

29 July 2010

First Gulf Bank

Well-flagged earnings numbers

Hold

Target price
Dh16.27

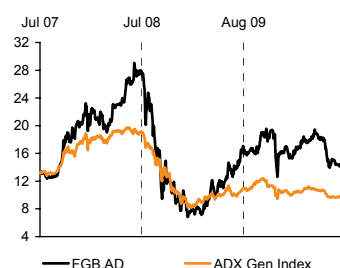
Price
Dh14.45

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	15.05	18.70	16.55
Absolute (%)	-4.0	-22.7	-12.7
Rel market (%)	-4.3	-15.4	-6.0
Rel sector (%)	-4.0	-14.0	-7.3



Market capitalisation
Dh21.67bn (€4.55bn)

Average (12M) daily turnover
Dh8.41m (US\$2.43m)

Sector: ADX Bank & Fin Index
RIC: FGB.AD, FGB.UH
Priced at close of business 28 Jul 2010.
Source: Bloomberg

Analyst

Raj Madha
United Arab Emirates
+971 55 224 8032
raj.madha@rasmala.com

Dubai International Financial Centre,
The Gate Village, Building 10, Level 1,
P.O. Box 31145, Dubai, United Arab
Emirates

www.rasmala.com

There were no real surprises on either the quality or quantity of 2Q10 earnings, as is typical for FGB. Nevertheless, on the balance sheet side there has been some trend divergence on loan quality. We see no reason to change our current Hold recommendation based on these results.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Reported PTP (Dhm)	2,937	3,331	3,410	4,561	5,917
Reported net profit (Dhm)	3,005	3,244	3,476	4,635	6,001
Reported EPS (Dh)	2.07	2.08	2.11	2.88	3.78
Normalised EPS (Dh)	2.07	2.14	2.11	2.88	3.78
Dividend per share (Dh)	0.32	0.45	0.49	0.79	1.00
Normalised PE (x)	6.98	6.76	6.84	5.02	3.82
Price/book value (x)	1.37	1.21	1.08	0.93	0.79
Dividend yield (%)	2.20	3.12	3.42	5.45	6.92
Return on avg equity (%)	23.40	19.80	18.30	21.40	23.70

Accounting standard: IFRS
Source: Company data, Rasmala forecasts

year to Dec, fully diluted

Comprehensive income in line

2Q10 comprehensive income matched our forecast. There was a negative variance on a headline basis, however, with unrealised gains being the primary exclusion, resulting in a 5% shortfall. Individual revenue lines were mostly as expected, although derivative income was negatively affected by markets, and property rental income benefitted from one-off factors. Cost growth of 9% qoq was 6% higher than expected. However, the positive variance on provisioning ensured no negative surprise for comprehensive income.

Earnings quality issues evenly balanced

The two main sources of positive variances were one-off property rental income and provisioning, neither of which should have long-term repercussions. Meanwhile, the negative issues were derivative income and cost growth, with the latter being driven by retail volume growth. Consequently none of the variances had significant implications for valuations.

Balance sheet shows a small negative quality variance

Loan growth was in line with expectations, rising 1% qoq, but deposit growth was weak, easing 1.1% qoq as FGB yielded high-cost deposits to more aggressive competitors. NPLs rose 50bp in 2q10 to 2.5% on a 180-day basis, and we believe this increase was also reflected on a 90-day basis, with Dubai corporate lending partially to blame. Nevertheless, FGB reiterated its expectation that NPLs will peak in the coming quarters.

Overall in line, but with greater caution on loan quality

The income statement was generally in line with expectations, but accelerating NPL growth is in contrast to the decelerating NPL growth for rest of the sector. This is also reflected in provisioning, where other UAE banks managed to significantly beat expectations. This could turn out to be a reflection of greater realism on the part of FGB. On the back of these numbers, we see little immediate reason to change our Hold recommendation.

Important disclosures can be found in the Disclosures Appendix.

