

19 August 2011

First Gulf Bank

Buy (from Hold)

Target price
Dh19.14 (from Dh19.99)

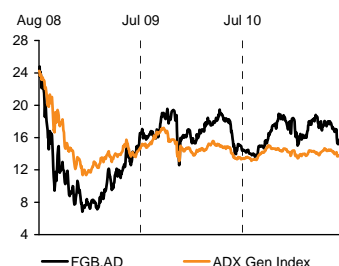
Price
Dh15.35

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	17.80	18.60	13.90
Absolute (%)	-13.8	-17.5	10.4
Rel market (%)	-9.1	-15.4	6.6
Rel sector (%)	-9.8	-16.0	-4.0



Market capitalisation
Dh23.02bn (€4.35bn)

Average (12M) daily turnover
Dh11.66m (US\$3.19m)

Sector: ADX Bank & Fin Index
RIC: FGB.AD, FGB.UH
Priced Dh15.35 at close 17 Aug 2011.
Source: Bloomberg

Analyst

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A derating too far

FGB's share price has dropped 18% since its 12 May peak (vs 3% for the ADX), while its underlying situation is little changed. Yes, retail regulations dragged fees & commissions down 28% qoq in 2Q11, but this had been well-flagged. In spite of more conservative assumptions we upgrade FGB to Buy.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Reported PTP (Dhm)	3,331	3,496	3,597	4,709	5,534
Reported net profit (Dhm)	3,310	3,420	3,645	4,758	5,590
Reported EPS (Dh)	2.01	1.99	2.18	2.98	3.53
Normalised EPS (Dh)	2.06	1.99	2.18	2.98	3.53
Dividend per share (Dh)	0.49	0.60	0.73 ▲	0.82 ▲	1.05 ▼
Normalised PE (x)	7.45	7.72	7.04	5.15	4.35
Price/book value (x)	1.36	1.26	1.07	0.93	0.81
Dividend yield (%)	3.21	3.91	4.75	5.37	6.85
Return on avg equity (%)	20.20	18.50	17.90	20.60	21.00

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
Accounting standard: IFRS
Source: Company data, Rasmala forecasts

year to Dec, fully diluted

We upgrade FGB to Buy from Hold

We believe FGB remains the quality play in the UAE banking sector and deserves to trade at a premium. We take a more conservative approach here, including lowering our long-term ROE estimate from 23% to 21%, dropping our TP from Dh19.99 to Dh19.14, but still implying 25% upside potential. This makes FGB our top pick in our UAE banking universe.

2Q11 results prompt slight negative revisions to our EPS forecasts

We lower our 2011-13 EPS forecasts 4%, 3% and 3%, respectively, following 2Q11 results. FGB's net profit did fall 13% short of our expectations, but this was due to early booking of provisions, with an improvement in the NPL ratio from 3.65% to 3.53%, and an increase in the coverage ratio. Fee & commission income declined 28% qoq on the back of adverse retail regulations, and we expect further declines in 3Q11. This, however, was no worse than we expected and we have not revised our 2011 fee & commission income numbers.

We trim our medium-term revenue forecasts by 3%

We have taken a more conservative stance on fees & commissions for 2012-13, lowering our forecasts by 10% and 11%, respectively. Together with greater prudence on non-interest income generally, this amounts to a 14% non-interest income downgrade and a 3% downgrade in revenue forecasts in both years. Although this flows through to earnings as a 3% downgrade, the most important impact from a valuation point is the associated reduction in our long-term ROE estimate from 23% to 21%, resulting in a reduction in our target price.

Our outlook for FGB is largely unchanged; we believe the derating is unjustified

FGB has declined 14% qtd, underperforming the worst performers in our UAE banking universe by 10%. We believe the stock deserves to trade at a premium to peers. Both interest and non-interest margins remain above the sector average, while the cost-to-income ratio is far below the sector average thanks to FGB's under-reliance on branches. With this in mind, the sector average 2011F PTB of 1.07x does not seem appropriate, and we rate the stock a Buy. FGB is our preferred UAE banking sector investment.

Important disclosures can be found in the Disclosures Appendix.

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Core valuation story still intact

FGB has been the most exposed among our coverage to the adverse retail banking regulations, which hit core earnings momentum. Nevertheless, we recognise this as a modest step change in core earnings and the related derating now seems excessive.

We upgrade FGB to Buy from Hold

We believe FGB remains a quality play in the UAE and deserves to trade at a premium to peers. We have, however, taken a more conservative approach in this review. We have, however, taken a more conservative approach in this review, lowering its long-term ROE from 23% to 21% given its exposure to retail regulation, which is still a premium to the sector average. Hence, we lower our target price from 19.99 to Dh19.14. This still implies 25% upside potential, making the stock our top pick within the UAE banking sector.

