Egyptian Banks
Initiation of Coverage

12 January 2010

Favourable macro economic performance relative to regional peers

The Egyptian economy is one of few Arab economies to record positive growth in both the real and nominal GDP in 2009. Despite a negative outlook on exports, which have been hit by the global recession, domestic demand driven by the government stimulus plan and consumer spending, remains strong.

Solid defensive play against regional economic slowdown

While other banks in the region have faced liquidity shortages, deteriorating asset quality and volatility in their funding resources, investors can take comfort from the strength of Egyptian banks, which have enjoyed an improvement in each of asset quality, capitalization and liquidity in 2009.

Retail lending: a story of potential

The retail credit market in Egypt remains underpenetrated despite the impressive growth in retail lending during the period from 2006 to 2008. We expect corporate credit to be the main driver for loan growth in 2010 but expect retail lending to have the greatest potential for double digit growth rates from 2011 onwards.

Factors to watch: falling utilization rates and margin compression

We expect Egypt's low loan to deposit rates (LTD) to fall below 50.0% in 2010 down from the current 52.3% on the back of: 1) increased risk aversion by banks and 2) a widening budget deficit will lead to government crowding out credit expansion. A shift towards lower yielding assets such as government securities is therefore expected to put pressure on net interest margins.

Initiating on Commercial International Bank with a Neutral rating

We are initiating coverage on Commercial International Bank (CIB) with a 12M target price of EGP 51.7 per share, implying a 7.0% downside potential to the current market price.

Initiating on National Société Générale Bank with a Buy rating

We are initiating coverage on National Société Générale Bank (NSGB) with a 12M target price of EGP 33.6 per share, implying a 15.9% upside potential to the current market price.

Table 1: Egyptian banks – key valuation metrics based on 11 January, 2010 closing prices

Company	Price (EGP)	Rating	Target (EGP)	Potential Return	PE (x) 2010E	PBV (x) 2010E	RoAE 2010E
CIB	55.6	Neutral	51.7	-7.0%	8.7	2.0	24.4%
NSGB	29.0	Buy	33.6	15.9%	6.4	1.5	25.6%

Source: Reuters, Rasmala Research

Contact

Financials Team

Monsef Morsy
monsef.morsy@rasmala.com

Head of Research

Mohamed El Nabarawy, CFA
mohamed.elnabarawy@rasmala.com

Rasmala Research Department
research@rasmala.com
+971 4365 3100

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A defensive play against the regional economic slowdown

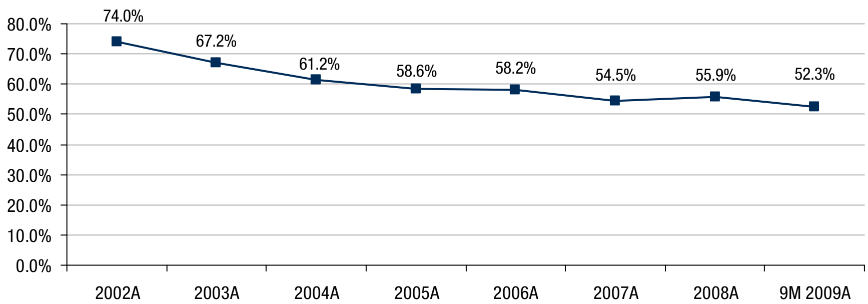
While other banks in the region have faced liquidity shortages, deteriorating asset quality and volatility in their funding resources, investors can take comfort from the strength of Egyptian banks, which are, in our view, a solid defensive play against the regional economic slowdown. In 2009, Egyptian banks have enjoyed an improvement in each of asset quality, capitalization and liquidity.

The factors that had hindered growth during good times are currently working in favor of Egyptian banks in the time of an economic slowdown. A tight credit policy implemented by the Central Bank of Egypt (CBE), a basic banking product mix, corporate driven credit and retail driven deposits are all characteristics that add to the defensive profile of the Egyptian banking sector.

Highest liquidity level in the region

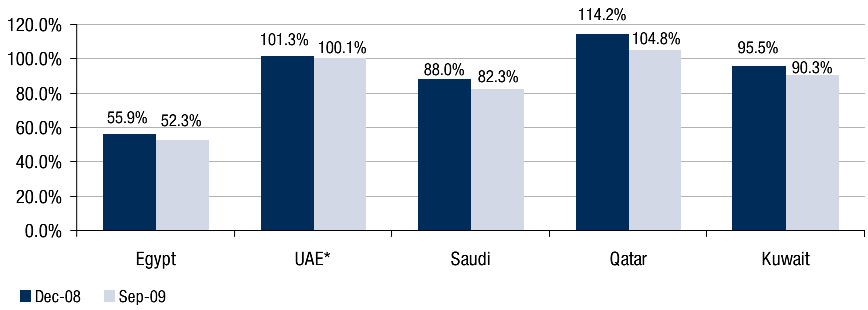
Egyptian banks have been historically characterized by high liquidity levels as evident by their low loan to deposit (LTD) ratio compared to regional peers. In fact, the LTD ratio has dropped from 74.0% in 2002 to 52.3% at the end of September 2009 to reach one of the lowest levels, not only on a regional scale, but also globally.

Figure 1: Egyptian banks – loan to deposit ratio



Source: Central Bank of Egypt

Figure 2: Egyptian vs GCC banks – loan to deposit ratio



Source: Central Banks reports
*LTD for UAE is as of 30 June 2009

Although the low LTD ratio and abundant liquidity in the system imply inefficiency in the deployment of funds by Egyptian banks, this helped put Egyptian banks in a better position compared to peers that suffered a shortage in liquidity as a result of the financial meltdown. CIB had a LTD ratio of 56.5% at the end of Q3 2009 while the ratio for NSGB stood at 63.7%.

An improving asset quality

In general, Egyptian banks have higher NPL ratios compared to regional peers. What is interesting to note is that Egyptian banks have actually witnessed a slight improvement in their asset quality in 9M 2009 whereas most regional peers have had their asset quality deteriorate during the same period.

Table 2: Egyptian vs. GCC banks – NPL ratio

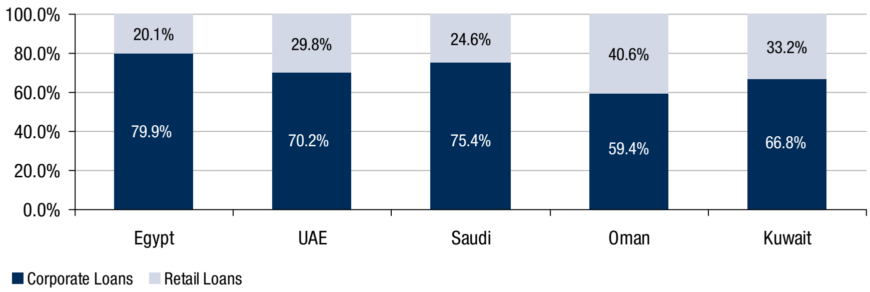
	Dec 2008	June 2009	Sep 2009
Egypt			
CIB	3.0%	2.8%	2.9%
NSGB	7.0%	7.1%	6.8%
UAE			
NBAD	0.9%	1.1%	1.2%
ADCB	1.1%	4.0%	4.2%
FGB	0.6%	1.1%	1.4%
ENBD	1.0%	1.6%	1.9%
Qatar			
QNB	0.7%	0.8%	0.8%
CBQ	0.8%	1.5%	2.1%
Saudi Arabia			
Samba	1.9%	3.5%	N/A
Fransi	0.9%	1.1%	N/A
SABB	0.2%	2.4%	N/A
Rajhi	2.0%	2.9%	N/A

Source: Company reports

The NPL ratios for both banks under our coverage dropped from 2008 levels with adequate coverage ratios. The NPL ratio for CIB dropped from 3.0% at the end of 2008 to 2.9% at the end of Q3 2009 with a relatively high coverage of 179.4%. Meanwhile, the NPL ratio for NSGB dropped from 7.0% at the end of 2008 to 6.8% at the end of Q3 2009 with a coverage ratio of 108.0%. In contrast, a number of GCC banks suffered deterioration in their loan books.

In our view, a key factor that sheltered Egyptian banks' assets quality from deterioration is the fact that credit in Egypt is driven mainly by corporate lending and has always represented more than 80.0% of the sector's total loans. The higher risk retail lending is still underpenetrated in Egypt in comparison to other markets in the region, where banks have higher retail exposures. Retail lending accounted for 20.0% of total loans in Egypt vs. 25.0% in Saudi Arabia and 30.0% in the UAE at the end of 2008. This ratio is even lower for the two banks under coverage. At the end of Q3 2009, retail lending to total loans amounted to 9.1% and 15.8% for CIB and NSGB, respectively.

Figure 3: Egyptian vs GCC banks – total credit breakdown (Dec. 2008)



Source: Central Banks reports

In the GCC two major incidents regarding companies' requests to restructure their debt, and concerns over severe defaults took place during H2 2009. In June 2009, two Saudi conglomerates, Saad Group and Ahmed Hamad Al Gosaibi & Brothers Co. defaulted after borrowing more than USD 15.0 billion from more than 80 regional and international banks. According to the UAE Central Bank, UAE banks have a combined exposure of USD 2.9 billion to the troubled groups' debt while no official statements were released regarding the exposure of Saudi banks. By contrast, Egyptian banks had no exposure to the Saudi groups' debt.

Table 3: GCC banks – exposure to the Saad & Al Gossaibi Groups' debt

	Exposure in USD mn
Abu Dhabi Commercial Bank	609
Mashreq Bank	400
Bank Muscat	171
Commercial Bank of Kuwait	119
First Gulf Bank	104
Union National Bank	60

Source: Reuters
*There is no clarity on the exposure of Saudi Arabian banks

In November 2009, Dubai World, a state-owned holding company, struggling with around USD 34.0 billion of debt (according to Moody's), announced that it would seek a standstill agreement with creditors and an extension of loan maturities until at least 30 May, 2010. The Dubai government stated that it is unwilling to guarantee the debts of its related entities and as a result, Dubai World is currently in talks with banks to restructure USD 26.0 billion of debt, of which USD 6.0 billion relates to one of its subsidiaries, Nakheel.

