

Results update – 1Q2016

Banks | UAE | 1 May 2016

First Gulf Bank (FGB) reported profit at AED1.33bn was lower than our expectation (AED1.45bn). Underlying profitability growth was weak. In particular, fee income growth was lower than expectation due to slower business activity. Margins continued to remain under pressure. Asset quality trends in wholesale banking was stable while consumer banking and SME remained under pressure. Management has been growing the loan book cautiously. In particular, growth in retail book has largely come from housing loans to UAE nationals, which are relatively lower risk in nature. Furthermore, the bank has been maintaining their guidance of low-single digit loan growth. Going forward, we believe the operating trends are likely to remain weak. Following the recent rally, FGB's multiple has risen to 1.8x P/BV 2016E, closer to our target multiple. Given limited upside from our target price, we downgrade our recommendation on FGB to Hold from Buy.

► **Margins remained under pressure, fee income growth was weak**

Margins were down 6bps QoQ to 3.13%, due to rise in cost of funds, which more than offset the impact from asset re-pricing and higher volumes. Growth in fee based income and forex and derivatives businesses were weak at -10% YoY and -24% YoY respectively, due to slower business activity and one-off gains in 1Q15. Cost was tightly controlled with cost-income ratio at 20.3%. Given its already lower operating leverage, we find limited scope for further cost control. We expect operating trends will continue to remain weak due to moderate revenue profile.

► **Asset quality trends were mixed; guiding for a better trend**

Credit costs (annualized) at 96bps was closer to full year guidance of <100bps, due to continued pressure in the consumer banking and SME sector. During the quarter, the bank has written off loans in the consumer banking segment. This along with positive trends in the wholesale banking segment led to drop in NPL ratio to 2.6% from 2.8% in Dec 15. Management has indicated that stress in consumer and SME banking are stabilising and expect the credit costs to improve from current levels.

► **Conscious control on business growth, CASA growth has been strong**

We view management's cautious approach towards growth positively in the current environment. In particular, the bank has been increasing its exposure in housing loans to UAE nationals (11% YoY) and at the same time moderating its growth in personal loans (4% YoY). Furthermore, the management has been maintaining their guidance of low-single digit loan growth in 2016. Deposit growth was weak (-1.2% QoQ). However, the change in deposit mix has been healthy. CASA ratio was up at 24% (21% in 4Q15) registering a strong growth of 13% QoQ.

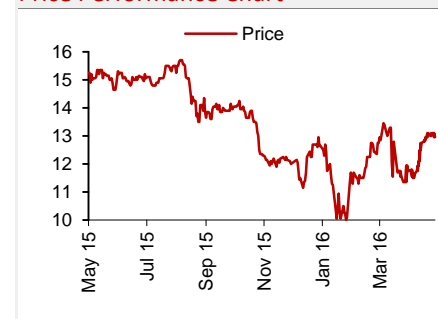
Key Financials	2014	2015	2016E	2017E	2018E
Net interest income (AEDm)	6,470	6,429	6,544	6,976	7,450
Total income (AEDm)	9,232	9,432	9,418	10,121	10,937
EPS (AED)	1.5	1.3	1.2	1.3	1.5
EPS (% Change)	(2.1)	(12.6)	(3.4)	7.8	10.4
P/E (x)	8.8	10.0	10.4	9.6	8.7
P/B (tangible)	1.7	1.9	1.8	1.7	1.7
Gross NPL (% of Loans and advances)	3.0	3.2	3.3	3.3	3.4
Dividend yield	7.7	7.7	7.7	8.5	8.9
ROAA (%)	2.8	2.6	2.4	2.4	2.5
RoAE (%)	20.1	18.8	17.3	18.0	19.2

Source: ADCB Securities Equity Research

Fundamentals

Recommendation	Hold
Target Price	AED 13.72
Price	AED 12.95
Price 12m High/Low	AED 15.70/10.00
Market Cap.	AED 58,950.00
Bloomberg/Reuters	FGB.UH / FGB.AD