2Q11 results prompt slight revisions to our EPS forecasts

We lower our 2011-13 EPS forecasts by 4%, 3% and 3%, respectively, following the 2Q11 results. FGB's net profits did fall 13% short of our expectations, but we believe this was due to the early booking of provisions, given the improvement in the NPL ratio from 3.65% to 3.53%, and the increase in the coverage ratio. The other main issue in the 2Q11 results was the deterioration in fee & commission income, which declined 28% qoq on the back of retail regulations and we expect further declines in 3Q11. This, however, was not as bad as we expected, and we have not had to revise our 2011 fee & commission forecast significantly.

We trim our medium-term revenue forecasts by 3%

Nevertheless, now we have more visibility on fees and commissions and given our more positive recommendation, we have taken a more conservative stance on fees & commissions for 2012-13. We lower our forecasts by 10% for 2012 and 11% for 2013. Together with greater prudence for non-interest income generally, this amounts to a 14% downgrade for non-interest income and a 3% downgrade in our revenue forecasts for each year. Although this flows through to earnings as a 3% downgrade, the most important impact from a valuation point of view is to lower our long-term ROE from 23% to 21%, resulting in the hit to our target price.

Our outlook for FGB is largely unchanged; we believe the derating is unjustified

FGB has declined 14% qtd, underperforming the worst performers in our UAE banking universe by 10%. We remain convinced that the stock deserves to trade at a premium to peers. Both interest and non-interest margins remain above the sector average, while the cost-income ratio is far below the sector average, thanks to FGB's under-reliance on branches. While revenues have taken a hit due to regulatory measures, the scale of this impact is not sufficient to alter our core assumption that FGB will continue to benefit from an above-average ROE. We do, however, decrease our long-term return assumption from 23% to 21%. Property exposure in a difficult market remains a concern, but we forecast this will contribute just 3% of revenues in 2013.

Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Net interest income	3834	4257	4852	5150	5817
Non-interest income	2295	2086	1564	1551	1856
Total income	6129	6343	6417	6701	7673
Operating costs	-1147	-1170	-1262	-1290	-1631
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
Other costs	0.00	-0.00	0.00	-0.00	0.00
<u>Pre-prov operating profit</u>	4982	5173	5154	5411	6042
Provisions charges	-1680	-1639	-1583	-741.0	-550.5
<u>Post-prov op prof</u>	3301	3534	3571	4670	5492
Associates (pre-tax)	29.0	-37.8	25.8	39.8	42.6
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	3331	3496	3597	4709	5534
Taxation	0.00	0.00	0.00	0.00	0.00
Minority interests	-2.63	-123.9	-2.47	-2.47	-2.47
Preference dividends	-120.0	-240.0	-240.0	-240.0	-240.0
Other post-tax items	102.4	288.0	290.4	290.7	298.1
Reported net profit	3310	3420	3645	4758	5590
Tot normalised items	-83.6	0.00	0.00	0.00	0.00
Normalised PTP	3331	3496	3597	4709	5534
Normalised net profit	3394	3420	3645	4758	5590

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Net loans to customers	90386	95628	101808	112140	125737
Other int earn assets	18199	25079	29544	33057	38899
Goodwill	0.00	0.00	0.00	0.00	0.00
Oth non-int earn assets	5340	4475	5681	6510	5697
Total assets	125473	140758	152439	167213	186272
Total customer deposits	86422	98742	103845	114383	128252
Oth int-bearing liabs	11761	13251	17500	17921	18476
Non int-bearing liab	5064	5034	5441	6026	6947
Total liabilities	103247	117027	126786	138330	153674
Share capital	17841	19226	21534	24764	28478
Reserves	0.00	0.00	0.00	0.00	0.00
Total equity (excl min)	21841	23226	25534	28764	32478
Minority interests	384.9	504.8	119.7	119.7	119.7
Total liab & sh equity	125473	140758	152439	167213	186272
Risk weighted assets	123911	127351	135582	149341	167448
Est non-perf loans	n/a	n/a	n/a	n/a	n/a
Specific provisions	-2530	-3295	-4054	-4187	-4109
General provisions	n/a	n/a	n/a	n/a	n/a

