المجموعة المالية - هيرميس

EFG HERMES

# MENA BANKING SECTOR

## From Autumn to Spring

06 OCTOBER 2009

### CONTENTS



- **Improving Outlook, Time for Cyclicality:** The slowdown in economic growth and deflation of asset prices has translated into strong headwinds for the banking sector. Credit growth has decelerated sharply across the region, but we expect a recovery in 2010e as the macro backdrop improves and risk appetite recovers. From a medium- to long-term perspective, favourable demographics and low penetration point towards a strong potential for credit growth.

- **Overcoming Challenges, Positioned for a Recovery:** We believe that banks in the MENA region still present attractive value relative to global peers, with ROEs expected to remain around 20% for most banks in the medium term. Banks have weathered the initial shock of the financial crisis and have spent most of 2009 strengthening their balance sheets. With the macro picture stabilising and improving visibility on risk, we believe that banks are strongly positioned for a recovery, justifying our view that the valuation discount for MENA banks to their historical averages should narrow. We highlight the UAE, Egypt and Saudi Arabia as our top picks.

- **UAE - Better than Feared:** From a macro perspective, the UAE has suffered the most from the global economic recession. Though risks to earnings still remain, Abu Dhabi is proving more resilient to the economic slowdown. Supported by the government, balance sheets have strengthened over the year, and banks appear to be in much better shape than was feared. First Gulf Bank and Emirates NBD are our top picks in the UAE.

- **Saudi Arabia - Poised for a Strong Recovery**: We believe Saudi banks will continue to head towards higher valuations; with the government taking a strong counter-cyclical stance to the slowdown in private sector spending, business confidence is gradually recovering. Strengthening capitalisation and liquidity levels have made banks less vulnerable to a sudden jump in NPLs. Samba is our top pick, despite continuing to suffer from overplayed risk perceptions. We also recommend Banque Saudi Fransi and Arab National Bank as both look attractive from a valuation stand point and are laggards to the recent rally.

- **Egypt - Comfortable on Risks:** We do not expect Egyptian banks' high profitability will be severely impaired by the rise in NPLs that we expect over the next year, with banks having been cautious on their lending practices over the recent short cycle of credit expansion. We expect banks to sustain ROEs at an average of 25% in 2010e. Low banking penetration makes Egypt one of the most attractive long-term growth stories in MENA. We highlight NSGB as our top pick in the country. We like CIB for its strong positioning and its ability to deliver strong returns, but we find its valuation demanding at current levels.

- **Underweight on Kuwait and Morocco:** Within our coverage universe, we believe that Kuwait's path to recovery is likely to be the longest. Political deadlock remains a stumbling block to government investment spending, suggesting that there will be little momentum for credit growth relative to the rest of the GCC. Meanwhile, Moroccan banks trade at a premium to the MENA banks' average, partially justified by capital controls. While long-term growth opportunities are attractive, especially in the SMEs and household sectors, we favour other banks with lower multiples valuations and higher profitability than Moroccan banks.

SECTOR NOTE

### STOCK PICKS

| | Price LC | LTFV LC | Rec. ST | Rec. LT | P/E 09e | P/E 10e | P/E 11e | P/B 09e | P/B 10e | P/B 11e | Yield 09 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **UAE – Overweight (01 Oct 09)** | | | | | **8.3** | **7.8** | **5.9** | **1.3** | **1.2** | **1.1** | **3.9%** |
| FGB | 16.8 | 26.31 | Acc. | Buy | 8.6 | 7.5 | 5.6 | 1.4 | 1.2 | 1.1 | 1.7% |
| **Saudi – Overweight (03 Oct 09)** | | | | | **15.6** | **13.1** | **10.8** | **2.8** | **2.4** | **2.1** | **3.2%** |
| Samba | 57.5 | 72.10 | Buy | Buy | 10.9 | 10.0 | 8.6 | 2.3 | 2.0 | 1.8 | 3.7% |
| **Egypt – Overweight (01 Oct 09)** | | | | | **9.9** | **8.5** | **7.6** | **2.4** | **2.0** | **1.7** | **3.0%** |
| NSGB | 28.5 | 38.19 | Buy | Buy | 7.3 | 6.6 | 6.3 | 2.1 | 1.7 | 1.4 | 3.5% |
| **Lebanon – Neutral (02 Oct 09)** | | | | | **8.5** | **7.6** | **6.5** | **1.4** | **1.2** | **1.1** | **3.9%** |
| BLOM (GDR) | 84.0 | 104.2 | Acc. | Buy | 7.3 | 6.4 | 5.6 | 1.4 | 1.2 | 1.1 | 4.1% |
| **Qatar – Neutral (01 Oct 09)** | | | | | **11.7** | **11.1** | **10.4** | **2.4** | **2.2** | **2.0** | **5.2%** |
| CBQ | 80.6 | 113.5 | Acc. | Buy | 11.2 | 11.0 | 8.8 | 1.7 | 1.6 | 1.5 | 7.3% |
| **Oman – Neutral (01 Oct 09)** | | | | | **14.0** | **12.0** | **9.2** | **1.5** | **1.4** | **1.3** | **1.9%** |
| Bank Muscat | 0.90 | 1.24 | Buy | Buy | 8.7 | 9.9 | 7.6 | 1.2 | 1.1 | 1.0 | 2.3% |
| **Morocco – Underweight (02 Oct 09)** | | | | | **29.0** | **24.2** | **21.7** | **3.6** | **3.3** | **3.0** | **1.6%** |
| Attijariwafa Bank | 269.0 | 309.8 | Neu. | Acc. | 16.1 | 14.9 | 13.6 | 2.4 | 2.2 | 1.9 | 1.9% |
| **Kuwait – Underweight (01 Oct 09)** | | | | | **33.7** | **17.0** | **12.1** | **2.5** | **2.3** | **2.1** | **1.9%** |
| Burgan Bank | 0.38 | 0.63 | Neu. | Buy | 18.1 | 7.3 | 4.9 | 1.2 | 1.1 | 1.0 | 1.6% |