Table 4: UAE banks – exposure to Dubai World's debt

	Exposure in USD mn
Abu Dhabi Commercial Bank	2,315
First Gulf Bank	1,360
National Bank of Abu Dhabi	345

Source: Reuters

The Central Bank of Egypt has announced that Egyptian banks' exposure to Dubai World's debt does not exceed USD 20.0 million. In addition, CIB stated that it has no exposure to Dubai World debt or its subsidiary Nakheel.

Both these incidents have created concerns over regional banks' asset quality, which had already deteriorated in 9M 2009 even before the full impact of the latest Dubai debt crisis hits banks' books. We expect to see further deterioration in asset quality of several GCC banks, particularly in the UAE, during Q4 2009 and 2010.

Improving capitalization in 2009

The majority of Egyptian banks are adequately capitalized, which puts them in a strong position to withstand any potential deterioration in asset quality and provides them with room for future loan growth.

CIB had a capital adequacy ratio (CAR) of 11.7% versus 14.1% for NSGB at the end of 2008. The capitalization for both banks has improved substantially in 9M 2009 as a result of the growth in assets being driven by the holdings of zero-risk-weighted government securities, resulting in an improvement in CAR for both banks. We expect CAR to further improve for CIB and NSGB to reach 17.4% and 15.9%, respectively at the end of 2009.

Although the Egyptian banking sector, in general, has lower capital adequacy ratio than its GCC peers, the two banks under coverage have CAR ratios that are in line with their GCC counterparts.

Table 5: Egyptian vs. GCC banks – capital adequacy ratios

	Dec 2008	June 2009
Egypt		
CIB	11.7%	14.1%
NSGB	14.1%	15.0%
UAE		
ENBD	11.4%	19.0%
NBAD	15.4%	17.9%
ADCB	11.4%	19.3%
DIB	10.7%	11.8%
FGB	14.1%	18.3%
UNB	11.6%	16.9%
CBD	13.0%	13.0%
Qatar		
QNB	13.9%	N/A
CBQ	15.7%	N/A
Qatar Islamic	17.0%	N/A
Saudi Arabia		
Samba	14.1%	N/A
Banque Saudi Fransi	11.6%	N/A
SABB	11.2%	N/A

Source: Company reports

The deposits driven funding base is boosting balance sheet growth

Egyptian banks fund their balance sheets largely through deposits. Total deposits represented 72.5% of the sector's balance sheet at the end of September 2009 compared to a ratio of around 67.5% and 63.7% for Saudi Arabia and UAE, respectively.

Table 6: Egyptian vs GCC banking sectors – deposits/assets (Sep 2009)

	Deposits/Assets
Egypt	72.5%
UAE	63.7%
Saudi Arabia	67.5%
Qatar	56.8%
Oman	63.1%
Kuwait	69.7%

Source: Central Banks reports

GCC banks' relative higher dependence on non deposit sources such as interbank deposits, EMTNs, bonds, subordinated loans and shareholders' equity resulted in a slower balance sheet growth rate compared to Egyptian banks in 9M 2009. Egyptian banks recorded the highest growth rate in assets in 9M 2009. Although Saudi Arabia, Qatar and Kuwait recorded higher growth in deposits for the same period, the decline in non deposit funding sources slowed down their banks' balance sheet growth.

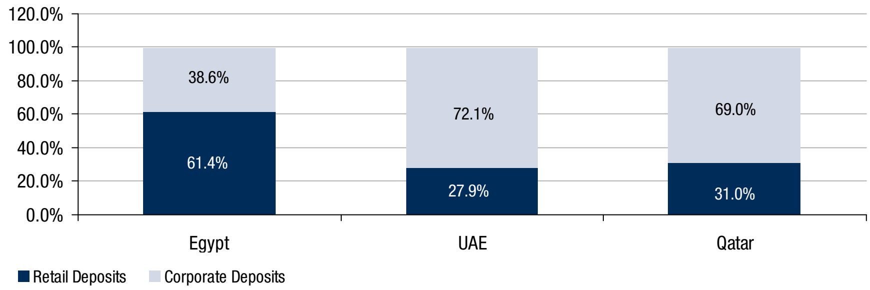
Table 7: Egyptian vs GCC banks – assets & deposits growth (9M 2009)

	Assets growth	Deposits growth
Egypt	6.0%	6.0%
UAE	3.0%	4.0%
Saudi Arabia	4.0%	8.0%
Oman	-1.0%	1.0%
Qatar	5.0%	13.0%
Kuwait	0.0%	11.0%

Source: Central Banks reports

In terms of composition, retail deposits represent the bulk of Egyptian banks' funding base. At the end of September 2009, retail deposits represented 61.7%, while corporate deposits represented the balance. The current composition of deposits further contributes to the funding stability for banks operating in Egypt when compared to other banks in the region, which depend more on wholesale funding.

Figure 4: Egyptian vs GCC banks – deposits breakdown (Dec. 2008)



Source: Central Banks reports

Stable credit ratings outlook

In general, the Egyptian economy, and hence several Egyptian banks, had their credit rating outlook remain stable during the crisis when compared to several other banks in the region, which have had their credit ratings either downgraded or put on review for possible downgrade. Fitch Ratings has recently affirmed its credit ratings for both NSGB and CIB. Meanwhile, Moody's downgraded the long-term local currency deposit ratings of three Egyptian banks, including CIB. However, according to Moody's, Egyptian banks have remained shielded from the global financial crisis given the absence of exposure to structured products and a negligible reliance on capital markets for funding needs. On the other hand, several GCC banks were downgraded by the different rating agencies or are currently on credit watch for possible downgrades.

In August 2009, Moody's Investors Service changed their outlook on Egypt's sovereign ratings and ceilings back to stable from negative. The upgrade in outlook was justified mainly by an easing inflation environment and relative resilience of the Egyptian economy and banking sector to the global economic meltdown as compared to peers. In addition, Moody's has maintained its stable outlook on the Egyptian banking sector due to the relatively stable economy and the sector's limited exposure to global financial markets.

Table 8: Egypt vs GCC – S&P sovereign ratings

	Local Currency	Foreign Currency
Abu Dhabi	AA/Stable/A-1+	AA/Stable/A-1+
Saudi Arabia	AA-/Stable/A-1+	AA-/Stable/A-1+
Qatar	AA-/Stable/A-1+	AA-/Stable/A-1+
Kuwait	AA-/Stable/A-1+	AA-/Stable/A-1+
Bahrain	A/Stable/A-1	A/Stable/A-1
Oman	A/Stable/A-1	A/Stable/A-1
Egypt	BBB-/Stable/A-3	BB+/Stable/B
Morocco	BBB/Stable/A-3	BB+/Stable/B
Lebanon	B-/Stable/C	B-/Stable/C

Source: S&P

However, in December 2009, Moody's downgraded the long-term global local currency (GLC) deposit ratings of three Egyptian banks and confirmed ratings on two other banks. The downgraded banks are; National Bank of Egypt (NBE), Commercial International Bank (CIB) (COMI.CA) and Banque du Caire. The GLC deposit ratings were downgraded from ‘Baa1/P-2’ to ‘Baa2/P-2’ for both NBE and CIB, while Banque du Caire’s GLC deposit ratings were downgraded from ‘Baa2/P-2’ to ‘Baa3/P-3’. Meanwhile, GLC deposit ratings were confirmed for Banque Misr and Bank of Alexandria (BoA) (BALX.CA) at ‘Baa2/P-2’. This mainly came on the back of the agency's change of the main input for its assessment of the ability of a national government to support its banks amid current tough conditions. All five banks mentioned are now on stable outlook and are no longer on review for possible downgrade.

In December 2009, Fitch Ratings affirmed NSGB's Support rating at ‘3’. As Fitch has not conducted a full review of NSGB, only a Support Rating has been assigned. The Support Rating is based on Fitch's belief that the bank's major shareholder, Societe Generale would have a strong propensity and ability to support NSGB's operational and funding requirements.

Additionally, in December 2009, Fitch Ratings also affirmed CIB's International ratings at Long-term Issuer Default (IDR) 'BB+' with stable outlook, Short-term IDR ‘B’, Individual ‘C’ and Support ‘3’. The Support Rating Floor is affirmed at ‘BB’. The rating reflects the strength of the bank's local franchise and management, its consistently strong profitability and adequate credit risk management.

As for regional peers, Moody's Investor Service downgraded the ratings of Abu Dhabi Commercial Bank (ADCB), Emirates NBD (ENBD.DU), Mashreq Bank (MASB.DU) and Dubai Islamic Bank (DISB.DU) in December 2009. The long-term deposit rating of ADCB was downgraded to ‘A1’ from ‘Aa3’ and its bank financial strength rating (BFSR) to ‘D+’ from ‘C-‘. In addition, the deposit rating of Emirates NBD was downgraded to ‘A2/ P-1’ from ‘A1/P-1’ and remains on review for further downgrade. Mashreq Bank's debt and deposit ratings were downgraded to ‘Baa1/P-2’ from ‘A2/P-1’ and the outlook was changed to negative. Dubai Islamic Bank's issuer ratings were downgraded to ‘Baa1/P-2’ from ‘A1/P-1’ and changed the outlook to negative. Moody's stated that it expects the current difficult economic conditions in Dubai to lead to further rise in NPL ratios over the foreseeable future and that the Dubai World incident is expected to still have further ramifications despite the recent emergency support extended by the Government of Abu Dhabi to Dubai.

In December 2009, S&P also downgraded its rating on four Dubai-based banks. The four banks include Dubai Islamic Bank, Mashreqbank, National Bank of Dubai and Emirates Bank International. Mashreqbank, National Bank of Dubai and Emirates Bank International were downgraded to ‘BBB’ from ‘A-’, while the long and short-term counterparty credit rating on Dubai Islamic Bank were lowered to ‘BBB-/A-3’ from ‘BBB+/A-2’. The rating agency stated that the action reflects the banks’ large exposure to Dubai World and Nakheel, and more generally to Dubai-based government related entities. In addition, S&P also placed ADCB's on ‘A/A-1’ long and short-term counterparty credit ratings on review for possible downgrade given the bank's large exposure to Dubai World's debt.

