. The offshore sector in the Eastern Caribbean is active, but has recently been under pressure with a sharp decline in the number of offshore banks to 53 from about 150 a few years ago. Offshore banks manage about US$5 billion in assets, with 1 jurisdiction responsible for approximately 66%, and 1 institution accounting for nearly 50% of total assets.

Many domestic banks are under stress with large exposures to the housing market and the public sector. Non-performing loans are in excess of 10% of total loans, partly reflecting connected lending and difficulties in foreclosure For a few of these banks, even though the risk-weighted capital ratios are above the Basel requirement of 8%, the quality of capital is uncertain. Banks apply a zero risk weight on loans to governments in arrears and in some cases have taken accrued interest on such loans into income. Stress tests indicated that indigenous banks are more at risk of insolvency or severe capital impairment if governments default. Knock-on effects on the private sector's ability to service debt and on confidence in the E.C. dollar could put the broader financial sector at risk.

Risks are compounded by weaknesses in the supervisory enforcement powers of the ECCB. Cross-border financial and trade linkages are likely to strengthen with the increasing integration of capital markets, so that the transmission of financial shocks will most likely be felt faster and to a greater extent than before. A general confidence effect, resulting in either a bank run, a disruption in financing flows to the region, or large capital outflows, could pose a significant challenge to the Eastern Caribbean region.

British Virgin Islands (BVI) & the Cayman Islands

British Virgin Islands

In line with its small population, the BVI has a small domestic market for financial services, comprising 11 banks made up of 6 general licensees, 4 restricted licensees, and 1 state-owned bank, the Government-Owned

Bank (GOB). The general license banks are authorized to engage in banking business both within and outside the BVI. The restricted license banks may only engage in banking business outside the BVI, with certain exceptions. All banks (other than GOB bank) of any significance are subsidiaries or branches of highly reputable foreign banking groups, subject to effective consolidated supervision by the home country supervisor. The legal framework for anti-money laundering and combating the financing of terrorism in the BVI is generally compliant with international standards.

The Cayman Islands

The Cayman Islands, located 500 miles south of Florida, has emerged in the last three decades as one of the world's leading financial centers. With assets on deposit of approximately US$1 trillion, the jurisdiction trails in size only London, New York, Tokyo, and Hong Kong. Currently, there are about 600 banks and trust companies in Cayman, including more than 40 of the world's 50 largest banks. Banks subscribe to the "know your client" tenet, and the Cayman Islands as a jurisdiction maintains a strong anti-money laundering regime, which extends to the proceeds of all serious crime as defined under the "gateway" legislation.

The authorities are coming under pressure from the United Kingdom to comply with the provisions of the European Union (EU) Savings Tax Directive. This EU tax directive aims to tax cross-border interest payments from 2005, which could compromise the tax haven status of the Cayman Islands since there could be flight from investment in the offshore financial sector. The implication of this tax directive may be slower GDP growth, given the major role the financial sector plays in the economy.

Jamaica

Jamaica is the only Caribbean country to be hit by a major financial crisis in the 1990s, which affected 5 of the 9 banks, along with their subsidiaries, as well as 5 life insurance companies. In January 1997, the Financial Sector Adjustment Company (FINSAC) was established, and by March it had assumed control of the failed institutions. The government's decision to bail out all depositors placed the estimated cost of financial restructuring at more than 30% of GDP. The resolution process has been completed. Steps were taken to strengthen the Bank of Jamaica's (BOJ's) capacity to supervise financial groups.

Recent developments in the aftermath of the prolonged post-financial crisis slowdown are encouraging. Prudential indicators for banks continue to improve, but the banks' large holdings of government debt (35% of assets) are zero-weighted. The capital adequacy ratio was around 17% and non-performing loans amounted to 6% of total loans at end-December 2002. Credit to the private sector, mainly to the tourism and telecommunications sectors, has shown a strong recovery. Interest rates on local current deposits have been stable in the 8-9% range, even during the near crisis in the first half of 2003, compared with rates of 5-6% on foreign currency deposits. Lending rates in local currency also held steady.

Nevertheless, prudential regulation needs to be strengthened, given the system's large exposure to public debt. Banks continue to use their foreign currency resources mainly to invest in government dollar-denominated debt and to lend to private sector clients who earn foreign exchange. The government is engaged in preparatory work on legislation to combat money laundering and the financing of terrorism, and have requested an FSAP, which is scheduled for early 2005.