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**Figure 1: Valuations***

| | Price | LTFV | MCAP | Recommendation | | P/E | | | P/B | | | Yield | ROAE | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | LC | LC | USD mn | ST | LT | 09e | 10e | 11e | 09e | 10e | 11e | 09e | 09e | 10e |
| **UAE** | | | | | | **8.3** | **7.8** | **5.9** | **1.3** | **1.2** | **1.1** | **3.9%** | **16.9%** | **16.1%** |
| ADCB | 2.44 | 3.85 | 3,717 | Acc. | Buy | 8.5 | 8.9 | 7.4 | 0.8 | 0.8 | 0.7 | 3.9% | 10.1% | 9.0% |
| ADIB | 3.15 | 5.78 | 1,690 | Buy | Buy | 6.8 | 5.6 | 4.2 | 1.1 | 1.0 | 0.9 | 8.7% | 16.2% | 18.4% |
| CBD | 3.93 | 6.22 | 1,888 | Neu. | Buy | 6.7 | 6.7 | 6.2 | 1.3 | 1.2 | 1.1 | 5.7% | 20.9% | 18.3% |
| DIB | 3.10 | 3.90 | 3,053 | Neu. | Acc. | 8.4 | 9.0 | 6.9 | 1.3 | 1.3 | 1.2 | 8.4% | 15.4% | 14.1% |
| ENBD | 4.40 | 7.17 | 6,657 | Buy | Buy | 7.8 | 6.9 | 5.4 | 1.2 | 1.1 | 1.0 | 4.0% | 15.3% | 15.9% |
| FGB | 16.80 | 26.31 | 6,861 | Acc. | Buy | 8.6 | 7.5 | 5.6 | 1.4 | 1.2 | 1.1 | 1.7% | 17.4% | 17.4% |
| NBAD | 13.35 | 18.40 | 7,902 | Neu. | Acc. | 9.2 | 8.4 | 5.8 | 1.7 | 1.4 | 1.3 | 2.6% | 20.8% | 18.3% |
| **Saudi Arabia** | | | | | | **15.6** | **13.1** | **10.8** | **2.8** | **2.4** | **2.1** | **3.2%** | **20.2%** | **20.1%** |
| Al Rajhi | 73.50 | 74.70 | 29,898 | Neu. | Neu. | 17.1 | 15.7 | 13.5 | 4.1 | 3.6 | 3.1 | 3.8% | 25.5% | 24.4% |
| Al Bilad | 21.60 | 17.50 | 1,780 | Red. | Red. | 77.1 | 41.2 | 23.4 | 2.0 | 1.9 | 1.8 | 0.0% | 2.6% | 4.7% |
| Al Jazira | 19.85 | 21.80 | 1,604 | Neu. | Neu. | 13.5 | 10.8 | 8.6 | 1.2 | 1.1 | 1.0 | 2.5% | 9.0% | 10.5% |
| Saudi British | 52.00 | 59.80 | 10,599 | Acc. | Acc. | 13.6 | 11.8 | 9.7 | 2.8 | 2.4 | 2.1 | 2.1% | 22.4% | 22.0% |
| Saudi Fransi | 44.50 | 53.30 | 8,678 | Acc. | Acc. | 11.5 | 10.1 | 8.4 | 2.2 | 1.9 | 1.7 | 2.7% | 18.2% | 18.3% |
| ANB | 48.20 | 55.80 | 8,441 | Acc. | Acc. | 12.5 | 11.2 | 9.7 | 2.2 | 1.9 | 1.6 | 2.5% | 19.3% | 18.5% |
| Samba | 57.50 | 72.10 | 14,279 | Buy | Buy | 10.9 | 10.0 | 8.6 | 2.3 | 2.0 | 1.8 | 3.7% | 22.7% | 21.7% |
| Saudi Hollandi | 34.20 | 39.00 | 3,069 | Neu. | Acc. | 17.0 | 11.0 | 8.9 | 1.9 | 1.6 | 1.4 | 1.2% | 11.5% | 15.6% |
| Riyad Bank | 29.90 | 34.00 | 11,959 | Acc. | Acc. | 15.4 | 11.7 | 9.2 | 1.8 | 1.6 | 1.5 | 4.6% | 12.1% | 14.6% |
| Saudi Inv. Bank | 18.55 | 21.50 | 2,250 | Acc. | Acc. | 10.4 | 8.8 | 7.5 | 1.1 | 1.0 | 0.9 | 2.2% | 11.6% | 12.3% |
| **Egypt** | | | | | | **9.9** | **8.5** | **7.6** | **2.4** | **2.0** | **1.7** | **3.0%** | **25.7%** | **24.9%** |
| CIB | 56.05 | 62.70 | 2,989 | Acc. | Acc. | 11.3 | 9.7 | 8.6 | 2.6 | 2.1 | 1.8 | 1.8% | 24.9% | 24.3% |