Source: Company data, Rasmala forecasts

year ended Dec

Capital

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Risk weighted assets	123911	127351	135582	149341	167448
Reported net profit	3310	3420	3645	4758	5590
Opening risk assets	110350	123911	127351	135582	149341
Closing risk assets	123911	127351	135582	149341	167448
Change in risk assets	13561	3441	8231	13759	18107
Capital required	1356	344.1	823.1	1376	1811
Free capital flow	2074	3316	3062	3622	4019
Ordinary dividend paid	-677.0	-900.0	-1094	-1237	-1577
Share buy back/spec div	0.00	0.00	0.00	0.00	0.00
Equity / preference issue	-154.0	-857.5	0.00	0.00	0.00
Cash flow from financing	-831.0	-1757	-1094	-1237	-1577
Net capital flow	1243	1559	1968	2385	2442
Tier 1 capital	22930	24532	26550	29914	33784
Tier 1 capital ratio (%)	18.5	19.3	19.6	20.0	20.2

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	First Gulf Bank					Abu Dhabi Comm Bank			Ntl Bank of Abu Dhabi		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Non-int inc/gr op inc (%)	37.4	32.9	24.4	23.1	24.2	27.8	28.7	29.2	26.4	27.7	27.4
Cost/income (%)	18.7	18.4	19.7	19.3	21.3	35.8	35.1	34.1	30.9	32.0	32.8
Costs/average assets (%)	0.98	0.88	0.86	0.81	0.92	1.08	1.08	1.05	1.10	1.15	1.20
Net income growth (%)	10.5	7.68	2.88	30.9	17.5	421.1	28.1	30.0	2.31	24.6	22.0
Net cust loan growth (%)	13.9	5.80	6.46	10.1	12.1	6.51	7.63	9.17	9.20	15.0	15.2
Cust deposit growth (%)	16.8	14.3	5.17	10.1	12.1	9.65	10.1	9.17	9.22	15.0	15.2
Net interest margin (%)	3.76	3.62	3.74	3.62	3.66	2.49	2.51	2.50	2.91	2.84	2.86
Return on avg assets (%)	3.02	2.84	2.65	3.13	3.30	1.39	1.62	1.91	1.86	2.10	2.23
Return on avg equity (%)	20.2	18.5	17.9	20.6	21.0	14.1	16.5	19.8	18.2	19.7	21.4
RORWA (%)	2.90	2.72	2.77	3.34	3.53	1.63	1.93	2.32	2.37	2.64	2.79
				year to Dec			year to Dec			year to Dec	
Valuation											
Normalised EPS growth (%)	3.29	-3.52	9.71	36.5	18.5	991.7	31.7	32.9	0.23	26.3	23.2
Reported PE (x)	7.65	7.72	7.04	5.15	4.35	8.05	6.11	4.60	9.25	7.32	5.95
Normalised PE (x)	7.45	7.72	7.04	5.15	4.35	8.05	6.11	4.60	9.25	7.32	5.95
Price/book value (x)	1.36	1.26	1.07	0.93	0.81	0.97	0.89	0.81	1.47	1.28	1.16
Price/adjusted BVPS (x)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Dividend yield (%)	3.21	3.91	4.75	5.37	6.85	4.03	8.07	10.6	1.95	3.46	9.00
				year to Dec			year to Dec			year to Dec	
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	1556	1575	1538	1500	1500	Tier 1 capital ratio (%)	18.5	19.3	19.6	20.0	20.2
Pre-prov prof/share (AED)	3.20	3.28	3.35	3.61	4.03	Total CAR (%)	22.3	23.0	23.4	23.9	24.1
Reported EPS (AED)	2.01	1.99	2.18	2.98	3.53	Equity/assets (%)	17.4	16.5	16.7	17.2	17.4
Normalised EPS (AED)	2.06	1.99	2.18	2.98	3.53	Net cust loans/dep (%)	104.6	96.8	98.0	98.0	98.0
Book value per sh (AED)	11.3	12.2	14.4	16.5	19.0	Rep NPL/gr cus adv (%)	0.00	0.00	0.00	0.00	0.00
Dividend per share (AED)	0.49	0.60	0.73	0.82	1.05	Tot prov/rep NPLs (%)	0.00	0.00	0.00	0.00	0.00
Dividend cover (x)	5.01	3.80	3.33	3.85	3.54	Bad debts/advances (%)	1.81	1.66	1.50	0.64	0.42
				year to Dec						year to Dec	

Priced as follows: FGB.AD - Dh15.35; ADCB.AD - Dh2.89; NBAD.AD - Dh11.35
Source: Company data, Rasmala forecasts