5. COMPANY ANALYSIS

FirstCaribbean: Selected Indicators of Financial Performance, 2002-2003
(%, unless otherwise indicated)

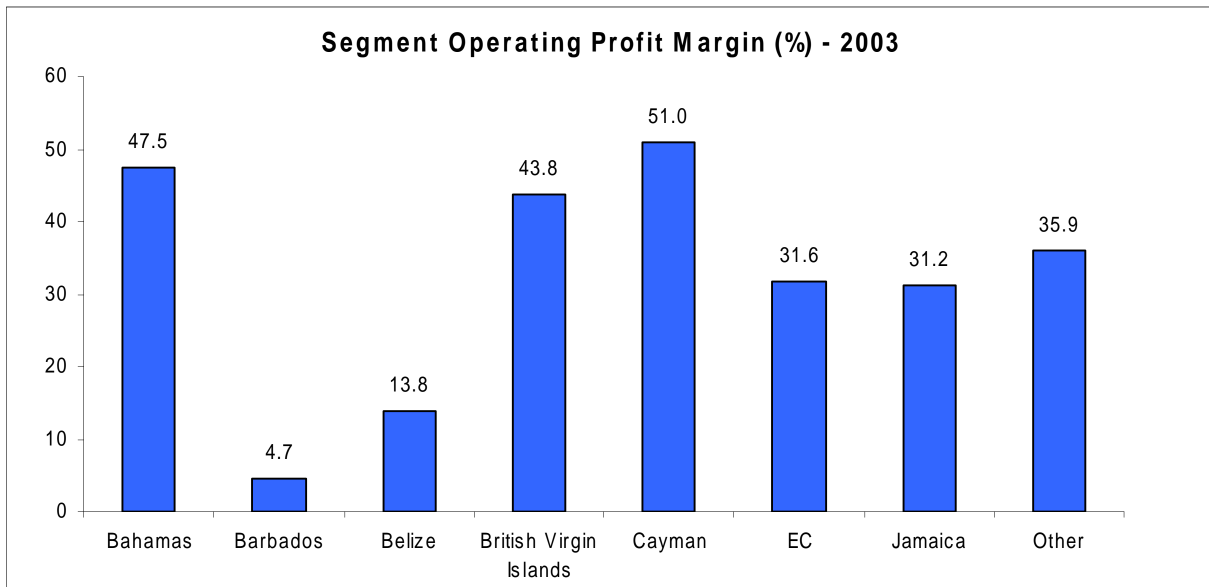
	2002	2003	HY 2004
PROFIT			
Net Interest Margin	5.8*	5.9	4.9
Gross Profit Margin	61.8	66.2	66.9
Operating Profit Margin	21.7	35.1	37.7
Net Profit Margin	na	18.4	20.0
Return on Equity	11.2*	9.5	8.0
EFFICIENCY			
Return on Assets	1.3	1.3	1.2
Efficiency Ratio	59.6	50.7	na
Total Asset Turnover	0.02	0.05	0.04
LEVERAGE			
Total Debt to Total Assets	0.94	0.92	0.88
Total Debt to Total Equity	7.90	6.70	7.20
SOLVENCY			
Tier 1 Capital Ratio	16.0	19.0	19.0
Total Capital Ratio	17.0	20.0	20

a. Profitability

Performance of FirstCaribbean's assets and equity in relation to its regional peers has been weaker, and is indicative of the bank's low earnings on its liquid investments and its limitations to convert these investments into high yielding loans as a result of weak credit demand. FirstCaribbean reported a Net Interest Margin (NIM), measured as net interest income as a percent of average assets, of 5.9% in 2003. This is relatively lower than the NIM of 6.9% reported by RBTT Bank and the

7.8% calculated for RBL. FirstCaribbean's NIM was affected by a reduction in the volume of loans and advances as well as investments and by reduced US$ interest rate spreads on loans and deposits.

Excluding goodwill amortization and restructuring charges, Return on Assets (ROA) for FirstCaribbean was reported at 1.3% compared to 1.7% and 2.6% for RBTT Bank and RBL, respectively. Return on Equity (ROE) for FirstCaribbean was 9.5%, lower than the 28% for RBTT Bank and 18.8% for Republic.



b. Operational Efficiency

Operating costs, measured by non-interest expense as a percent of net revenue, are used to gauge the bank's operational efficiency. FirstCaribbean experienced significant integration and restructuring charges in the order of US$25.9 million in 2002 and US$18.9 million in 2003. These costs are necessary for the bank to realize synergies from the merging of operating functions. However, they are also considered extraordinary since the charges are expected to fall off by 2005 and therefore are not included in gauging FirstCaribbean's operational efficiency. Major components of operational costs includes staff costs and general and administrative expenses. For FirstCaribbean,

the efficiency ratio was 50.7% of total net income, which appears favorable when compared to 56.5% for RBTT Bank but is significantly below RBL's ratio of 37%.

Differentials in interest rate spreads across territories are reflected in part by the segmented operating profit margin. Countries such as the Cayman Islands, The Bahamas and British Virgin Island exhibit high operating profit margin. Low interest rate differentials in Barbados are reflected in just a 4.7% operating margin, however, operations in Barbados, where FirstCaribbean's head office is located, account for the highest level of operating expenses to the tune of 32%.

