

Forecast Update

FGB

ST Rating: Outperform

LT Rating: Outperform

New TP – AED 20.4

Old TP – AED 11.6

First Gulf Bank – raise TP to AED 20.4 and upgrade rating to Outperform

- **Based on strong results in a tough environment in 2009, we are revising our balance sheet and income statement forecast numbers.** While the NPL's and commensurate build up in reserves is as we expected, **we did not anticipate the strong growth in revenues.** The bank continues to display strong balance sheet expansion along with the ability to grow and maintain high margins. We believe the combination of higher fee and commission income and investment portfolio gains could help alleviate the pain from missing investment property related gains of the previous years.
- FGB has risen by 74% ytd, and currently trades at a 09e P/B of 0.95x (16% premium to sector avg. of 0.82x), but has displayed strong earnings momentum and estimated ROE of 15%. **We are updating our TP to AED 20.4 (28% upside) and upgrade our ST and LT ratings to 'Outperform'**
- Detailed below are the particular changes made for '09 and '10 with the rest of the changes feeding through into our detailed 5 year numbers. –

1. **Higher than sector growth in loans and deposits** - While sector loan and deposit growth ytd has been muted – 2.7% and 5.9%, FGB has been able to grow its loan book and deposit base 3-4 times faster. Loans and deposit growth in the first three quarters was 14% and 21%, respectively vs. our previous full year expectations of 14% and 10%. We increase our loan growth estimates to 21% for 2009 and 24% in 2010, with the changes in outer years increasing the 5-year CAGR to 19% from 11% previously. In addition, we are updating the unadjusted deposit growth for 2009 and 2010 to 24%, changing the adjusted 5-year CAGR to 20% from 12% previously. Adjustment is made for conversion of Ministry of Finance deposits (AED 4.5bn) to tier II capital to be completed by the end of 2009.
2. **Stronger Interest Income** - FGB's interest income continues to perform better than our previous expectations. The big kicker has come in the form of higher margins which are now being sustained through 5 consecutive quarters. NIM in 2008 was 3.1% and we had expected a retrenchment in 2009 and going forward, however NIM for the first three quarters of the year is averaging 3.6%. FGB has been able to increase the yield on interest earning assets to an average of 6.3% while lowering funding costs due to strong deposit generation.
3. **Doing well to substitute for weaker real estate gains** – Increasing non-interest income to AED2.0bn versus our earlier expectations of AED1.7bn in 2009. Higher fee and commission plus gains in foreign exchange and derivatives income (due to strong market recovery) continue to negate the lack of investment property related gains (AED528mm in 2008). Subsidiaries and associate profits have also contributed strongly to the bottom line, especially in Q309.
4. **Efficiency remains a hallmark** – Quarterly run-rate for non-interest expenses are running at AED 275mm for the first 2 quarters with strong cost control displayed in the last two quarters. The ytd efficiency ratio is 18.5% and we are lowering our full year expense assumptions and moving to a forecasted efficiency ratio of 19-23% over the 5 year horizon instead of 27-28% previously

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5. **Increasing Provisioning** – While margin expansion is helping the bottom line, we were too conservative in our estimates of provision in 2009. We had assumed AED 682mm in provisions for 2009, but the provisioning activity through Q309 has already been AED 1.0bn. We increase our provisions to AED 1.5bn for 2009 and AED 1.3bn in 2010 trailing off from that point. Our NPL estimate for 2009 was low, with FGB hitting our previous 1.2% NPL estimate in the middle of the year. We believe NPL's will peak in late 2010 to early 2011 and trail off from there. We are now estimating NPL at end 2009 to be 1.7% of the loan book and 2.5% at the end of 2010. We increase our provisioning levels to maintain a loss coverage ratio averaging 130% over our forecast period.
6. We reflect the impact to the major balance sheet and income statement items below :

First Gulf Bank (AED Millions)	2009E			2010E		
	Old	New	Change	Old	New	Change
Net Interest Income	2,961	3,624	22%	3,188	3,935	23%
Non-Interest Income	1,661	1,973	19%	1,714	2,135	25%
Total Income	4,621	5,596	21%	4,903	6,070	24%
Non-Interest Expense	(1,263)	(1,065)	-16%	(1,361)	(1,303)	-4%
Provisions	(682)	(1,499)	120%	(671)	(1,259)	88%
Net Profit	2,677	3,033	13%	2,871	3,508	22%
Adjusted EPS	1.97	2.23	13%	2.11	2.58	22%
Investments	9,481	12,375	31%	9,955	13,365	34%
Net Loans	90,124	93,266	3%	101,580	113,200	11%
Total Assets	119,144	126,293	6%	132,488	148,235	12%
Customer Deposit	81,297	91,651	13%	92,678	108,149	17%
Loans/Deposits	111%	102%	-9%	110%	105%	-5%
Efficiency Ratio	27%	19%	-8%	28%	21%	-6%
NIM	2.88%	3.40%	0.52%	2.78%	3.10%	0.32%
NPL	1.20%	1.70%	0.50%	1.40%	2.50%	1.10%
Coverage Ratio	150%	156%	6%	146%	126%	-21%
Loan Growth	14%	19%	5%	13%	22%	9%
Deposit Growth	10%	24%	14%	14%	18%	4%

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