Distributed outside MENA by The Royal Bank of Scotland N.V. and its affiliates under a strategic alliance with Rasmala Investment Bank Ltd.

Table 1 : FGB 2Q10 results versus prior periods and estimates

Dh m	2Q09A	1Q10A	2Q10A	2Q10F	yoy	qoq	vs forecast
Balance Sheet							
Loans & Islamic Financing	86,041	93,257	94,205	94,571	9%	1%	0%
Financial instruments	12,652	14,519	17,607	15,187	39%	21%	16%
Total Assets	118,644	132,772	131,528	133,371	11%	-1%	-1%
Customer deposits & Islamic Funding	83,725	89,432	88,428	90,316	6%	-1%	-2%
Capital Market Liabilities	3,030	9,813	11,191	9,813	269%	14%	14%
Total Liabilities	97,278	109,938	107,941	109,573	11%	-2%	-1%
Net Liquid Assets	4,315	7,234	5,047	7,299			
Shareholders' Equity	21,367	22,833	23,587	23,798	10%	3%	-1%
Income Statement							
Net Interest & Islamic Returns	958	1,037	1,043	1,039	9%	1%	0%
Total Non-Interest Income	330	635	415	466	26%	-35%	-11%
Total Banking Income	1,287	1,672	1,458	1,505	13%	-13%	-3%
Total Operating Expenses	(257)	(246)	(268)	(252)	4%	9%	6%
Provisioning	(260)	(492)	(411)	(424)	58%	-17%	-3%
Profit before tax	776	921	788	834	2%	-14%	-5%
Tax, Minorities & Appropriations	(1)	(121)	(1)	(1)	81%	-99%	48%
Attributable Income	775	800	787	833	2%	-2%	-5%
Headline Net Income	775	920	787	833	2%	-14%	-5%
Comprehensive Income	740	805	831	833	12%	3%	0%

Source: Company reports, Rasmala forecasts

Income statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Net interest income	2560	3834	4218	4718	5330
Non-interest income	1982	2295	2139	2311	2669
Total income	4542	6129	6357	7029	7999
Operating costs	-1195	-1147	-1090	-1307	-1567
Goodwill (amort/impaird)	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>	3347	4982	5267	5723	6432
Provisions charges	-566.3	-1680	-1858	-1205	-562.3
<u>Post-prov op prof</u>	2780	3301	3408	4518	5870
Associates (pre-tax)	156.9	29.0	1.82	43.2	47.6
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	2937	3331	3410	4561	5917
Taxation	0.00	0.00	0.00	0.00	0.00
Minority interests	8.05	-2.63	-3.26	-3.26	-3.26
Preference dividends	0.00	-120.0	-240.0	-240.0	-240.0
Other post-tax items	60.0	36.4	309.3	316.6	327.2
Reported net profit	3005	3244	3476	4635	6001
Tot normalised items	0.00	-83.6	0.00	0.00	0.00
Normalised PTP	2937	3331	3410	4561	5917
Normalised net profit	3005	3328	3476	4635	6001

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Net loans to customers	79363	90386	98536	113902	132782
Other int earn assets	12393	18199	22356	25080	28519
Goodwill	0.00	0.00	0.00	0.00	0.00
Oth non-int earn assets	6769	5340	6485	6870	7610
Total assets	107522	125473	138904	158807	182085
Total customer deposits	73963	86422	93609	108432	124613
Oth int-bearing liabs	13098	11761	15267	16130	17913
Non int-bearing liab	4319	5064	5493	6687	7827
Total liabilities	91380	103247	114369	131248	150353
Share capital	15768	17841	20160	23184	27357
Reserves	0.00	0.00	0.00	0.00	0.00
Total equity (excl min)	15768	21841	24160	27184	31357
Minority interests	374.4	384.9	374.8	374.8	374.8
Total liab & sh equity	107522	125473	138904	158807	182085
Risk weighted assets	110350	115685	126116	145783	169947
Est non-perf loans	n/a	n/a	n/a	n/a	n/a
Specific provisions	-1141	-2530	-4135	-4926	-4996
General provisions	n/a	n/a	n/a	n/a	n/a