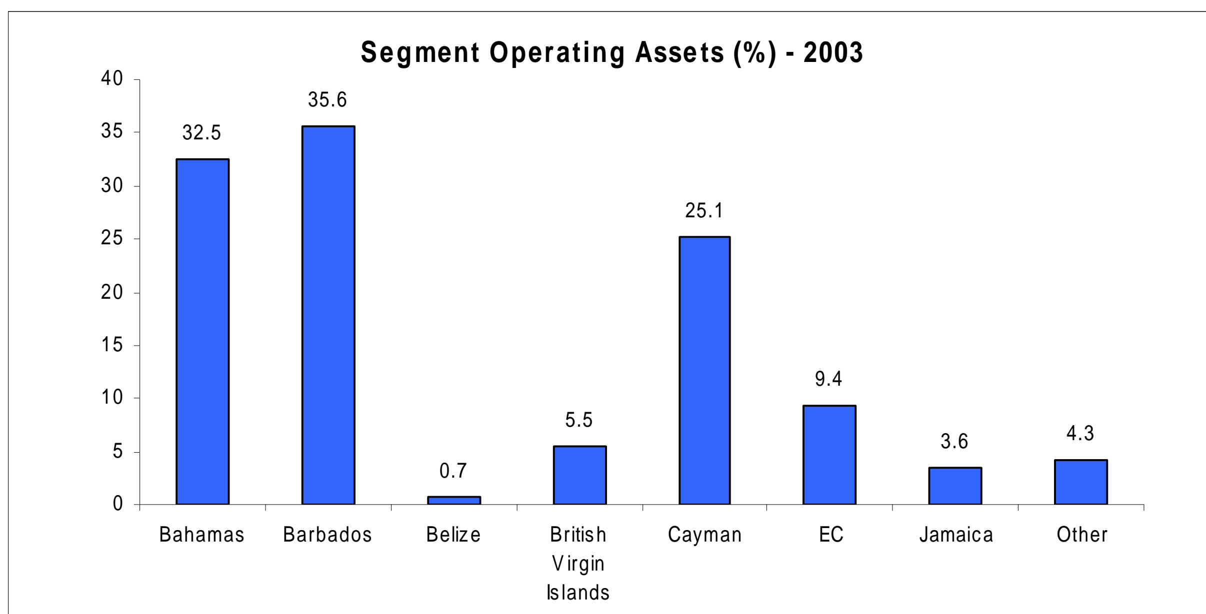
c. Diversification

Geographical Diversification

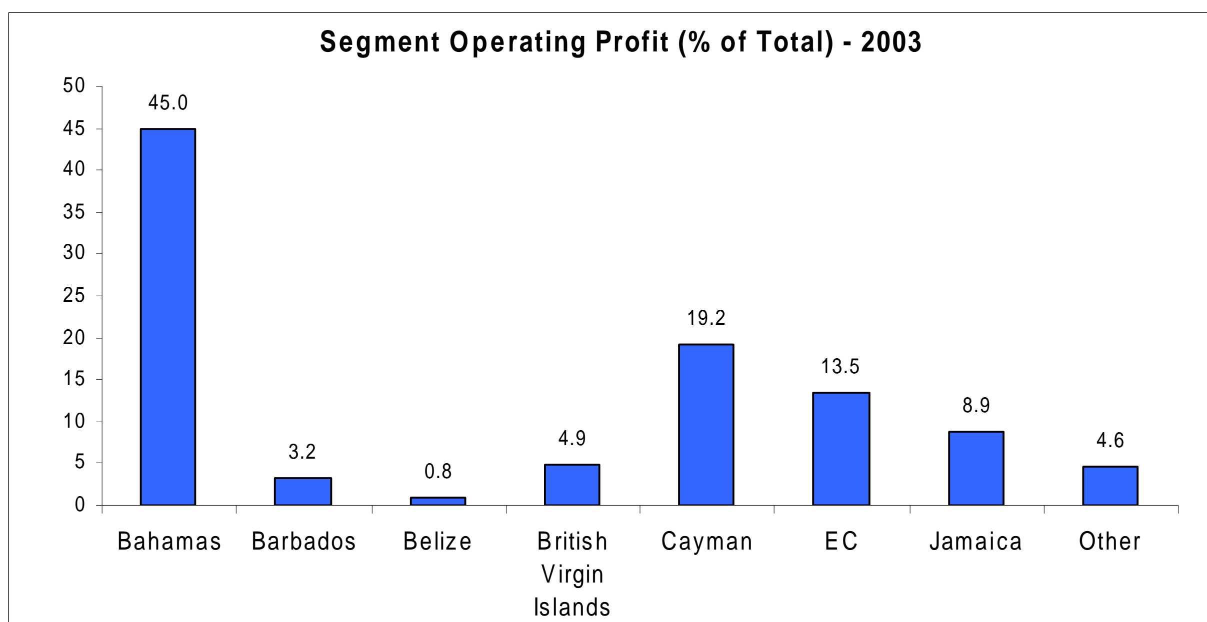
FirstCaribbean is diversified across highly rated countries such as The Bahamas and Barbados. Though not rated, countries such as the Cayman Islands and the British Virgin Island are stable economies, demonstrating resilience to economic downturns. On the other hand, Jamaica and Belize are less stable, demonstrated by their non-investment grade ratings by Standard and Poor's. FirstCaribbean's risk is mitigated by its limited exposure to these non-investment grade countries.