| NSGB | 28.50 | 38.19 | 1,731 | Buy | Buy | 7.3 | 6.6 | 6.3 | 2.1 | 1.7 | 1.4 | 3.5% | 29.3% | 26.2% |
| Credit Agricole Egypt | 12.71 | 16.65 | 665 | Acc. | Buy | 10.6 | 8.1 | 7.1 | 2.1 | 1.9 | 1.7 | 7.1% | 19.8% | 24.2% |
| **Lebanon** | | | | | | **8.5** | **7.6** | **6.5** | **1.4** | **1.2** | **1.1** | **3.9%** | **17.2%** | **17.1%** |
| BLOM (GDR) | 84.00 | 104.2 | 2,022 | Acc. | Buy | 7.3 | 6.4 | 5.6 | 1.4 | 1.2 | 1.1 | 4.1% | 20.6% | 20.2% |
| Audi (GDR) | 72.90 | N/R | 2,120 | N/R | N/R | 9.8 | 9.3 | 8.1 | 1.4 | 1.3 | 1.2 | 3.7% | 15.1% | 15.5% |
| Byblos Bank | 1.90 | 2.60 | 796 | Acc. | Buy | 8.4 | 7.8 | 6.8 | 1.1 | 1.0 | 0.9 | 5.2% | 14.1% | 13.7% |
| **Qatar** | | | | | | **11.7** | **11.1** | **10.4** | **2.4** | **2.2** | **2.0** | **5.2%** | **21.4%** | **19.9%** |
| CBQ | 80.60 | 113.55 | 5,020 | Acc. | Buy | 11.2 | 11.0 | 8.8 | 1.7 | 1.6 | 1.5 | 7.3% | 16.7% | 15.3% |
| QIB | 90.00 | 108.79 | 5,353 | Neu. | Acc. | 13.2 | 13.9 | 11.8 | 2.5 | 2.4 | 2.3 | 6.3% | 20.0% | 16.6% |
| QNB | 154.00 | 169.40 | 12,734 | Acc. | Acc. | 11.2 | 10.0 | 10.4 | 2.6 | 2.3 | 2.0 | 4.0% | 23.8% | 23.2% |
| **Oman** | | | | | | **14.0** | **12.0** | **9.2** | **1.5** | **1.4** | **1.3** | **1.9%** | **12.8%** | **12.3%** |
| Bank Muscat | 0.93 | 1.24 | 2,588 | Buy | Buy | 8.9 | 10.2 | 7.9 | 1.2 | 1.1 | 1.0 | 2.2% | 14.4% | 11.2% |
| NBO | 0.33 | 0.41 | 932 | Acc | Acc | 13.0 | 9.2 | 7.8 | 1.4 | 1.3 | 1.2 | 1.9% | 11.6% | 15.0% |
| Dhofar | 0.61 | 0.53 | 1,172 | Red. | Red. | 17.3 | 15.2 | 12.4 | 2.2 | 2.0 | 1.8 | 2.0% | 13.1% | 13.6% |
| Sohar | 0.22 | 0.20 | 563 | Neu. | Neu. | 32.8 | 18.7 | 11.3 | 2.1 | 1.8 | 1.6 | 0.0% | 6.6% | 10.6% |
| **Morocco** | | | | | | **29.0** | **24.2** | **21.7** | **3.6** | **3.3** | **3.0** | **1.6%** | **15.7%** | **15.4%** |
| Attijariwafa Bank | 269.00 | 309.82 | 6,607 | Neu. | Acc | 16.1 | 14.9 | 13.6 | 2.4 | 2.2 | 1.9 | 1.9% | 16.7% | 16.1% |
| BMCE Bank | 235.00 | 150.34 | 4,837 | Red. | Red. | 53.3 | 42.3 | 37.2 | 5.8 | 5.4 | 5.0 | 1.0% | 12.8% | 13.2% |
| BCP | 267.00 | 296.92 | 2,127 | Neu. | Neu. | 13.5 | 12.1 | 11.7 | 2.5 | 2.2 | 1.9 | 2.2% | 19.0% | 18.4% |
| **Kuwait** | | | | | | **33.7** | **17.0** | **12.1** | **2.5** | **2.3** | **2.1** | **1.9%** | **11.5%** | **13.7%** |
| NBK | 1.28 | 1.27 | 12,077 | Neu. | Neu. | 15.2 | 13.6 | 12.0 | 2.5 | 2.3 | 2.1 | 3.0% | 16.9% | 16.2% |
| CBK | 0.99 | 0.78 | 4,395 | Red. | Red. | 112.1 | 24.9 | 13.3 | 2.8 | 2.7 | 2.4 | 0.0% | 2.5% | 11.2% |
| Burgan Bank | 0.38 | 0.63 | 1,363 | Neu. | Buy | 18.1 | 7.3 | 4.9 | 1.2 | 1.1 | 1.0 | 1.6% | 5.7% | 12.5% |
| Kuwait Finance House | 1.32 | 1.39 | 10,736 | Neu. | Neu. | 24.3 | 18.7 | 12.7 | 2.5 | 2.3 | 2.0 | 1.6% | 9.9% | 12.2% |