Source: Company data, Rasmala forecasts

year ended Dec

Capital

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Risk weighted assets	110350	115685	126116	145783	169947
Reported net profit	3005	3244	3476	4635	6001
Opening risk assets	64149	110350	115685	126116	145783
Closing risk assets	110350	115685	126116	145783	169947
Change in risk assets	46201	5335	10432	19666	24165
Capital required	4620	533.5	1252	2360	2900
Free capital flow	-1615	2831	2464	2515	3341
Ordinary dividend paid	-477.4	-677.0	-740.9	-1182	-1501
Share buy back/spec div	0.00	0.00	0.00	0.00	0.00
Equity / preference issue	3555	-154.0	0.00	0.00	0.00
Cash flow from financing	3078	-831.0	-740.9	-1182	-1501
Net capital flow	1463	2000	1723	1333	1841
Tier 1 capital	16142	22226	24535	27559	31732
Tier 1 capital ratio (%)	14.6	19.2	19.5	18.9	18.7

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: Dh14.45, TP: Dh16.27): The primary downside risk to our GGM-derived valuation and target price is the property book (equivalent to 62% of equity). Further, we believe that going forward these property-related assets will be slow-moving, provide weak returns and, in some cases, show little prospect of providing normal rates of return.

Disclaimer

This report is prepared by Rasmala Investment Bank Limited ("RIB"). RIB is regulated by the Dubai Financial Services Authority ("DFSA"). RIB products or services are only made available to customers who RIB is satisfied meet the regulatory criteria to be a "Professional Client", as defined under the Rules and Regulations of the Dubai International Financial Centre ("DIFC").

Our investment recommendations take into account both risk and expected return. We base our long-term fair value estimates on a fundamental analysis of a company's future prospects, after having taken perceived risks into consideration. We have conducted reasonable research to arrive at our investment recommendations and fair value estimates for the company or companies mentioned in this report. Although the information in this report has been obtained from sources that RIB believes to be reliable, we have not independently verified such information thus it may not be accurate or complete. RIB does not represent or warrant, either expressly or impliedly, the accuracy or completeness of the information or opinions contained within this report and no liability whatsoever is accepted by RIB or any other person for any loss howsoever arising, directly or indirectly, from any use of such information or opinions or otherwise arising in connection therewith.

Readers should understand that financial projections, fair value estimates and statements regarding future prospects may not be realized. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. This research report is prepared for general circulation and is intended for general information purposes only. It is not intended as an offer or solicitation or advice with respect to the purchase or sale of any securities referred to in the report. It is not tailored to the specific investment objectives, financial situation or needs of any specific person that may receive this report. We strongly advise potential investors to seek financial guidance when determining whether an investment is appropriate to their needs.

RIB is not registered with the U.S. Securities and Exchange Commission, or any U.S. state authority, as a broker-dealer or investment advisor. This report has not been approved, disapproved or recommended by the U.S. Securities and Exchange Commission, any state securities commission in the United States, the securities commission of any non-U.S. jurisdiction or any other U.S. or non-U.S. regulatory authority. None of these authorities has passed on or endorsed the merits or the accuracy or adequacy of this report.

RIB and its group entities (together and separately, "Rasmala") does and may seek to do business with companies covered in its reports. As a result, users should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Rasmala and its respective employees, directors and officers shall not be responsible or liable for any liabilities, damages, losses, claims, causes of action, or proceedings (including without limitation indirect, consequential, special, incidental, or punitive damages) arising out of or in connection with the use of this report or any errors or omissions in its content.

The research analyst or analysts responsible for the content of this research report certify that: (1) the views expressed and attributed to the research analyst or analysts in the research report accurately reflect their personal opinion(s) about the subject securities and issuers and/or other subject matter as appropriate; and, (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report. On a general basis, the efficacy of recommendations is a factor in the performance appraisals of analysts.