Revenue Diversification

The most important component of revenue for banks continues to be



income on loans, which, of course, is highly dependent on credit demand and interest rates. One avenue of diversifying revenue streams, is non-interest income, which mainly includes fees and commissions and, to a lesser extent, foreign exchange earnings. Over the past few years, non-interest income has become an important and stable source of revenue for banks. An examination of the revenue mix for FirstCaribbean's regional peers show that non-interest income now represent almost 30% and 24% of revenue, respectively, for RBTT Bank and Republic compared to approximately 22% and 15% in 1998. FirstCaribbean has followed a similar pattern; its non-interest income represented almost 24% of total income at end-April 2004.



Loans

FirstCaribbean's provision for loan loss was 3.1% of the total loan portfolio in 2003, up from 2.7% in 2002. This compares with the loan loss provision levels of 3.9% for RBTT and 3.7% for RBL in 2003. Higher loan loss provisioning may indicate that the FirstCaribbean is assuming higher levels of credit risks. However, compared to the two regional players, FirstCaribbean's loan loss provisioning is in line with the 5- year averages for RBTT Bank (3.3%) and RBL (3.0%).

FirstCaribbean experienced a much slower growth in its loan portfolio. Loans grew by 4.1% over 2002-2003, compared to growth of 22.1% and 30.7%, respectively, for RBTT and RBL. Loan pricing, calculated as interest on loans divided by average loans outstanding, improved from approximately 3.4% in 2002 to 5.2% in 2003. RBTT and RBL experienced declines in loan pricing, with RBL's average interest on loans declining from 11.8% in 2002 to 9.8% in 2003.

The slowdown in FirstCaribbean's loan portfolio was attributable to a decline in consumer (7%) and business loans (11.7%), which represented 16% and 48% of total credit and which would have been impacted by the decline in tourist arrivals from a number of territories in which the bank operates. However loan growth was buoyed by a 12.5% increase in mortgages, which represents approximately 36% of total loans. The shortfall in loan growth when compared to its regional peers could be attributable to FirstCaribbean's lack of presence in the fast-expanding Trinidad and Tobago and Jamaican markets. Weak credit demand in Barbados, in which FirstCaribbean has 36% of its operating assets, also contributed to the poor loan performance.

Historically, CIBC WIHL has experienced consistent growth in loans, averaging 17% per annum over the period 1997 to 2001 while Barclays PLC has seen a 7% decline in loans. In the future, the combination of these entities should add marketing and product synergies towards enhancing the performance of these once weak Barclays subsidiaries.

The outlook for loan growth is moderately positive though it should come in higher than the 2003 recorded growth of 4.1% as a result of marketing and brand synergies as well as moderate growth for the economies in which FirstCaribbean operates. The demand for business loans is expected to increase given the strong positive outlook on the tourism sector, amongst other things. The low level of interest rates, increasing disposable income and increasing employment levels, inter alia, should increase household credit demand, though moderately. For the first six months ended April 31st 2004, loan growth was moderately positive at 4.3% from its October 2003 balance.

Deposits

The growth and stability of deposits are important indicators of the resilience of funding for banks. FirstCaribbean's deposit balances fell by 4.1% for the period 2002 to 2003. The decline was mainly attributable to a

10% fall in individual deposits and mitigated somewhat by a slight 0.1% increase in commercial deposits. The general decline in interest rates as well as depositors' skepticism with respect to the success of the FirstCaribbean integration process may have contributed to the fall in deposits. For the first six months ended April 31st, 2004, FirstCaribbean's deposit base grew by 5.5% from its closing balance in October 2003.

Generally, a wider retail deposit base represents a more stable source of funding, since a bank is less exposed to the risk of a large institutional or commercial depositor withdrawing its funds and, thus, has less balance sheet risk. FirstCaribbean's personal deposit base represents almost 42.8% of its total deposits, while commercial deposits account for the major portion of total deposits (55.5%). This contrasts to its peers RBL and RBTT; personal deposits represent approximately 62% and 59% of total deposits for these banks, respectively, and imply a relatively narrow deposit base for FirstCaribbean. Commercial sector deposits comprise approximately 30% of total deposits for RBL and 28% for RBTT, respectively.