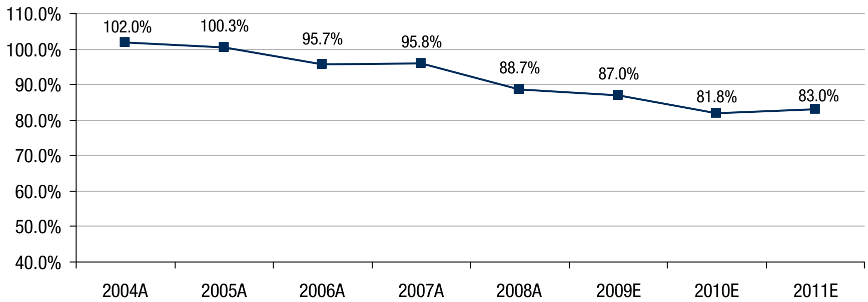
In the same context, three Kuwaiti banks have also been downgraded by Moody's in September 2009. The downgrade was attributed to the weakening credit environment and loan book concentration to property and construction sectors. The three banks are Commercial Bank of Kuwait, Al Ahli Bank of Kuwait and Bank of Kuwait and Middle East.

Economic slowdown to limit banks' balance sheet growth

For Egyptian banks, deposits are the main driver for balance sheet growth. Our forecast for the sector's total deposits is linked to the growth in the economy. Growth in deposits slowed down to 7.0% in 9M 2009 compared to a CAGR of 12.2% during the period of 2003-2008 on the back of a slowdown in economic activity. We expect total banking sector deposits to grow by 9.5% in 2010 and to return to double digit growth of 15.0% in 2011 on the back of an acceleration in economic growth in that year.

Deposits growth has been lagging nominal GDP growth over the past four years. Deposits to GDP fell from 100.3% in 2005 to 88.7% in 2008. With negative real interest rates in place and expected to continue going forward, we do not think there are enough factors that could lead deposit growth to significantly outpace nominal GDP growth and reach historical levels. We expect deposits to GDP to deteriorate further reaching 82.0% in 2010 and hover around 83.0% thereafter.

Figure 5: Egypt – deposits / nominal GDP

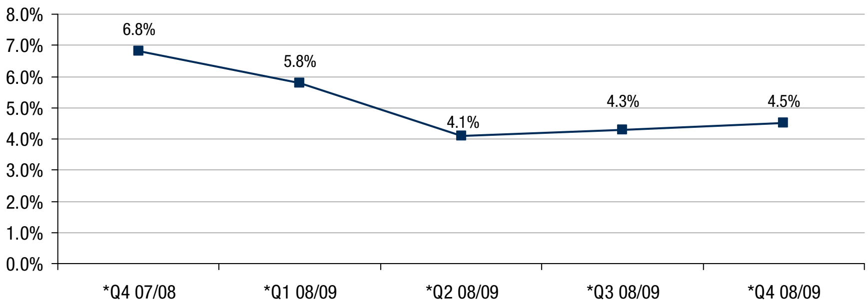


Source: Central Bank of Egypt

Egypt is one of few MENA economies to record positive growth in both real and nominal GDP in 2009. The economy has recorded a real GDP growth rate of 4.7% in FY 2008/09 and is expected to grow at 5.0% in the FY 2009/10. Despite a negative outlook on exports, which have been hit by the global recession, domestic demand driven by the government stimulus plan and consumer spending, remains strong.

The overall rate of real economic growth slowed sharply during the second quarter of 2008/09 to 4.1% compared to 5.8% in quarter one. It then recovered slightly in quarter three to 4.3% and to 4.5% by the end of the fourth quarter.

Figure 6: Egypt – real GDP quarterly growth (%)



Source: Central Bank of Egypt
*Fiscal year for Egypt ends 30 June. Therefore for example Q4 07/08 is the period between March 31 2008 – 30 June 2008

Despite the economic slowdown, the performance of the Egyptian economy in 2009 was very favourable when compared to other MENA economies with the UAE, Saudi Arabia and Kuwait all expecting to have their economies contract in 2009. Egypt is also expected to outperform the UAE, Saudi Arabia and Kuwait in real economic growth in 2010.

Table 9: Egyptian vs GCC economies – real & nominal GDP growth rates

	2008A	2009E	2010E
Egypt*			
Real GDP growth %	7.2%	4.7%	5.0%
Nominal GDP growth %	22.6%	21.0%	18.1%
UAE			
Real GDP growth %	7.4%	-3.5%	4.0%
Nominal GDP growth %	23.3%	-6.9%	10.2%
Saudi Arabia			
Real GDP growth %	4.2%	-1.0%	3.2%
Nominal GDP growth %	22.1%	-11.5%	12.7%
Qatar			
Real GDP growth %	13.4%	9.2%	24.5%
Nominal GDP growth %	41.3%	-9.9%	27.4%
Kuwait			
Real GDP growth %	8.5%	-0.7%	4.4%
Nominal GDP growth %	29.1%	-7.2%	19.9%

Source: EIU
* Fiscal year for Egypt ends 30 June

Real interest rates stood at -5.1% in October 2009. According to the CBE, Egypt's urban inflation rate reached 13.3% in October 2009 compared to 10.8% in September 2009. Meanwhile, the official deposit rate following the six rate cuts since the beginning of 2009 reached 8.25%. Both figures imply a negative real interest rate of 5.1%, which is expected to put some pressure on deposit growth in Q4 2009 and 2010.

Table 10: Egypt – monthly inflation rate, policy deposit rate and real interest rate

	CPI (%)	Policy Deposit Rate (%)	Real Interest Rate (%)
10/31/2009	13.3	8.25	-5.1
9/30/2009	10.8	8.25	-2.6
8/31/2009	9.0	8.5	-0.5
7/31/2009	9.8	9.0	-0.8
6/30/2009	10.0	9.0	-1.0
5/31/2009	10.2	9.5	-0.7
4/30/2009	11.7	10.0	-1.7
3/31/2009	12.1	10.5	-1.6
2/28/2009	13.5	10.5	-3.0
1/31/2009	14.3	11.5	-2.8

Source: Central Bank of Egypt

We believe that the economic slowdown witnessed in 2009 is likely to challenge deposit growth especially in the corporate and government segments. We project that Egyptian banking sector deposits will increase by 7.9% in the 2009 calendar year and 9.5% in 2010. Meanwhile, deposit growth is expected to accelerate as of 2011 on the back of the expected economic improvement and a potential rise in real interest rates in that year.

Table 11: Egypt – real interest rates

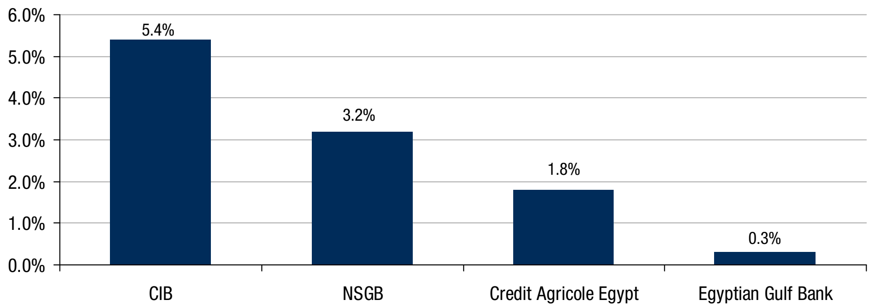
Company	2005A	2006A	2007A	2008A	2009E	2010E	2011E
Average Deposit Rate	7.2%	6.0%	6.1%	6.6%	6.5%	6.5%	7.0%
Inflation Rate	4.9%	7.6%	9.5%	18.3%	11.2%	10.7%	7.5%
Implied Real Interest Rate	2.3%	-1.6%	-3.4%	-11.7%	-4.7%	-4.2%	-0.5%

Source: EIU

We are forecasting that customer deposits in the Egyptian banking industry will grow at 12.4% per year over the next five years, which is in line with the historical trend where deposits grew by a CAGR of 12.2% during the period from 2003 to 2008.

At an individual company level, deposits will be more stable for banks focused on retail rather than corporate. Theoretically, withdrawals of corporate cash are expected to increase in times of scarce credit, placing deposits under pressure. At the end of 9M 2009, retail deposits represented 54.0% and 38.0% of total deposits for CIB and NSGB, respectively. However, NSGB managed to grow its total deposits by 17.6% in 9M 2009 while CIB grew its total deposits by 4.2% during the same period. We believe that CIB and NSGB will face no difficulties in expanding their funding base given their well perceived reputation among local depositors.

Figure 7: Egyptian banks – market share of retail deposits (Sep 2009)



Source: Central Bank of Egypt, Company reports

Government borrowing is crowding out credit to private sector

Egypt is distinctly underleveraged with a LTD ratio of 52.3% for banking in September 2009. Whereas the high liquidity ratio provides comfort to investors at times of economic slowdown, it is often looked at unfavorably at times of an economic boom.

We believe that the main factors that led to such a low LTD ratio are:

1 Rigid credit policy implemented by the CBE in an effort to improve the quality of banks' balance sheets.

2 The concentration of credit to blue chip corporations.

3 Reluctance to aggressively penetrate retail and SME segments.

4 Attractive yields on government securities.

Going forward we expect it will take several years to bring the LTD ratio in line with regional standards (see figure 2). In fact, we expect further deterioration in the LTD ratio going forward for the following reasons:

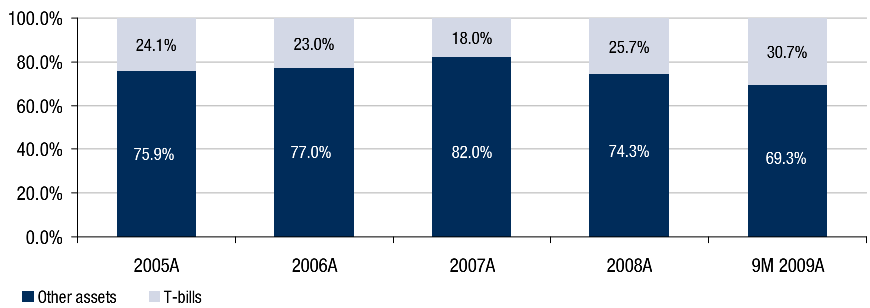
1 Slowdown in economic activity will discourage banks from taking risks and they will continue to focus on blue chip corporations.

2 Growth in retail lending will remain muted in 2009 and 2010.

3 A widening budget deficit will lead to the government crowding out credit expansion to private sector borrowers.

The government has indicated that the budget deficit is expected to widen and will reach 8.5% of GDP for FY 2009/2010. The government will finance the widening deficit by issuing more local debt. With risk aversion in place following the international financial crisis, banks will find it attractive to invest in government debt.

