

14 July 2011

# First Gulf Bank

## Hold

Target price

Dh19.99

Price

Dh17.75

Short term (0-60 days)

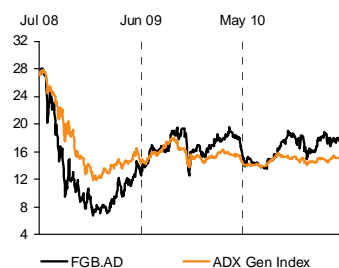
n/a

Market view

No Weighting

### Price performance

	(1M)	(3M)	(12M)
Price (Dh)	17.45	17.50	14.40
Absolute (%)	1.7	1.4	23.3
Rel market (%)	1.5	-0.6	14.3
Rel sector (%)	1.6	-3.5	2.4



### Market capitalisation

Dh26.63bn (€5.17bn)

### Average (12M) daily turnover

Dh11.31m (US\$3.10m)

Sector: ADX Bank & Fin Index  
 RIC: FGB.AD, FGB.UH  
 Priced Dh17.75 at close 13 Jul 2011.  
 Source: Bloomberg

## Well flagged

**FGB's 2Q11 results were short of expectations, but in the areas that matter the variances were evenly distributed. In spite of a shortfall in headline numbers, we believe there are insufficient grounds for a substantial revision.**

### Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Reported PTP (Dhm)	3,331	3,496	3,735	4,863	5,732
Reported net profit (Dhm)	3,310	3,420	3,776	4,905	5,782
Reported EPS (Dh)	2.01	1.99	2.27	3.08	3.65
Normalised EPS (Dh)	2.06	1.99	2.27	3.08	3.65
Dividend per share (Dh)	0.49	0.60	0.38	0.42	2.78
Normalised PE (x)	8.61	8.92	7.83	5.77	4.86
Price/book value (x)	1.57	1.45	1.20	1.02	0.97
Dividend yield (%)	2.77	3.38	2.13	2.38	15.70
Return on avg equity (%)	20.20	18.50	18.30	20.40	21.60

Accounting standard: IFRS

Source: Company data, Rasmala forecasts

year to Dec, fully diluted

### Bottom-line miss driven by provisioning

FGB reported headline net income of Dh890m for 2Q11, up 13% yoy, 2% qoq, but 13% short of our expectations. The shortfall was mainly due to a higher level of provisioning, which exceeded our forecasts by 45%. However, this was associated with a reduction in the NPL ratio from 3.65% to 3.53% and an increase in the coverage ratio to 102%, suggesting no deterioration in asset quality.

### Low cost of funding offset by weak market returns

Loan growth disappointed at 5% yoy and 2% qoq, falling 1% below expectations. Interbank funding was used to build up cash balances, but in spite of higher liquidity, spreads continued to rise due to cheaper funding costs, resulting in net interest income rising 6% qoq and beating our forecasts by 3%. Meanwhile fee income was down 28% qoq due to regulations, although this was still better than we had forecast, perhaps due to the timing of implementation. The offsetting areas of revenue shortfall came from derivative losses and continued weak investment income.

### Higher costs a cause of uncertainty

Although revenues were almost as forecast (0% variance), operating expenses increased 10% qoq, exceeding our forecasts by 5%. We believe this is partially due to readjustment cost for the retail regulations and some cost investment, although we have not had this confirmed by management. Provisioning was also sharply higher, echoing FGB's earlier caution, but without this being backed by other indicators of asset quality, it isn't clear whether there is any deterioration.

### Minor question marks don't necessitate immediate changes

In terms of the long-term impact of these numbers, loan growth yoy is testing new lows, perhaps due to retail banking regulations, but this is still a minor effect. Our forecasts for investment and derivative returns and costs now seem a little optimistic. However, only cost increases are of potential concern. Nevertheless, we do not believe there is any need to adjust forecasts before further clarification from management. We maintain our Hold recommendation.

### Important disclosures can be found in the Disclosures Appendix.

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**Table 1 : FGB 2Q11 results table**