However, the majority of FirstCaribbean's individual and commercial deposit bases are in the form of fixed deposits, which are characterized as less liquid relative to demand or notice deposits (thus more stable) and usually attract higher interest rates. Fixed deposits (both individual and corporate) accounted for 58% of total deposits. Fixed deposits also increased from its 2002 level by approximately 3%, which may partly explain the increased pricing of deposits from 1.8% in 2002 to 2.2% in 2003. FirstCaribbean's average interest on deposits, calculated as interest expense over average deposits, was 1.18% for 2003, compared to 1.0% for 2002. RBTT and RBL, however, experienced declines in deposit rates. RBL's average interest on deposits, for instance, declined from 4.6% to 2.7% over the period 2002 to 2003 and which mitigated the reduction in loan pricing and allowed the bank to maintain its spread of approximately 7.2%. FirstCaribbean's spread improved from 2.4% to 4.0%.

FirstCaribbean's deposit base is expected to experience fair growth in 2004 due to the positive economic climate, lack of other investment alternatives, and marketing initiatives. With respect to deposit rates, the current shift from bank deposits to mutual funds may result in increased personal deposit costs.

Liquidity

The level of a bank's liquidity affects the balance sheet risks. Liquidity, measured by the performance of cash and investments as a percent of total assets, was calculated at a high 54.3% for FirstCaribbean, compared to 46.5% for RBTT Bank and 27.5% for RBL. Though subject to less balance sheet risks, FirstCaribbean's high liquidity levels reflect large yielding cash resources, which would explain the comparatively low profit levels. Asset/Liability matching highlights a normal liquidity gap in between short-term assets and liabilities (less than 1 year). The liquidity gap for 1-3 month obligations is 35% of liabilities and decreases drastically to 7% for 3-12 month obligations. After 1 year, the liquidity gap is highly positive.

Exchange Rate Risk

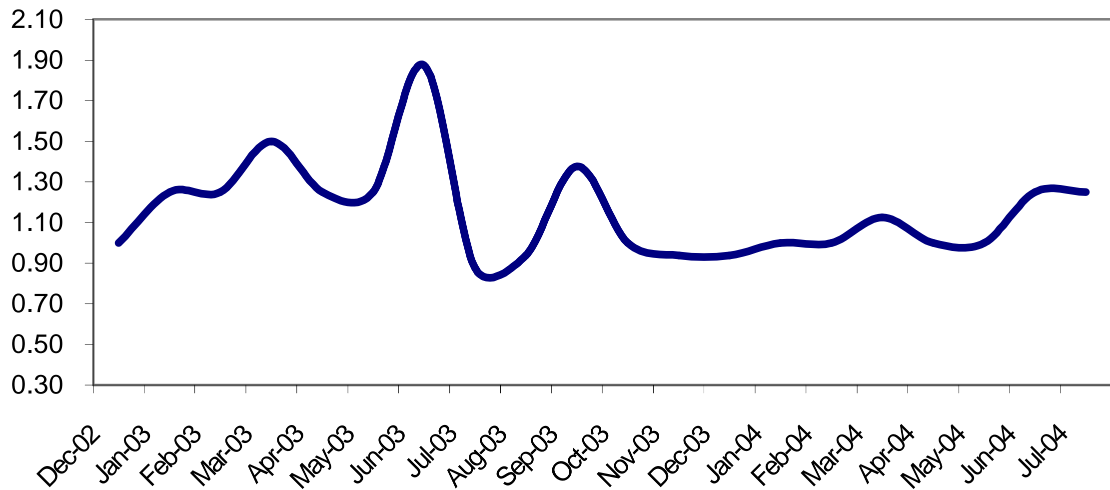
Stable currencies and sufficient matching of same currency denominated assets and liabilities limits FirstCaribbean's exposure to exchange rate risks. US denominated assets represent approximately 48% of total assets and are matched with 51% liabilities denominated in US dollars. The second major currency is Barbados dollars, which represents 15% of assets and 13.6% of liabilities. The most volatile currency for FirstCaribbean is the Jamaican dollar; however, exposure to this currency is limited to 2.3% of assets and matched by an equal 2.3% of liabilities denominated in the same currency.

Interest Rate Risk

One of the major external risk factors facing FirstCaribbean lies in fluctuations in US interest rates, which have been experiencing historically low levels. US dollar denominated deposits and loans account for 52.6% and 29%, respectively, of total deposits and total loans. Accordingly, if US interest rates were to increase this would impact the earnings rate of deposits and the net interest income from loans as well as the volume of deposits and loans. Furthermore, FirstCaribbean also has a large exposure to US interest rates reflected in 65.8% of its liquid assets, which includes cash, due from banks as well as investments denominated in US dollars.

US interest rates have began to trend upwards, with the Federal Fund rate increasing from 1% at the end of June 2004 and to 1.25% at the end of July. This upward trend is expected to continue, though at a moderately paced level. Since deposits tend to price earlier than loans, increases in US interest rates will transmit into higher deposit rates, which could

attract higher deposit volumes. Furthermore, loan rates can increase to maintain the spread between deposit and lending rates. Increases in US interest rates can result in greater interest income from FirstCaribbean's cash and investments.