Figure 8: Egyptian banks – government securities/total assets



Source: Central Bank of Egypt

Table 12: Egypt – budget deficit/GDP

Company	2005A*	2006A*	2007A*	2008A*	2009E*	2010E*	2011E*
Egypt	-9.6%	-8.2%	-7.5%	-6.8%	-6.8%	-8.5%	-7.2%

Source: Central Bank of Egypt
*Fiscal year ending 30 June

In fact, 9M 2009 central bank figures confirm that LTD rates have actually deteriorated in 2009. Total credit increased by a mere 0.1% in 9M 2009, while investment in government securities increased by 29.6%. We expect credit growth to continue witnessing a slowdown at least until the end of 2010. Credit growth is expected to continue to be driven mainly by corporate lending in 2009 and 2010.

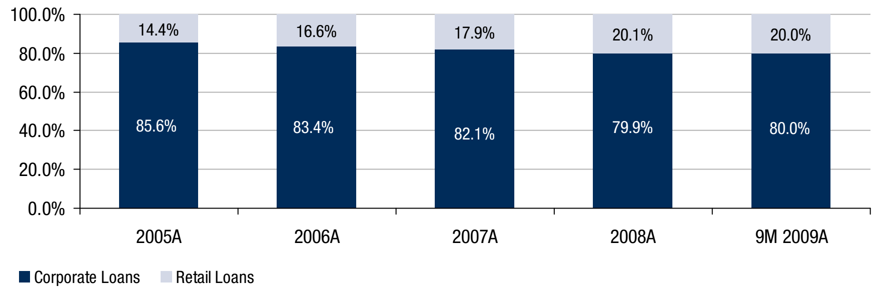
CIB and NSGB will have the upper hand in corporate lending compared to local peers as both have a strong corporate client base. However, we believe CIB has a stronger foothold in corporate banking due to its longer and well established presence in the local market.

In general, a pick up in credit growth is expected to take place in 2011 as a result of a better economic environment in addition to an expected pick-up in retail banking. In the longer term, retail lending will be the key factor in stimulating lending activity in Egypt and achieving better utilization of funds.

Retail lending: a story of potential

The retail lending market in Egypt is clearly underpenetrated as retail loans represented 20.1% of total loans at the end of December 2008 compared to 24.6% in Saudi Arabia and 29.8% in the UAE (see figure 3). Egyptian banks have been historically corporate oriented and only started targeting the retail segment in 2004. As a result, retail credit as a percentage of total credit rose from 14.1% in 2005 to 20.0% in September 2009. However, the international financial crisis resulted in increased risk aversion by banks which led to a halt in credit growth, both corporate and retail, in 9M 2009. Corporate loans grew by a mere 0.6% while retail lending declined by 1.8% during 9M 2009.

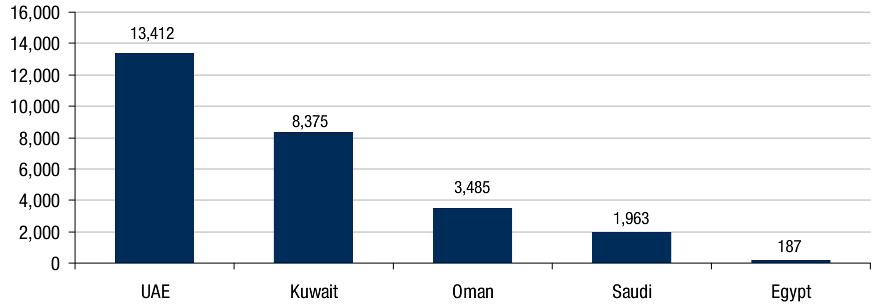
Figure 9: Egyptian banking sector – total credit breakdown



Source: Central Bank of Egypt

We estimate that only 3.0% of the Egyptian population has access to retail credit. Retail loans per capita in Egypt are substantially lower than in other MENA markets.

Figure 10: Egypt vs GCC – retail loans per capita (USD) (Dec. 2008)



Source: Central Banks reports, Rasmala Research

Despite the great underlying potential in the retail segment, we expect growth to remain muted in Q4 2009 and 2010, as banks' risk aversion will prevent them from aggressively tapping into this market.

We see the retail story as more of a medium term one, and expect growth in corporate credit to outpace retail credit growth in the short-term. NSGB has a higher retail exposure compared to CIB. At the end of Q3 2009, retail loans represented 15.8% of NSGB's total loans while retail loans to total loans stood at 9.1% for CIB. In addition, NSGB's retail operations are backed by the prominent retail expertise of its French parent, Société Générale (SG). This puts NSGB in a leading position in terms of acquiring market share of retail loans.

Despite the expected slowdown in lending activity during 2010, we assume that some lending opportunities might still present themselves in the market. The driver for those opportunities is expected to be the funding requirements of the corporate sector. We believe that local corporations will have no other funding alternatives except credit from local banks given the difficulty of raising capital amid current stock market volatility. In addition, the scarcity of liquidity in global banking systems also limits borrowing from abroad.

We expect the best performers in the short-term to be either banks with a strong foothold in corporate lending or those with a specific market niche. Nevertheless, banks enjoying considerable retail expertise would be able to increase their market shares over the longer term. NSGB fits the two criteria to a great extent, a relatively sound corporate banking operation and a well recognized retail ability supported largely by its French parent. CIB also fits the profile at least in the short-term as it is the leading private corporate bank in the local market. However, unless the bank implements a thorough and aggressive retail expansion plan, this may put pressure on the bank's market share gains in the future.

Factors to watch – Egyptian banking sector

In general, we have a positive view on the Egyptian banking sector on the back of Egypt's favourable macro economic performance relative to regional peers, and our view that the banking sector in Egypt provides investors with a defensive play against the regional economic slowdown. While other banks in the region have faced liquidity shortages, deteriorating asset quality and volatility in their funding resources, investors can take comfort from the strength of Egyptian banks which have enjoyed an improvement in each of asset quality, capitalization, liquidity and credit ratings outlook in 2009.

We think, however, that Egyptian banks are facing several challenges including:

- A slowdown in banks' asset growth on the back of a slowdown in general economic activity.
- Potential margin compression on the back of:
  - Credit growth in 2009 and 2010 being mainly driven by corporate credit, which has a lower yield compared to retail credit.
  - Shift in asset allocation in favour of lower yielding government securities.
  - Increasing competition as foreign banks start implementing their expansion plans which have been shelved as a result of the financial turmoil.

Commercial International Bank

Initiation of Coverage

Egypt 12 January 2010

RASMALA

Strong foothold in corporate lending

CIB is the leading private corporate lender in Egypt. In the short-term, we believe that CIB is in a position to fully benefit from an environment largely driven by corporate lending despite an expected slowdown in credit demand.

A superior asset quality compared to local peers

CIB has one of the highest asset qualities in the local banking sector. Its NPL ratio stood at 2.9% at the end of September 2009 with a relatively high coverage ratio of 179.4%.

Factors to watch: potential competition to restrain market share gains and lead to margin compression

As soon as the dust settles, we expect CIB to face intense competition from foreign banks with strong balance sheet positions and higher retail expertise. This might put potential pressure on CIB's market share gains and result in margin compression.

Initiating on Commercial International Bank at Neutral

We are initiating coverage on Commercial International Bank (CIB) with a 12M target price of EGP 51.7 per share, implying a 7.0% downside potential to the current market price.

Table 13: CIB - key valuation metrics based on 11 January, 2010 closing price

Year End 31 December	2008A	2009E	2010E	2011E	2012E
Net Profits (EGP mn)	1,371	1,727	1,815	1,946	2,221
PE (x)	10.3	9.1	8.7	8.1	7.2
PBV (x)	2.7	2.3	2.0	1.7	1.5
D.Yield (%)	1.8%	1.8%	2.5%	2.7%	3.0%
RoAE (%)	30.3%	27.4%	24.4%	22.5%	22.2%

Source: Rasmala Research

Recommendation

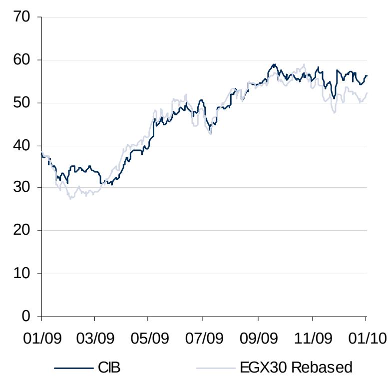
Neutral

Stock Data

Price (as of 11 Jan 2010) (EGP)	55.6
Target Price (EGP)	51.7
Potential Return (%)	-7.0%
GDR Price (as of 11 Jan 2010) (USD)	10.0
GDR Ratio	1-to-1
Market Cap (EGP mn)	16,406
Market Cap (USD mn)	3,038
Number of Shares (mn)	295.1
Av Daily Value (USD mn) (2009)	6.5
Reuters / Bloomberg	COMI.CA / COMI EY
Exchange Rate (EGP / USD)	5.4

Source: Reuters, Rasmala Research

Performance graph



Source: Reuters, Rasmala Research

12M High / Low (EGP)	58.9 / 30.9

	1M	3M	12M
CIB	0.4%	-1.4%	48.7%
EGX 30 Index	4.3%	-4.5%	39.6%

Source: Reuters, Rasmala Research

Major Shareholders

	(%)
Actis Private Equity	9.3
Free Float	90.7

Source: Company data

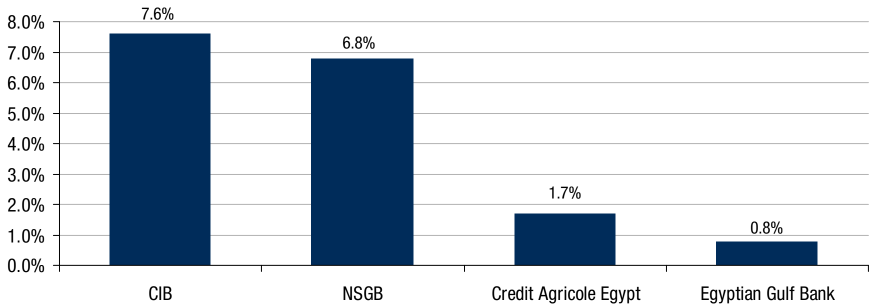
Investment Case – CIB

Leading private bank: top destination for corporate borrowers

CIB is the leading private bank in Egypt with a well recognized brand name. The bank has been outperforming its sector on both lending and deposit levels despite the entrance of heavyweight foreign banks over the past years. CIB has a strong foothold in corporate lending, which has always been the driver for commercial banking.