Dh m	2Q10A	1Q11A	2Q11A	2Q11F	yoy	qoq	vs est
<b>Balance sheet</b>							
Loans & Islamic financing	94,205	97,064	98,598	99,239	5%	1.58%	-1%
Interbank assets	4,082	9,108	12,584	9,312			
Financial instruments	17,607	19,677	18,539	17,863	5%	-6%	4%
Cash & CB deposits	5,587	6,579	9,025	6,947			
Other assets	10,047	10,376	10,482	13,677	4%	1%	-23%
Total assets	131,528	142,805	149,229	147,038	13%	4%	1%
Customer deposits & Islamic funding	88,428	98,455	100,394	102,216	14%	2%	-2%
Dues to banks	4,622	2,789	7,266	2,044	57%	161%	255%
Capital market liabilities	11,191	12,525	12,602	12,525	13%	1%	1%
Other operating items	3,700	4,969	3,931	5,159	6%	-21%	-24%
Total liabilities	107,941	118,739	124,192	121,945	15%	5%	2%
Net liquid assets	5,047	12,899	14,344	14,215			
Shareholders' equity	23,587	24,067	25,038	25,094	6%	4%	0%
NPL ratio	4.50%	3.65%	3.53%	3.73%			
<b>Income statement</b>							
<b>Net interest &amp; Islamic returns</b>	<b>1,043</b>	<b>1,146</b>	<b>1,220</b>	<b>1,188</b>	<b>17%</b>	<b>6%</b>	<b>3%</b>
Fees & commissions	360	408	294	255	-18%	-28%	15%
FX & derivative	-	38	8	64	n.a.	-79%	-88%
Core non-interest	360	445	302	318	-16%	-32%	-5%
Trading & investments	(3)	(11)	26	51	-937%	-336%	n.a.
Property	56	16	25	22	-55%	59%	n.a.
Other operating income	2	1	15	4	607%	1729%	262%
Non-core non-interest	55	5	66	77	21%	1131%	-14%
<b>Total non-interest income</b>	<b>415</b>	<b>451</b>	<b>368</b>	<b>395</b>	<b>-11%</b>	<b>-18%</b>	<b>-7%</b>
<b>Total banking income</b>	<b>1,458</b>	<b>1,596</b>	<b>1,588</b>	<b>1,584</b>	<b>9%</b>	<b>-1%</b>	<b>0%</b>
Total operating expenses	(268)	(266)	(292)	(279)	9%	10%	5%
Provisioning	(411)	(459)	(411)	(283)	0%	-10%	45%
Other adjustments	10	7	5	7			
<b>Profit before tax</b>	<b>788</b>	<b>878</b>	<b>890</b>	<b>1,029</b>	<b>13%</b>	<b>1%</b>	<b>-14%</b>
Tax, minorities & appropriations	(1)	(122)	-	(2)	-100%	-100%	-100%
<b>Attributable Income</b>	<b>787</b>	<b>755</b>	<b>890</b>	<b>1,027</b>	<b>13%</b>	<b>18%</b>	<b>-13%</b>
<b>Headline net income</b>	<b>787</b>	<b>875</b>	<b>890</b>	<b>1,027</b>	<b>13%</b>	<b>2%</b>	<b>-13%</b>
<b>Comprehensive Income</b>	<b>831</b>	<b>802</b>	<b>971</b>	<b>1,027</b>	<b>17%</b>	<b>21%</b>	<b>-5%</b>

Source: Company data, Rasmala forecasts

## Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Net interest income	3834	4257	4760	5085	5780
Non-interest income	2295	2086	1650	1813	2159
<b>Total income</b>	<b>6129</b>	<b>6343</b>	<b>6410</b>	<b>6898</b>	<b>7939</b>
Operating costs	-1147	-1170	-1220	-1328	-1688
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	5190	5570	6251
Provisions charges	-1680	-1639	-1484	-746.9	-561.9
<u>Post-prov op prof</u>	3301	3534	3706	4823	5689
Associates (pre-tax)	29.0	-37.8	28.8	39.8	42.6
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported PTP</b>	<b>3331</b>	<b>3496</b>	<b>3735</b>	<b>4863</b>	<b>5732</b>
Taxation	0.00	0.00	0.00	0.00	0.00
Minority interests	-2.63	-123.9	-9.87	-9.87	-9.87
Preference dividends	-120.0	-240.0	-240.0	-240.0	-240.0
Other post-tax items	102.4	288.0	290.4	292.2	300.1
<b>Reported net profit</b>	<b>3310</b>	<b>3420</b>	<b>3776</b>	<b>4905</b>	<b>5782</b>
Tot normalised items	-83.6	0.00	0.00	0.00	0.00
Normalised PTP	3331	3496	3735	4863	5732
Normalised net profit	3394	3420	3776	4905	5782

Source: Company data, Rasmala forecasts

year to Dec

## Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Net loans to customers	90386	95628	102249	114003	127921
Other int earn assets	18199	25079	27358	31026	36679
Goodwill	0.00	0.00	0.00	0.00	0.00
Oth non-int earn assets	5340	4475	7825	9777	10064
<b>Total assets</b>	<b>125473</b>	<b>140758</b>	<b>151338</b>	<b>168751</b>	<b>188860</b>
Total customer deposits	86422	98742	105578	117715	132086
Oth int-bearing liabs	11761	13251	14158	14879	15167
Non int-bearing liab	5064	5034	4987	5561	9708
<b>Total liabilities</b>	<b>103247</b>	<b>117027</b>	<b>124723</b>	<b>138156</b>	<b>156961</b>
Share capital	17841	19226	22110	26090	27395
Reserves	0.00	0.00	0.00	0.00	0.00
<b>Total equity (excl min)</b>	<b>21841</b>	<b>23226</b>	<b>26110</b>	<b>30090</b>	<b>31395</b>
Minority interests	384.9	504.8	504.8	504.8	504.8
<b>Total liab &amp; sh equity</b>	<b>125473</b>	<b>140758</b>	<b>151338</b>	<b>168751</b>	<b>188860</b>
Risk weighted assets	123911	127351	136168	151822	170357
Est non-perf loans	n/a	n/a	n/a	n/a	n/a
Specific provisions	-2530	-3295	-4449	-4751	-4838
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	136168	151822	170357
Reported net profit	3310	3420	3776	4905	5782
Opening risk assets	110350	123911	127351	136168	151822
Closing risk assets	123911	127351	136168	151822	170357
Change in risk assets	13561	3441	8817	15653	18535
Capital required	1356	344.1	881.7	1565	1853
Free capital flow	2074	3316	3134	3580	4169
Ordinary dividend paid	-677.0	-900.0	-566.9	-632.8	-4177
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	-566.9	-632.8	-4177
Net capital flow	1243	1559	2567	2947	-8.91
Tier 1 capital	22930	24532	27536	31681	33040
Tier 1 capital ratio (%)	18.5	19.3	20.2	20.9	19.4

Source: Company data, Rasmala forecasts

year to Dec

## 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: Hold, CP: Dh17.75, TP: Dh19.99):** 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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