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6. SWOT ANALYSIS

a. Strengths

- **Capital Adequacy**: FirstCaribbean is now the largest Caribbean banking entity with total assets in excess of US$9.5 billion. FirstCaribbean has sound capital adequacy, reflected in its strong Tier 1 capital ratio of 19% of assets at the end of 2003. Tier 1 Capital represents the highest quality of capital and generally includes equity capital and disclosed reserves.

- **Currency Exposure:** Assets include a large amount of US$ denominated cash, and other investment securities of approximately US$3.5 billion as at end-April 2004. The large US$ capital base of almost 50% of total capital minimizes the bank's exposure to exchange rate risks.

- **Reputation:**
  - Standard and Poor's rated FirstCaribbean as A-, attributing the investment grade rating and positive outlook to the bank's strong balance sheet and dominant market share. Its peers, RBL and RBTT, are rated BBB- and BB+, respectively.
  - The two parent entities CIBC WIHL and Barclays PLC are highly reputable financial institutions. CIBC was the market leader in most territories except Jamaica, where it was third.

- **Diversification:** FirstCaribbean is well-diversified in what can be considered healthy economies. FirstCaribbean has a significant positioning in the Bahamas, Barbados and Cayman coupled with a minimal exposure in the high risk Jamaican economy.

- **Current Level of Interest rates:** The current low interest rate environment may increase consumer borrowing in sound

economies that may follow the positive outlook for the US economy.

- **Operations:** FirstCaribbean has rationalized and upgraded its communication systems and is in the process of integrating its technology as well as other operational processing functions, which will result in greater operational efficiencies.

- **Marketing**: Barclays has a strong track record in selling offshore products and both CIBC and Barclays have strong branch networks in domestic and corporate retail banking.

- **Distribution:** A strong distribution network extending in over 15 countries which will augur well for the company's new products and market expansion initiatives

- **Human Resource:** Strong human resource initiatives undertaken for the newly formed entity which includes:
  - New Performance Management System aligning pay and performance
  - US$3.8 million for training and development in the first 18 months of operations
  - Employee stock reward program

b. Weaknesses

- Goodwill arising from the excess of fair value over the net book value of assets will be amortized over an estimated useful life of 20 years and charged to the income statement. At the end of April 2004, goodwill on the balance sheet stood at US$293 million. Since inception, FirstCaribbean has amortized US$24.5 million in goodwill, which has been a significant recurring cost on the bank's income statement.

- FirstCaribbean estimated restructuring and integration charges to be US$76 million on aggregate for the first three years of operations. As at April 30th 2004, the Bank recognized US$48.2 million of integration and restructuring charges with another US$27.8 million to be written off for the next half of 2004 and

financial year 2005. These costs are significant and will continue to dampen reported profits until 2005.

- Relative to the capital base of its regional peers, FirstCaribbean had a lower return on assets (before goodwill and restructuring charges) in 2003. Its ROA was 1.3% compared to 1.7% and 2.6%, respectively, for RBTT and RBL. In 2003, FirstCaribbean's ROE of 9.5% was lower than that of RBTT (25.5%) and that of RBL, which was 18.8%.

c. Opportunities

- FirstCaribbean enjoys the reputation of CIBC and Barclays and has the capital base to increase market share in the region and become a dominant player.

- The likely trend of US interest rates is to increase in the medium-term which will bode well for the company's US$ denominated investments or investments linked to US interest rates. As at October 2002, cash and investments represented approximately 50% of FirstCaribbean total assets.

- With US$ cash and short-term investments available, the bank can increase its loan portfolio within the region to achieve a higher yield on these funds.

- FirstCaribbean intends to set up operations in Trinidad. As one of the leading economies in the Caribbean, Trinidad can provide a viable market for the bank's products and services and give significant impetus to FirstCaribbean's profitability.

d. Threats

- Integration of various information technology platforms poses a tremendous challenge, in terms of practicality and costs especially given Barclay's outdated IT Infrastructure.

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- ❖ With substantial shareholding by two international banks, localization of decision-making can be obscured. Additionally, the merger of such large entities poses the threat of anti-synergies resulting from cultural differences, which may prove costly.

Critical Success Factors

- ❖ FirstCaribbean's ability to integrate the banks on time and within budget so as to realize the planned synergies.

- ❖ The ability of FirstCaribbean to achieve higher returns by converting its cash and short-term investments into high yielding assets, which will in turn improve the bank's return on equity.

- ❖ Developing key product areas and enhancements under each business area to increase and sustain market share. The company also has to promote itself as a leader in customer service to sustain and gain market share over niche competitors.

- ❖ Undertaking aggressive business strategies and innovation to compete with its regional peers such as RBTT and RBL as well as with new aspiring players such as NCB Jamaica

7. SHARE PRICE VALUATION

Four valuation models are used to estimate the fair value of FirstCaribbean Bank, namely, a Three Stage Dividend Discount Model, a Justified Price to Earnings Multiple, a Justified Price to Book Multiple, and Comparative P/E Valuation. Fundamental assumptions as well as earnings and dividends projections are based mainly on expectations of the fall-off in restructuring charges, reduction in non-interest expenses resulting from synergies, higher income from cash and investments as a result of a likely rise in US interest rates in the medium term, and moderate increases in the loan portfolio.