CIB is the preferred destination for the corporate sector due to its historically well established presence in the local market. CIB is the largest corporate lender among private banks operating in the local market. The bank managed to increase its market share of corporate loans from 5.0% in 2004 to 7.6% at the end of September 2009.

Figure 11: CIB vs. domestic peers – market share of corporate loans (Sep 2009)



Source: Central Bank of Egypt, Company reports

Despite the slowdown in credit demand witnessed in 9M 2009, and expected to continue in 2010, some lending opportunities might still be present in the market. In light of the scarcity of external liquidity and volatility in capital markets, we believe that local corporations will have no other funding alternatives except domestic credit. With its strong position in corporate lending, CIB is expected to benefit from an environment where corporate banking is expected to dominate, at least in the short-term.

The majority of CIB's client base comprises of large scale corporations with continuing funding needs. The list includes some of the blue chips listed on the stock market: Orascom Construction Industries (OCI) (OCIC.CA), Ezz Steel Rebars (ESRS.CA), Palm Hills Developments (PHDC.CA), El Sewedy Cables (SWDY.CA) and Oriental Weavers (ORWE.CA).

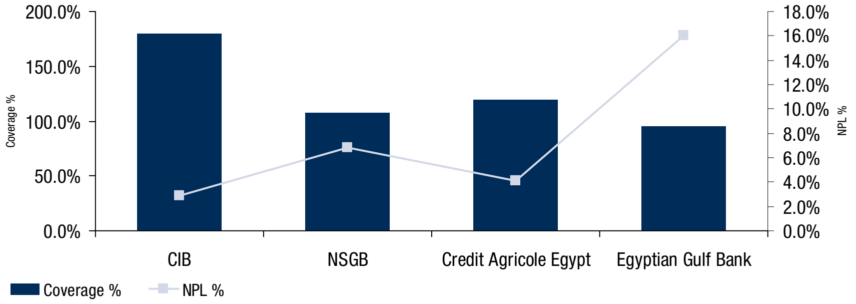
Highest asset quality in Egypt

CIB has one of the highest asset qualities in the local market. The bank's NPL ratio has slightly improved during 9M 2009 and reached 2.9% at the end of 9M 2009 compared to 3.0% at the end of 2008. The strong asset quality comes on the back of:

- A relatively low exposure to the retail segment (9.1% of total loan book as of 30 September 2009)
- A focus on blue chip corporations
- A conservative industry focus. Industrial and services sectors represented 39.4% and 37.3% of total loans, respectively. The bank's exposure to the real estate sector stands at around 1.0% of its loan portfolio and is extended mainly to large scale developers with sufficient collateral.

The bank is adequately provisioned with a high coverage ratio of 179.4%. We do not expect significant write-downs in CIB's loan book given that the majority of the bank's clients are large corporates with strong balance sheets and low risk profiles. As for retail loans, we do not expect serious defaults due to the bank's low exposure to the retail segment, which is primarily through lower risk payroll banking offered to its corporate clients' employees.

Figure 12: CIB vs. domestic peers – NPL & coverage ratios (Sep 2009)



Source: Company reports

Factors to watch

Improvement in utilization rates unlikely

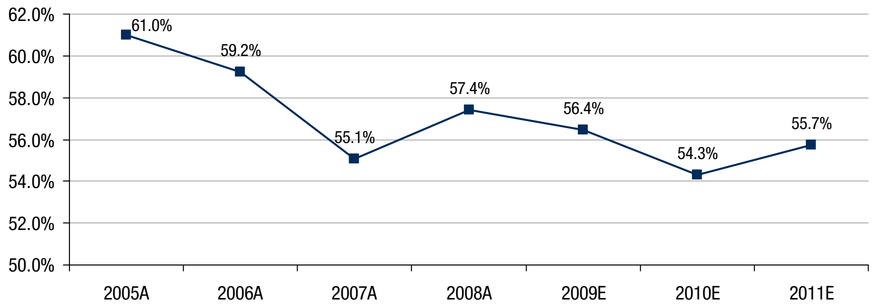
CIB's LTD ratio has been falling over the past years (from 61.0% in 2005 to 56.4% at the end of 9M 2009). CIB's LTD ratio is lower than that of most of its local peers. Although a high liquidity level is favored at times of economic slowdown, we believe CIB's liquidity is excessively high and do not expect the bank's LTD ratio to improve at least over the coming three years due to the following reasons:

1 The general slowdown in economic activity

2 The bank's limited exposure to retail lending.

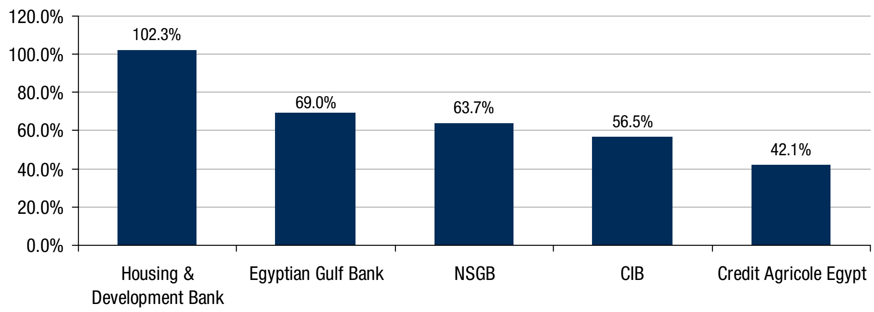
3 The deployment of excess funds in government securities and interbank assets.

Figure 13: CIB – loan to deposit ratio



Source: Company reports, Rasmala Research estimates

Figure 14: CIB vs. domestic peers – loan to deposit ratio (Sep 2009)



Source: Company reports

Competition to put pressure on market share

CIB is in a strong position to benefit from a credit environment expected to be largely driven by corporate lending at least in the short-term. However, we believe that difficult times lie ahead.

Firstly, intense competition is expected to be witnessed as soon as the effects of the financial turmoil dissipate. Foreign operators with strong balance sheet positions have been entering the local market aggressively since the beginning of banking reforms in 2004 and might represent a long-term threat to CIB's leading position in corporate lending.

Table 14: Recent foreign acquisitions of domestic banks

Acquirer	Target	Date
National Bank of Kuwait	Al Watany Bank of Egypt	Oct-07
Abu Dhabi Islamic Bank	National Development Bank	May-07
Sanpaolo IMI	Bank of Alexandria	Oct-06
Credit Agricole (Calyon)	The Egyptian American Bank	Sep-06
Bank Audi	Cairo Far East Bank	Mar-06
National Societe Generale Bank	Misr International Bank	Nov-05
Blom Bank	Misr Romanian Bank	Oct-05
Piraeus Bank	Egyptian Commercial Bank	Jun-05

Source: Ministry of Investment

Secondly, in light of our expectations of a pick up in retail lending as of 2011, we believe that CIB's lack of retail expertise and conservative credit approach would put limitations on the bank's retail expansion in the long-term. Meanwhile, foreign players with well established retail expertise and support from their parent banks would have a competitive edge over CIB in that area.

This would restrain CIB's market share gains unless it decided to aggressively expand into retail lending and compromise the quality of its loan book which we doubt that the bank would do. We expect CIB's outstanding retail credit to represent 13.1% of total loans at the end of our forecast horizon up from a current 9.1%.

At the end of September 2009, corporate lending represented 84.0% of the loan book while SMEs and retail contributed by 6.0% and 9.1%, respectively. We expect CIB's retail exposure to pick up somewhat over our forecast horizon on the back of our expectations that retail lending will be the growth engine for lending over the long-term. However, we believe that CIB's main competitive edge will continue to be corporate lending and that retail loans will represent 13.1% of total loans by 2014. CIB's market share of corporate loans stood at 7.6% while market share of retail loans stood at 3.1% at the end of Q3 2009.

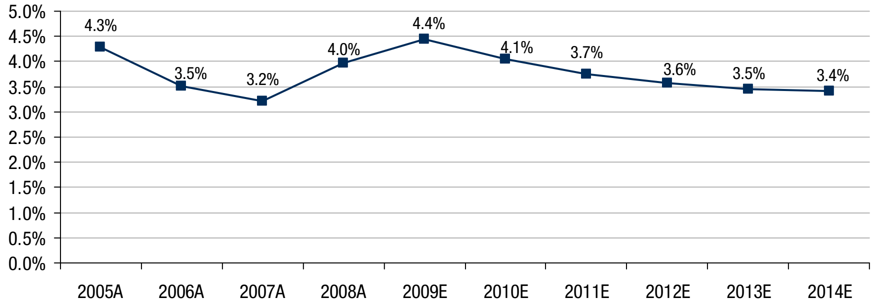
Margin compression over the long-term

We believe that there are three factors that are expected to put pressure on CIB's future margins. The first factor is a general one, intense competition expected to come into play as soon as the economy starts recovering will lead to price competition among banks thus impacting margins.

The second is specific to CIB where the focus on corporate lending versus retail credit would put further pressure on the bank's margins compared to peers expanding their retail exposure. We forecast CIB's Net Interest Margin (NIM) to reach 4.4% at the end of 2009 and to gradually decrease to reach 3.4% at the end of 2014.

Finally, given the expectation of a decline in the LTD and the deployment of a significant portion of CIB's excess funds in government securities and interbank deposits, which have lower yields compared to loans, we expect margins to suffer further pressure.

Figure 15: CIB – net interest margin



Source: Company reports, Rasmala Research estimates

Valuation

Our Economic Value Added (EVA) model arrives at a value per share for CIB of EGP 51.7 based on the sum of the net present value of the bank's future economic value added. Economic value added is determined as the bank's earnings (adjusted to assume optimal capital base) less a capital charge reflecting the opportunity cost of capital.

We utilize a 16.2% cost of equity, based on a 10.2% risk free rate, 6.0% equity risk premium and a beta of 1.0. We utilize a terminal growth rate of 5.0%, which is inline with Egypt's long-term economic growth rate. We accounted for CIB's excess provisions in our valuation.