Valuation methodology

Stage 1 (2010-2013)		2010	2011	2012	2013
Explicit Dividends	Forecast CF to shareholders	1,288	1,094	1,237	1,577
	NPV Stage 1	4,247	3,383	2,617	1,577
Stage 2 (2014-23)		Model Numbers			
Modelled Dividends	Excess Capital	ROE1	Growth	Capital Req'd	RWA
	Modelled Dividends	21%	15%	15,070	167,448
	NPV Stage 2				
	16,482				
Stage 3 (2024+)		Model Numbers			
Terminal Value	2023	ROE1	Growth	Capital Req'd	
		12%	6%	60,968	
	NPV Stage 3				
	8,844				
Total NPV		COE			
Stage 1 (2010-2013)	3,383	US RFR			3.31%
Stage 2 (2014-23)	16,482	Country Risk Spread			5.00%
Stage 3 (2024+)	8,844	Sector Risk Spread			3.00%
NPV	28,708	Stock Spread			3.00%
		Discount Rate			14.31%
Shares	1,500				
Price Target	19.14				
Price	15.35				
Upside/(Downside)	25%				

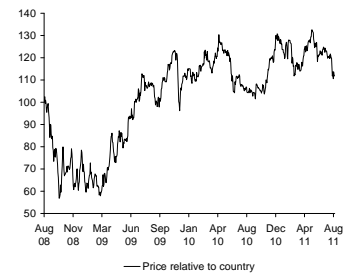
Source: Company data, Rasmala forecasts

Company description

Buy

Price relative to country

First Gulf Bank, headquartered in Abu Dhabi, was established in 1979 and provides financial services in various businesses through a network of 19 branches across the Emirates. FGB remains one of the best-performing local banks, as its operating income and net profit delivered CAGRs of 78% and 70%, respectively, during 2002-09. As of March 2010, the bank's market share in loans and deposits amounted to 9.1% and 8.8%, respectively, representing increases of 72bp and 114 bp over a year. FGB is 66.9% owned by the members of the Abu Dhabi Ruling Family, and has a freefloat of 26.4%.



Strategic analysis

Average SWOT company score:

2

Loan split, 2010

Strengths

Highest NIMs with the lowest cost-income ratio provide it with comparatively high ROEs. A low LD ratio also provides FGB the capability to win market share in the UAE.

3

Weaknesses

High exposure to retail loans and significant property exposure (worth 62% of common equity) remain the top weaknesses of FGB.

1

Opportunities

The primary opportunities for FGB are increasing its international branch network (and thus achieving geographical diversification) and its capability to increase leverage to fuel growth.

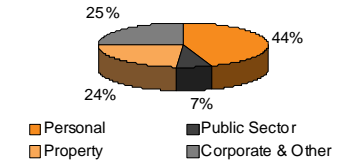
2

Threats

Significant decline in oil prices (thus limiting country growth rates) or geo-political instability remain top threats for UAE banks.

2

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters

First Gulf Bank Building, Al Khalidiya Street, P.O. Box 6316, Abu Dhabi, United Arab Emirates

Website

www.fgb.ae

Shares in issue

1500.0m

Freefloat

26%

Majority shareholders

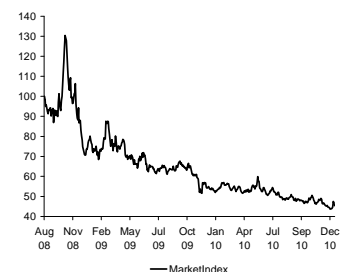
Abu Dhabi Ruling Family Members (61%)

Country view: United Arab Emirates

Country rel to M East & Africa

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation or RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score:

4+

Broker recommendations

Supplier power

The lack of significant regulator control allows the banks to change contract arrangements (such as the base rate). This substantially increases the supplier power for all banks in the UAE.

3+

Barriers to entry

Strong local government ownership in most banks coupled with branch limits for foreign banks keeps barriers to entry high for this sector.

4+

Customer power

Customer power is extremely low in the UAE, as any change in bank policies has to be accepted by clients. Points of contact at institutions remain limited, thus raising customer redressal issues.

5+

Substitute products

We believe the availability of substitute products (capital markets and syndicate loans) has diminished in recent times, thus improving margin capabilities for banks in the core interest business.

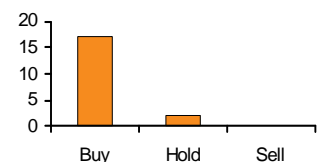
4+

Rivalry

Competition (and price war) among local banks is low. However, recent low growth has forced a few newer institutions to lower product prices, indicating a trend towards more competition long term.

4+

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

First Gulf Bank (RIC: FGB.AD, Rec: Buy, CP: Dh15.35, TP: Dh19.14): We base our valuation on a 3-stage DDM: a 3-year stage of explicit forecasts, a 10-year stage of trend forecasts and a terminal stage based on a GGM. The primary downside risk to our GGM-derived valuation and target price is regulatory risk, property market deterioration and increasing competition. On the positive side, a return to private sector corporate growth should benefit FGB, while stabilisation of the Maghreb may also provide a longer-term opportunity.

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