In the Three Stage Dividend Discount Model, three different growth estimates were made. Stage 1 estimated growth of 6% for 2004, Stage 2 was 12% from 2005 and 2006, and Stage 3 assumes a sustainable growth rate of 7%. In 2003, FirstCaribbean paid EC$0.04 in dividends with an estimated payout ratio of 54%. The Required Rate of Return was assumed to be 10%. Based on this model, the fair value price for FirstCaribbean was estimated at EC$2.24.

The assumptions in the second model, the Justified Price to Earnings Multiple, included a 50% payout ratio, a sustainable growth rate of 7%, and a required rate of return of 10%. The result, based on projected cash earnings of EC$0.14 and a justified fair value multiple of 16.7 times, was a price projection of EC$2.32.

The third model, the Justified Price to Book multiple, assumed a higher return on equity of 14%, based on expectations of increased profitability of FirstCaribbean in the medium term. The payout ratio was assumed to be 50% and sustainable growth was estimated at 7%. Projected book value was estimated at EC$1.18 and the justified book value multiple was estimated at 2.33, resulting in a fair book value estimate of EC$2.75.

The last model, a more simplistic model, estimated a comparative price/earnings multiple of the regional market players, namely RBTT Bank and RBL. The weighted average multiple for these players is estimated at 18 times and assigning this multiple to FirstCaribbean

results in a fair value estimate of EC$2.51.

Using these valuation models, the fair value estimate for FirstCaribbean is an average of EC$2.46 or a range of EC$2.24 to EC$2.75.

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8. INVESTMENT CONCLUSION

FirstCaribbean International Bank is the largest Caribbean banking entity with assets in excess of US$9.5 billion and is the second largest publicly traded financial institution in the region with a market capitalization of over US$2 billion. Established on October 11 2002 and commencing operations on October 14, FirstCaribbean was formed from the merger of the retail, corporate and offshore Caribbean operations of Barclays Bank PLC and Canadian Imperial Bank of Commerce (CIBC).

FirstCaribbean spans 15 countries across the region through its 5 major subsidiaries and has an extensive network of over 80 branches. The bank has a significant positioning in stable economies like The Bahamas, Barbados and Cayman Islands, mitigated by low exposure to the high-risk Jamaican economy. Its operations in The Bahamas, the Cayman Islands, the Eastern Caribbean, and Jamaica represent the majority of operating profit.

Standard and Poor's has rated FirstCaribbean at investment grade A-, attributing the rating and positive outlook to the bank's strong balance sheet and dominant market share. Its regional peers - RBTT Bank and Republic Bank Limited (RBL) - are rated BB+ and BBB- respectively.

FirstCaribbean also has a sound capital adequacy position, reflected in a strong Tier 1 capital ratio of 19% of assets at the end of 2003. A large US$ capital base of almost 50% of total capital minimizes the bank's exposure to exchange rate risks. The upward trend of US interest rates in the medium-term bodes well for the company's large stock of US$ denominated investments.

Relative to the capital base of its regional peers, FirstCaribbean had a lower return on assets (before goodwill and restructuring charges) of 1.3% in 2003 compared to 1.7% and 2.6%, respectively, for RBTT Bank and RBL. Its return on equity was 9.5%, much lower than that of RBTT (25.5%) and RBL, which was 18.8%.

With substantial shareholding by two international banks, localization of decision-making can be obscured. Additionally, the merger of such large entities poses the threat of anti-synergies resulting from business cultural differences, which may prove costly and result in a decision gridlock. Moreover, bigger is not always better. Big banks have a record of charging higher fees on their customers' accounts and are usually less responsive to small business loans. In post-merger activity, there is usually a net transfer out of the combination.

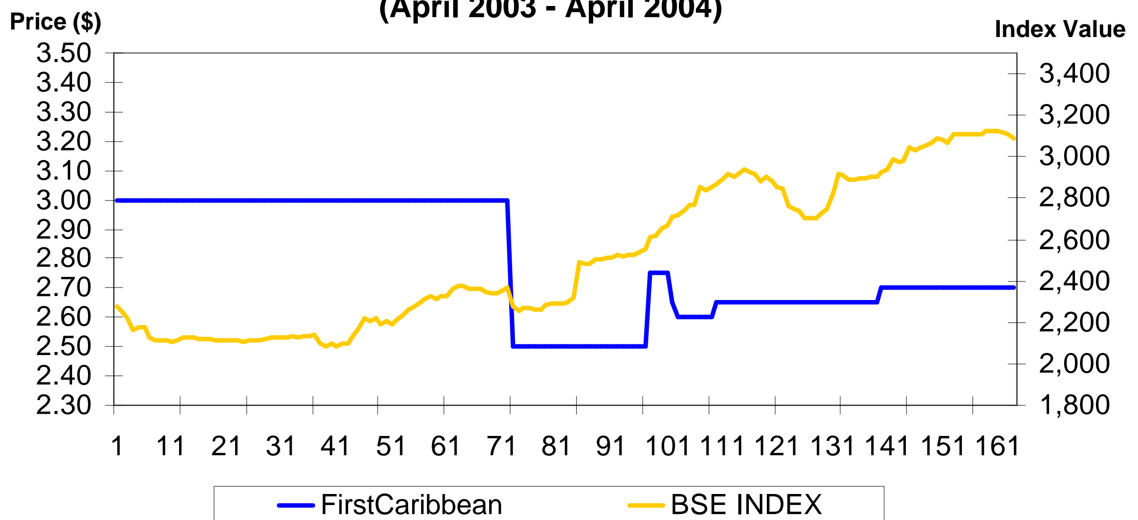
FirstCaribbean has rationalized and upgraded its communication systems but the integration of its various information technology platforms poses a tremendous challenge in terms of practicality and costs, especially given Barclay's outdated IT Infrastructure.