We derived our target price using the following assumptions:

- Market share of loans is forecasted to grow from 6.7% at the end of Q3 2009 to reach 7.1% in 2010 and 7.6% at the end of 2014;
- Market share of deposits is expected to rise from 6.2% at the end of Q3 2009 to reach 6.4% in 2010 and 6.9% at the end of the forecast horizon;
- LTD stood at 56.5% at the end of Q3 2009 and we expect it to be maintained at 55.6% over the forecast period;
- NPLs are expected to stand at 3.0% over our forecast horizon;
- NIM is forecasted to reach 4.4% at the end of 2009 and gradually decrease to reach 3.4% at the end of 2014.

Table 15: CIB valuation – Economic Value Added (EVA)

	2009E	2010E	2011E	2012E	2013E	2014E
Average Risk Free Rate	10.2%	10.2%	10.2%	10.2%	10.2%	10.2%
Actual CAR	17.5%	18.8%	18.0%	17.6%	17.5%	17.4%
Risk Weighted Assets (RWA) (EGP mn)	36,096	39,131	47,245	55,851	64,927	75,203
Required Equity (EGP mn)	3,610	3,913	4,725	5,585	6,493	7,520
Forecast Equity (EGP mn)	7,035	8,233	9,517	10,983	12,649	14,567
Excess Equity (EGP mn)	3,425	4,320	4,793	5,398	6,157	7,047
Earnings on Excess Equity (EGP mn)	349.4	440.6	488.9	550.6	628.0	718.8
Forecasted Net Profit (EGP mn)	1,727	1,815	1,946	2,221	2,524	2,906
Deduct: Earnings on Excess Equity (EGP mn)	1,377	1,374	1,458	1,671	1,896	2,187
Add Back: Tax on Earnings on Excess Equity (EGP mn)	69.9	88.1	97.8	110.1	125.6	143.8
Adjusted Earnings (EGP mn)	1,447	1,463	1,555	1,781	2,022	2,331
Capital Charge (EGP mn)	562.0	609.3	699.6	835.1	978.3	1135.1
EVA (EGP mn)	885.1	853.3	855.6	945.9	1,043	1,196
NPV (EGP mn)	885.1	734.3	633.7	602.8	572.3	564.5
Discount Rate	16.2%	16.2%	16.2%	16.2%	16.2%	16.2%
Terminal Growth	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Years Out	0	1	2	3	4	5
Discount Factor	1	0.86	0.74	0.64	0.55	0.47

Last Reported Book Value (EGP mn)	5,411
EVA Flows (2009 – 2014) (EGP mn)	3,993
Terminal Value (EGP mn)	5,293
PV of Excess Provisions (EGP mn)	568.8
Total Equity Value (EGP mn)	15,265
Number of Shares (mn)	295.1
Value per Share (EGP)	51.7

Source: Rasmala Research estimates

Summary financials and forecasts

Table 16: CIB – summary income statement

EGP mn (YE 31 Dec)	2008A	2009E	2010E	2011E	2012E
Interest Income	3,765	4,038	4,317	4,894	5,589
Interest Expense	(1967)	(2023)	(2180)	(2559)	(2972)
Net Interest Income	1,799	2,015	2,137	2,335	2,617
Net Fees and Commission Income	747.7	716.8	798.6	929.9	1,061.8
Other Income	688.0	661.3	581.0	669.9	750.1
Total Fee Income	1,436	1,378	1,380	1,600	1,812
Provisions	(410.5)	(106.0)	(134.8)	(297.6)	(306.8)
Minority Interest	(5.2)	(7.6)	(9.6)	(10.3)	(11.7)
Tax	(251.0)	(331.9)	(364.4)	(389.6)	(444.0)
Attributable Profit	1,371	1,727	1,815	1,946	2,221

Source: Company reports, Rasmala Research estimates

Table 17: CIB – summary balance sheet

EGP mn (YE 31 Dec)	2008A	2009E	2010E	2011E	2012E
Assets					
Cash and Equiv.	4,473	4,662	5,790	6,855	8,100
Due from Banks	6,572	6,618	13,639	16,650	21,114
Treasury Bills & Other Government Securities	12,457	11,309	9,571	9,644	9,718
Net Loans & Overdrafts	26,330	27,455	29,530	35,990	42,527
Investment Assets	4,803	8,547	7,527	8,912	10,530
Other Assets	2,078	2,107	2,041	2,172	2,336
Fixed Assets	748.3	898.0	1,078	1,347	1,684
Total Assets	57,462	61,597	69,176	81,570	96,010
Liabilities					
Due to Banks	229.0	777.0	868.5	1,028	1,215
Deposits	48,790	51,802	57,902	68,553	81,003
Long Term Debt	109.3	125.7	144.5	166.2	191.1
Provisions	372.6	388.6	417.9	509.4	601.9
Others	2,136	1,413	1,545	1,720	1,927
Total Liabilities	51,637	54,506	60,878	71,977	84,938
Minority Interest	48.6	56.3	65.9	76.1	87.9
Total Shareholders Equity	5,776	7,035	8,233	9,517	10,983
Total Liabilities and Shareholders Equity	57,462	61,597	69,176	81,570	96,010
Contingent Liabilities	13,291	12,319	13,835	16,314	19,202

Source: Company reports, Rasmala Research estimates

Table 18: CIB – financial ratios

	2008A	2009E	2010E	2011E	2012E
PE (x)	10.3	9.1	8.7	8.1	7.2
PBV (x)	2.7	2.3	2.0	1.7	1.5
D. Yield (%)	1.8%	1.8%	2.5%	2.7%	3.0%
Net Interest Margin (%)	4.0%	4.4%	4.1%	3.7%	3.6%
Interest Income/Total Revenues (%)	72.4%	74.6%	75.8%	75.4%	75.5%
Net Fee Income/Total Revenues (%)	14.4%	13.2%	14.0%	14.3%	14.3%
Cost to Income (%)	33.6%	37.0%	34.5%	33.6%	33.9%
Loans / Total Assets (%)	45.8%	44.6%	42.7%	44.1%	44.3%
Loans / Deposits (%)	54.0%	53.0%	51.0%	52.5%	52.5%
Deposits/Assets (%)	84.9%	84.1%	83.7%	84.0%	84.4%
NPL / Gross Loans (%)	3.0%	2.9%	3.0%	3.0%	3.0%
NPL Coverage Ratio (%)	185.5%	195.2%	190.0%	180.0%	173.3%
Shareholders Equity/Total Assets (%)	10.1%	11.4%	11.9%	11.7%	11.4%
Capital Adequacy Ratio (%)	11.7%	17.5%	18.8%	18.0%	17.6%
RoAE (%)	30.3%	27.4%	24.4%	22.5%	22.2%
RoAA (%)	3.0%	3.0%	2.9%	2.7%	2.6%
Payout Ratio (%)	21.5%	17.1%	22.5%	22.5%	22.5%

Source: Company reports, Rasmala Research estimates

*Prices as of 11 January 2010

National Société Générale Bank

Initiation of Coverage

Egypt 12 January 2010

The best corporate/retail mix among private operators

NSGB has a strong corporate and retail loans mix with a market share of 6.8% and 5.2%, respectively. We believe that NSGB has the required tools to capitalize on a corporate driven credit environment in the short-term while being able to capitalize on longer term retail opportunities.

A foreign bank with strong local market knowledge

NSGB has extensive local market knowledge as a result of its 30 years of operations in Egypt. In addition, the bank's operations are backed by the renowned expertise of its French parent, Société Générale (SG).

Low but improving asset quality

NSGB succeeded in bringing down its NPL ratio from 16.1% in 2006 to 7.0% at the end of 2008. The bank's NPL ratio is still relatively high when compared to domestic and regional peers. The bank's asset quality has, however, slightly improved to 6.8% at the end of Q3 2009 despite the slowdown in economic activity witnessed since the beginning of 2009. We expect the NPL ratio to reach 6.0% in 2011 and think that positive surprises are likely with regards to 1) faster than expected asset quality improvement and 2) provision recoveries that would impact the bank's bottom line positively.

An expected jump in 2011 earnings

NSGB's earnings are depressed by an annual amortization charge of EGP 361.9 million resulting from the acquisition of MIBank. As of 2011, goodwill will be fully amortized, which will boost 2011 earnings.

Factors to watch: pressure on margins, and stock illiquidity

We expect competition to heat up as of 2011 which will drive banks to offer competitive pricing on their products and result in potential margin compression. The stock's relative illiquidity should also be taken into consideration. Compared to a local peer group of seven banks, NSGB has the third lowest free float percentage and is the fourth highest traded banking stock during the last two years.

Initiating on National Société Générale Bank with a Buy rating

We are initiating coverage on National Société Générale Bank (NSGB) with a 12M target price of EGP 33.6 per share, implying a 15.9% upside potential to the current market price.

Table 19: NSGB – key valuation metrics based on 11 January, 2010 closing price

Year End (31 December)	2008A	2009E	2010E	2011E	2012E
Net Profits (EGP mn)	1,137	1,048	1,148	1,533	1,721
PE (x)	6.4	6.9	6.4	6.3	5.6
PBV (x)	2.1	1.8	1.5	1.4	1.1
D.Yield (%)	1.8%	1.6%	1.8%	2.4%	2.7%
RoAE (%)	34.4%	27.8%	25.6%	22.8%	22.1%

Source: Reuters, Rasmala Research

Recommendation

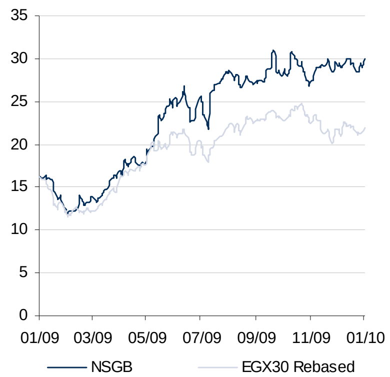
Buy

Stock Data

Price (as of 11 Jan 2010) (EGP)	29.0
Target Price (EGP)	33.6
Potential Return (%)	15.9%
Market Cap (EGP mn)	9,666
Market Cap (USD mn)	1,790
Number of Shares (mn)	333.3
Av Daily Value (USD mn) (2009)	0.4
Reuters / Bloomberg	NSGB.CA / NSGB EY
Exchange Rate (EGP / USD)	5.4