Price Performance Chart



Source: Bloomberg

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Financials

Income Statement () (AEDmn)	2015	2016E	2017E	2018E
Net interest income	6,429	6,544	6,976	7,450
Total non interest income	3,003	2,874	3,146	3,487
Fee income	1,967	2,102	2,279	2,538
Trading income	139	164	199	254
Other income	896	609	668	694
Total income	9,432	9,418	10,121	10,937
Total operating expenses	1,947	2,078	2,237	2,441
Salaries and wages	869	921	985	1,064
Other operating expenses	1,079	1,157	1,252	1,377
Pre provision profit	7,485	7,340	7,884	8,495
Total provisions	1,454	1,537	1,641	1,617
Profit before tax and MI	6,031	5,803	6,243	6,878
Taxes	13	6	2	1
Minority interest	13	43	47	52
Reported net profit	6,006	5,756	6,196	6,828
Adjusted net profit	5,820	5,620	6,060	6,692

Source: ADCB Securities Equity Research

Balance Sheet (AEDmn)	2015	2016E	2017E	2018E
Loans and advances	149,766	157,081	167,753	180,769
Investments	22,692	24,054	25,737	27,796
Fixed assets	1,486	1,634	1,798	1,978
Other assets	10,597	11,657	12,822	14,105
Total assets	227,496	240,352	257,882	280,977
Total equity	31,904	33,024	34,134	35,651
Sub/hybrid/other debt	4,000	4,000	4,000	4,000
Minority interests	400	444	491	542
Deposits	142,463	149,586	160,057	172,861
Total borrowings	40,799	44,337	48,896	56,380
Total liabilities	191,192	202,884	219,258	240,784

Source: ADCB Securities Equity Research

Valuation and leverage metrics	2015	2016E	2017E	2018E
P/E (x)	10.0	10.4	9.6	8.7
P/PPE (x)	7.8	7.9	7.4	6.9
P/B (tangible)	1.9	1.8	1.7	1.7
Dividend yield (%)	7.7	7.7	8.5	8.9
Tier I ratio	16.3	15.3	14.6	14.0
Core tier I ratio	14.0	13.2	12.6	12.1
CAR (%)	17.5	16.7	15.9	15.3
Average assets/Equity (x)	7.1	7.2	7.4	7.7
Loan to deposit ratio (%)	105.1	105.0	104.8	104.6

Source: ADCB Securities Equity Research

Key Ratios (%)	2015	2016E	2017E	2018E
ROAA	2.6	2.4	2.4	2.5
RoAE	18.8	17.3	18.0	19.2
Net interest margin	3.3	3.1	3.2	3.2
Cost-income	20.6	22.1	22.1	22.3
CASA	20.7	20.9	21.6	22.4
Gross NPL (% of Loans and advances)	3.2	3.3	3.3	3.4
Loan loss coverage	91.1	87.0	85.7	85.2
Credit costs (% of avg loans)	1.0	1.0	1.0	0.9

Source: ADCB Securities Equity Research

Per-share data (AED)	2015	2016E	2017E	2018E
EPS	1.3	1.2	1.3	1.5
DPS	1.0	1.0	1.1	1.2
BVPS	7.1	7.3	7.6	7.9
Total no. of outstanding shares (mn)	4,500	4,500	4,500	4,500

Source: ADCB Securities Equity Research

Investment case

We recommend Hold on FGB. Track record of consistent performance supported by strong board and management team. Strong asset franchise with dominant position in both Abu Dhabi corporate and retail segments that has proven to be less risky. It has the strongest pre-provisioning profitability, providing it a strong loss absorbing cushion. However, given its recent strong outperformance, we find limited upside from our target price.

Upside case

AED15.9

Higher than expected book growth led by a more positive macro or growth environment. We value upside case at 2.2x P/BV 2016E.

Downside case

AED9.7

Given its proximity to Abu Dhabi, lower oil price may have a negative impact on growth and profitability. Also, margins compression can be higher in a rising interest rate environment, due to its wholesale funding profile. In this scenario, we value FGB at 1.3x P/BV 2016E.