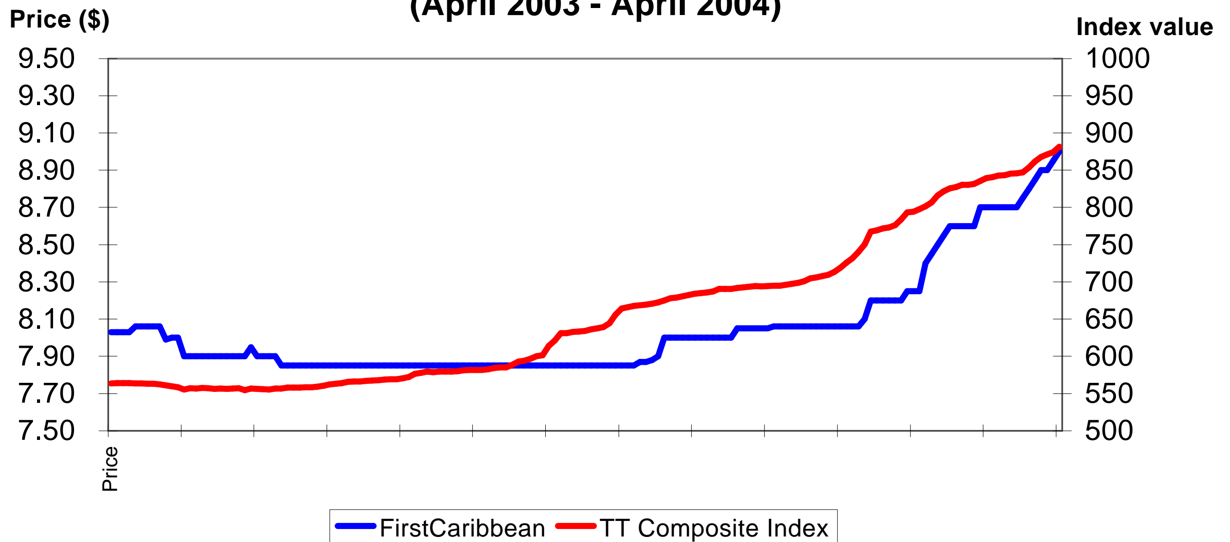
Goodwill arising from the excess of FirstCaribbean's fair value over the net book value of assets will be amortized over an estimated useful life of 20 years and charged to the income statement. Since inception, FirstCaribbean has amortized US$24.5 million in goodwill, which has been a significant recurring cost on the bank's income statement. At the end of April 2004, goodwill on the balance sheet stood at US$293 million.

FirstCaribbean expects to achieve cost savings from rationalization of front and back office operation and revenue increases from new products and service introductions. The company estimates synergies from the merger to be approximately US$180 million by the end of the first three years of operations in 2005. However, restructuring and integration costs are also significant and will continue to dampen reported profits until 2005. As at April 30th 2004, FirstCaribbean recognized US$48.2 million of integration and restructuring charges with another US$27.8 million to be written off for the next half of 2004 and financial year 2005.

FirstCaribbean enjoys the reputation of its heritage banks. The predecessor institutions bring various specializations to the table with some cross-operational expertise. For example, Barclays dominates market share in the Trustee services segment, especially so in Barbados where it holds a majority of the pension fund portfolios. On the other hand, CIBC has significant Merchant and Investment Banking operations in the territories while both are registered brokers on the Barbados Stock Exchange. In the offshore business, CIBC also holds the edge over Barclays, as the latter has been relatively dormant in the recent past. Together, they present a formidable combination.

FirstCaribbean has the capital base to increase market share in the region and become a dominant player. With US$ cash and short-term investments available, the bank can increase its loan portfolio within the region to achieve a higher yield on these funds. A strong regional distribution network augurs well for the company's new products and market expansion initiatives. FirstCaribbean intends to set up operations in Trinidad, which can give significant impetus to its profitability.





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