Source: Reuters, Rasmala Research

Performance graph



Source: Reuters, Rasmala Research

12M High / Low (EGP)	31.0 / 11.8

	1M	3M	12M
NSGB	0.0%	3.2%	77.9%
EGX Index	4.3%	-4.5%	39.6%

Source: Reuters, Rasmala Research

Major Shareholders

	(%)
Société Générale (France)	77.2
Free Float	22.8

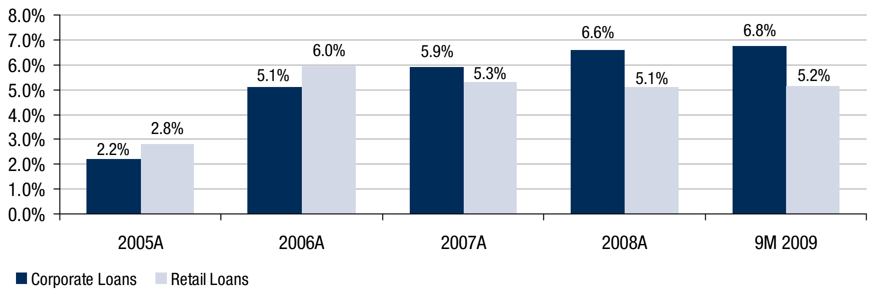
Source: Rasmala Research

Investment Case – NSGB

Strong corporate and retail mix

NSGB is the second largest private lender in Egypt with a market share of 6.4% and 5.2% in terms of loans and deposits, respectively. Unlike CIB, which has a predominantly corporate loan book, NSGB provides exposure to both the corporate and retail segments of the economy. Retail loans represented 15.8% of NSGB's loan portfolio at the end of Q3 2009 with the balance being directed towards corporate credit. Growth in retail loans has outperformed that of corporate loans for NSGB in 2008 and in 9M 2009. We forecast growth in retail loans to continue outperforming that of corporate loans over the next five years and see retail loans constituting 22.0% of the bank's total outstanding loans by 2014.

Figure 16: NSGB – market share of loans



Source: Company reports

NSGB has been more aggressive than CIB in growing its retail loan book over the past two years with its share of the retail credit market in Egypt currently at 5.2% versus 3.1% for CIB. We attribute this to the following:

- The acquisition of MIBank in 2005. MIBank was well known for its strong retail client base. Prior to the acquisition of MIBank, NSGB's retail loans represented 3.2% of total loans compared to 5.2% as of September 30, 2009.
- The strong retail expertise of Société Générale (SG), the bank's major shareholder. Société Générale is one of the leading banks in France with a renowned retail expertise.
- Management being more aggressive by operating at a higher utilization ratio compared to Egyptian peers. (LTD of 63.7% in Sep 2009 compared to the sector average of 52.3%)

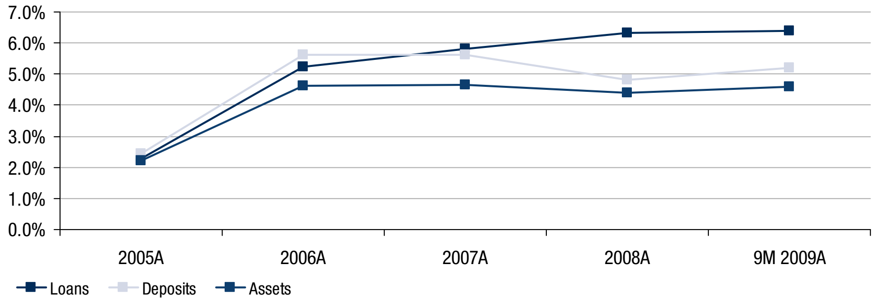
Credit growth, including retail, was muted in Egypt in 9M 2009. We do not expect a return to double digit growth figures for retail lending before 2010. Corporate lending has been the main driver for credit growth in 9M 2009 and we expect this to continue in Q4 2009 and 2010. With a better balanced retail/corporate mix than CIB, NSGB is in our view in a stronger position to benefit from the expected higher demand for corporate loans in 2010 and the expected pickup in retail business starting 2011.

A foreign bank with strong local market knowledge

As a foreign bank, NSGB is at an advantage over other foreign players in Egypt as the bank has been present in the local market for over 30 years. Its local knowledge has been further strengthened with the acquisition of a strong local player, MIBank, back in 2005, while foreign players that have been entering the market recently still lack local market knowledge. Furthermore, the new entrants to the market will be hampered by the complicated and lengthy consolidation and integration process, which will slow down the rate at which they are penetrating the market.

Having Société Générale as a major shareholder is a key advantage for NSGB as the French parent provides operational and financial support to its Egyptian subsidiary. As a case in point, SG has provided NSGB with a USD 140.0 million subordinated loan maturing in 2014 priced at 90 bps over 12m LIBOR. With LIBOR at 1.0%, this is an attractive facility for NSGB. Operational support is also very important, particularly in the retail business, an area in which local banks do not have a strong track record.

Figure 17: NSGB – market share evolution



Source: Company reports

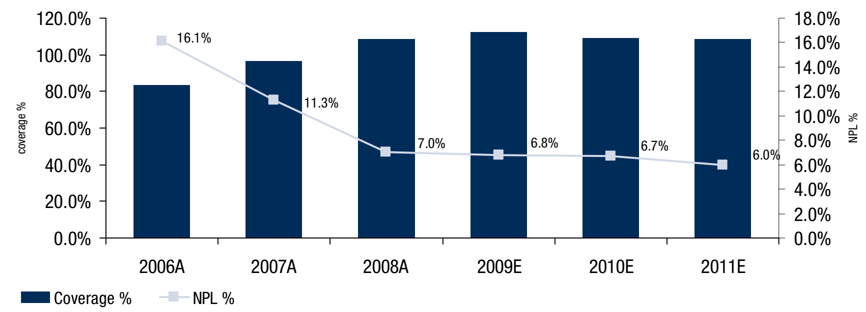
A low but improving asset quality

Following the acquisition of MIBank, NSGB inherited a substantial portfolio of bad loans. The bank succeeded in bringing down its NPL ratio from 16.1% in 2006 to 6.8% at the end of Q3 2009.

NSGB's asset quality is low when compared to CIB and regional peers. The bank's asset quality has, however, slightly improved in 9M 2009 to reach 6.8% down from 7.0% in 2008 despite the slowdown in economic activity that took place during 2009. We forecast NSGB's NPL ratio to decline to 6.7% in 2010 and 6.0% in 2011.

It is important to point out that NSGB reversed provisions of around EGP 300.0 million in 2008 which had a positive impact on earnings. It is difficult to account for reversal of provisions going forward, but we may well see further contributions to the bottom line as we forecast further improvements to asset quality.

Figure 18: NSGB – NPL & coverage ratios



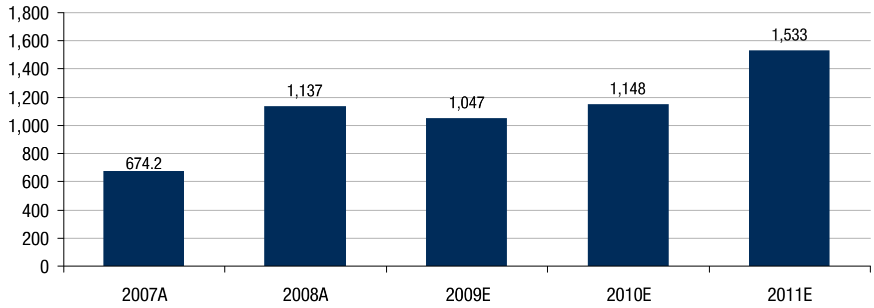
Source: Company reports, Rasmala Research estimates

In terms of coverage, the bank is adequately provisioned with a coverage ratio of 108.0%, which we expect will hover around 110.0% going forward.

Earnings jump expected in 2011

Since 2007, NSGB's bottom line has been depressed by an annual amortization charge of EGP 361.9 million, relating to the bank's acquisition of MIBank. The goodwill will be fully amortized by 2010 and no amortization expense will take place in 2011, which will boost earnings.

Figure 19: NSGB – net profit (EGP mn)



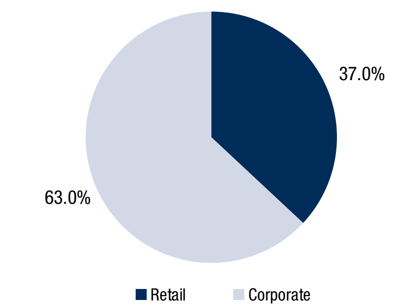
Source: Company reports, Rasmala Research estimates

Factors to watch

Potential competition to compress future margins

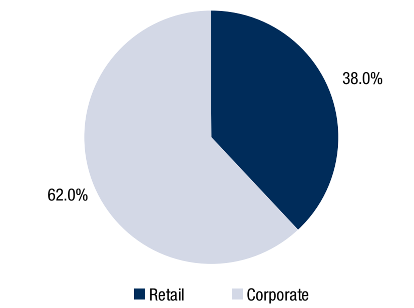
NSGB's margins improved in 9M 2009 compared to the previous year. The margin enhancement was due to better asset allocation and higher retail funding. Historically, the bank's excess liquidity has always been directed mainly towards interbank assets, but during 9M 2009, NSGB has shifted its asset allocation away from interbank assets and into higher yielding government securities. In addition, the bank grew its retail deposit base in 9M 2009 by 20.0% to represent 38.0% of total deposits, up from 37.0% at the end of 2008. The relatively higher contribution of cheaper retail deposits to the bank's funding base as compared to corporate deposits, also contributed somewhat to margin enhancement during the period. We expect the bank's NIM to increase from 3.7% in 2008 to 4.0% during 2009.

Figure 20: NSGB – Dec 2008 deposits composition



Source: Company reports

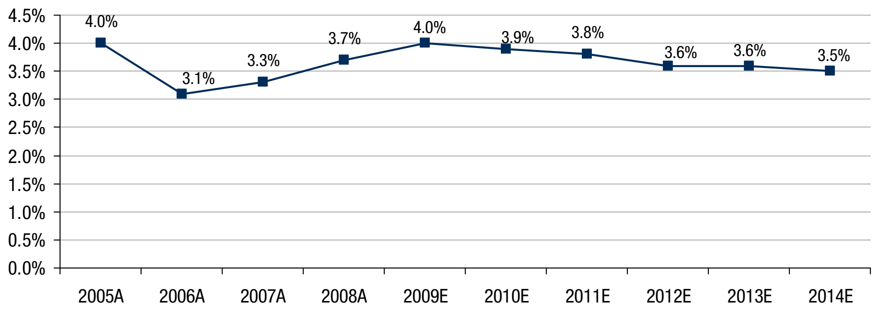
Figure 21: NSGB – Sep 2009 deposits composition



Source: Company reports

Competition in the Egyptian banking sector is expected to heat up once the dust settles and the economy starts to improve. This will drive banks to offer competitive pricing on their products which will put pressure on margins. We forecast NSGB's NIM to gradually drop to reach 3.5% in 2014.