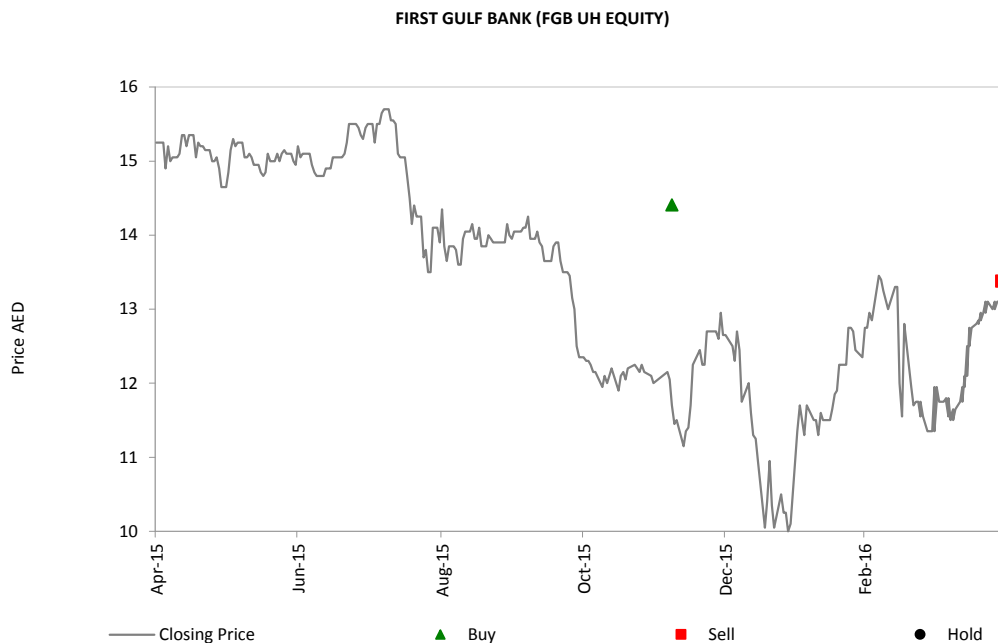
Results summary

Fig. 1. Results review - 1Q2016

Income statement (AEDmn)	1Q15	4Q15	1Q16	% YoY	% QoQ
Interest income	1,997	2,181	2,140	7.1	(1.9)
Interest expense	411	523	554	34.9	5.9
Net Interest Income	1,587	1,658	1,586	(0.1)	(4.4)
Non-interest Income	672	1,074	561	(16.5)	(47.8)
- Fee based income	506	414	441	(12.9)	6.5
- Trading revenue	73	111	49	(32.8)	(55.9)
Total income	2,259	2,732	2,146	(5.0)	(21.4)
Operating expenses	462	500	436	(5.6)	(12.7)
Pre-provision profit	1,797	2,232	1,710	(4.8)	(23.4)
Total provisions	372	507	376	1.1	(25.8)
Profit before tax	1,425	1,725	1,334	(6.4)	(22.7)
Associate, taxes and minorities	7	6	2	(75.6)	(70.8)
Net Income	1,417	1,719	1,332	(6.0)	(22.5)
Balance sheet (AEDbn)					
Loans	143	150	152	6.8	1.8
Deposits	143	142	141	(1.5)	(1.2)
- CASA ratio	18.9	20.7	23.6		
Ratios					
Cost/income ratio (%)	20.5	18.3	20.3		
NIM (%)	3.4	3.2	3.1		
RoAA (%)	2.7	3.0	2.3		
Tier I (%)	16.8	16.3	16.9		
CAR (%)	18.0	17.5	16.7		
Asset quality (AEDmn)					
Gross NPA	3,666	4,294	4,056	10.6	(5.5)
Gross NPA (%)	2.5	2.8	2.6		
Coverage (%)	126.1	102.9	109.8		

Source: Company, ADCB Securities Equity Research.

Recommendation history



Date	Recommendation	Target Price (AED)	Closing Price (AED)
08-Dec-2015	Buy	14.41	11.70
02-Feb-2016	Buy	13.72	11.50
28-Apr-2016	Hold	13.38	13.10
28-Apr-2016	Hold	13.72	13.10

Rating Distribution

Rating	Coverage Universe %
Buy	25%
Hold	75%
Sell	0%

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