Figure 22: NSGB – net interest margin



Source: Company reports, Rasmala Research estimates

Stock illiquidity

Another factor to consider is the stock's relative illiquidity in the market. Compared to a local peer group of seven banks, NSGB has the third lowest free float percentage on the market at 22.8%. In terms of value traded, NSGB is the fourth largest traded bank with an average daily turnover of EGP 3.8 million during the period from January 2008 to November 2009.

Table 20: NSGB – stock liquidity

	Ticker	Average Daily Turnover (Jan 08 - Nov 09) (EGP mn)	Free Float %
CIB	COMI.CA	38.4	76.1%
NDB	DEVE.CA	5.3	51.8%
HDBK	HDBK.CA	3.9	11.0%
NSGB	NSGB.CA	3.8	22.8%
CAE	CIEB.CA	2.7	21.0%
EXDB	EXPA.CA	1.2	46.5%
EGB	EGBE.CA	1.0	46.4%

Source: Reuters, Company reports, Rasmala Research

Valuation

Our Economic Value Added (EVA) model arrives at a value per share for NSGB of EGP 33.6 based on the sum of the net present value of the bank's future economic value added. Economic value added is determined as the bank's earnings (adjusted to assume optimal capital base) less a capital charge reflecting the opportunity cost of capital.

We utilize a 16.2% cost of equity, based on a 10.2% risk free rate, 6.0% equity risk premium and a beta of 1.0. We utilize a terminal growth rate of 5.0% which is inline with Egypt's long-term economic growth rate.

We derived our target price using the following assumptions:

- Market share of loans is forecasted to grow from 6.4% at the end of Q3 2009 to reach 6.7% in 2010 and 7.2% at the end of 2014;
- Market share of deposits is expected to rise from 5.3% at the end of Q3 2009 to reach 5.4% in 2010 and 5.5% at the end of the forecast horizon;
- LTD stood at 63.7% at the end of Q3 2009 and we expect it to decline in 2010 on the back the expected slowdown in credit demand. The ratio is forecasted to improve to reach 68.6% in 2014 triggered by retail lending growth;
- NPLs are expected to drop from 6.8% at the end of Q3 2009 to 5.0% over our forecast horizon;
- NIM is forecasted to reach 4.0% at the end of 2009 and gradually decrease to reach 3.5% at the end of 2014.

Table 21: NSGB valuation – Economic Value Added (EVA)

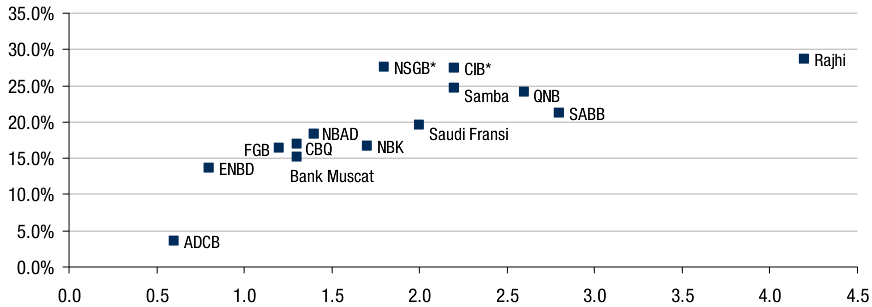
	2009E	2010E	2011E	2012E	2013E	2014E
Average Risk Free Rate	10.2%	10.2%	10.2%	10.2%	10.2%	10.2%
Actual CAR	15.9%	17.1%	16.50%	16.6%	16.7%	16.7%
Risk Weighted Assets (RWA) (EGP mn)	32,826	34,488	42,036	48,668	56,646	66,139
Required Equity (EGP mn)	3,283	3,449	4,204	4,867	5,665	6,614
Forecast Equity (EGP mn)	5,105	5,972	7,130	8,430	9,951	11,743
Excess Equity (EGP mn)	1,822	2,523	2,927	3,563	4,287	5,129
Earnings on Excess Equity (EGP mn)	186	257	299	364	437	523
Forecasted Net Profit (EGP mn)	1,048	1,148	1,533	1,721	2,014	2,371
Deduct: Earnings on Excess Equity (EGP mn)	861.7	890.8	1,235	1,337	1,577	1,953
Add Back: Tax on Earnings on Excess Equity (EGP mn)	37.2	51.5	59.7	72.7	87.5	104.6
Adjusted Earnings (EGP mn)	898.9	942.2	1,294	1,430	1,664	1,848
Capital Charge (EGP mn)	523.6	545.2	619.8	734.7	853.0	994.6
EVA (EGP mn)	375.2	397.0	674.5	695.4	811.0	958.1
NPV (EGP mn)	375.2	341.6	499.5	443.2	444.8	452.2
Discount Rate	16.2%	16.2%	16.2%	16.2%	16.2%	16.2%
Terminal Growth	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Years Out	0	1	2	3	4	5
Discount Factor	1	0.86	0.74	0.64	0.55	0.47
Last Reported Book Value (EGP mn)	4,413					
EVA Flows (2009 - 2014) (EGP mn)	2,557					
Terminal Value (EGP mn)	4,240					
Total Equity Value (EGP mn)	11,209					
Number of Shares (mn)	333.3					
Value per Share (EGP)	33.6					

Source: Rasmala Research estimates

Trading at a relative discount given high ROE

NSGB is trading at a price to book multiple of 1.8x 2009E, which is at a discount to CIB's 2.3x. Relative to regional peers, NSGB is trading at the average price to book multiple. We believe that NSGB should be trading at a higher multiple compared to its regional counterparties given its higher ROE which is expected to stand at 27.5% at the end of 2009. It should be noted that earnings and book values for NSGB and CIB are adjusted for goodwill amortization and impairment charges.

Figure 23: NSGB & CIB vs. GCC banks – PBV vs. ROE



Source: Reuters, Rasmala Research
*CIB & NSGB ROE adjusted for goodwill amortization
**Prices as of 18 November 2009

Summary financials and forecasts

Table 22: NSGB – summary income statement

EGP mn (YE 31 Dec)	2008A	2009E	2010E	2011E	2012E
Interest Income	3,200	3,321	3,685	4,201	4,731
Interest Expense	(1,772)	(1,670)	(1,837)	(2,093)	(2,422)
Net Interest Income	1,428	1,651	1,849	2,108	2,309
Net Fees and Commission Income	545.3	548.0	589.7	672.2	757.0
Other Income	623.2	283.5	248.5	259.7	291.9
Total Fee Income	1,168.5	831.5	838.1	931.9	1,048.9
Provisions	(213.4)	(54.5)	(71.7)	(210.2)	(210.7)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Tax	(160.2)	(214.4)	(251.4)	(338.8)	(374.6)
Attributable Profit	1,137	1,048	1,148	1,533	1,721

Source: Company reports, Rasmala Research estimates

Table 23: NSGB – summary balance sheet

EGP mn (YE 31 Dec)	2008A	2009E	2010E	2011E	2012E
Assets					
Cash and Equiv.	3,103	3,524	3,884	4,556	5,203
Due from Banks	9,027	7,335	7,447	9,250	11,877
Treasury Bills & Other Government Securities	2,976	8,839	12,730	12,827	12,925
Net Loans & Overdrafts	25,011	25,547	27,627	34,169	39,673
Investment Assets	3,801.3	5,726.0	4,855.3	5,694.9	6,503.7
Other Assets	1,399	1,313	1,060	1,249	1,442
Fixed Assets	729.5	766.0	804.3	844.5	886.7
Total Assets	46,048	53,050	58,408	68,590	78,510
Liabilities					
Due to Banks	1,460	766.4	828.8	1,025	1,190
Deposits	36,889	44,046	48,553	56,949	65,037
Long Term Debt	821.5	815.5	810.3	805.7	771.9
Provisions	689.3	704.0	761.4	941.6	1,093
Others	1,875	1,612	1,482	1,738	1,987
Total Liabilities	41,735	47,945	52,436	61,459	70,080
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total Shareholders Equity	4,313	5,105	5,972	7,130	8,430
Total Liabilities and Shareholders Equity	46,048	53,050	58,408	68,590	78,510
Contingent Liabilities	12,649	12,467	14,602	17,147	19,627

Source: Company reports, Rasmala Research estimates

Table 24: NSGB – financial ratios

	2008A	2009E	2010E	2011E	2012E
PE (x)	6.4	6.9	6.4	6.3	5.6
PBV (x)	2.1	1.8	1.5	1.4	1.1
D. Yield (%)	1.8%	1.6%	1.8%	2.4%	2.7%
Net Interest Margin (%)	3.9%	4.0%	3.9%	3.7%	3.6%
Interest Income/Total Revenues (%)	73.3%	80.0%	81.5%	81.8%	81.9%
Net Fee Income/Total Revenues (%)	12.5%	13.2%	13.0%	13.1%	13.1%
Cost to Income (%)	29.6%	33.4%	32.8%	32.5%	32.3%
Loans / Total Assets (%)	54.3%	48.2%	47.3%	49.8%	50.5%
Loans / Deposits (%)	67.8%	58.0%	56.9%	60.0%	61.0%
Deposits/Assets (%)	80.1%	83.0%	83.1%	83.0%	82.8%
NPL / Gross Loans (%)	7.0%	6.8%	6.7%	6.0%	5.5%
NPL Coverage Ratio (%)	108.8%	112.1%	109.0%	108.3%	110.9%
Shareholders Equity/Total Assets (%)	9.4%	9.6%	10.2%	10.4%	10.7%
Capital Adequacy Ratio (%)	14.1%	15.9%	17.1%	16.5%	16.6%
RoAE (%)	34.4%	27.8%	25.6%	22.8%	22.1%
RoAA (%)	3.2%	2.8%	2.7%	2.4%	2.3%
Payout Ratio (%)	15.0%	15.0%	15.0%	15.0%	15.0%

Source: Company reports, Rasmala Research estimates

*Prices as of 11 January 2010

Research Contact

research@rasmala.com
+971 4 365 3100

MENA Sales Contact

menasales@rasmala.com
+971 4 424 2770

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