*Countries averages weighted by market cap.
Note: Pricing as of 01 October 09 for UAE, Egypt, Qatar and Oman. Pricing as of 02 October 09 for Lebanon and Morocco
Pricing as of 03 October 09 for Saudi Arabia
Source: EFG-Hermes estimates

## EXECUTIVE SUMMARY - SIGHTING LAND

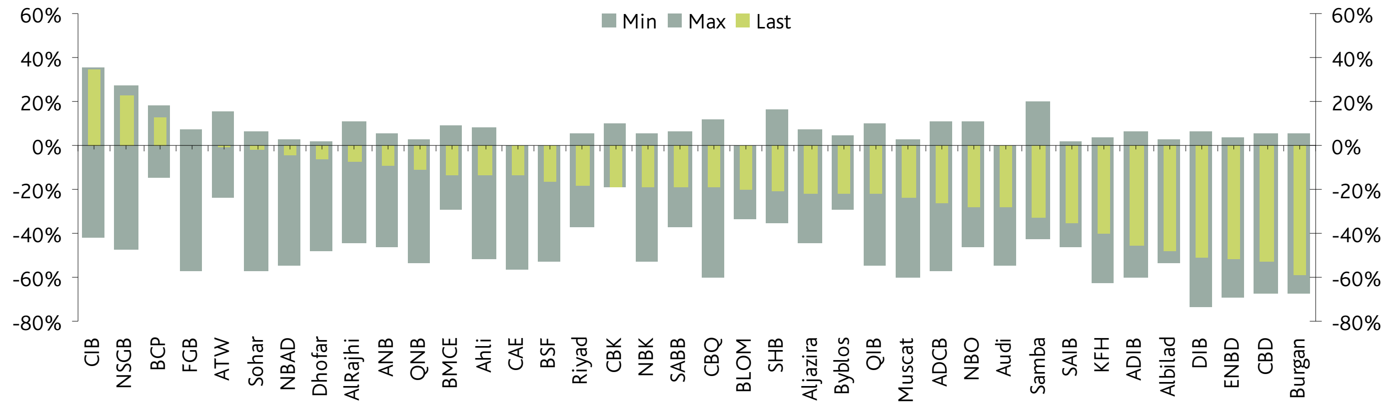
As the crisis began, we took a rather sanguine view of the outlook for most of the banks in the region. We did indicate a higher discount rate to account for uncertainty, and adjusted forecasts for substantial trading losses and a heavier burden from loan loss provisioning. However, we did not forecast a catastrophic downturn for any of our banks, which left most upsides on the then prices exceeding 100%. While for a period, therefore, the main challenge was to differentiate our preferred picks from the remaining good opportunities, the rebound of valuations across the board has made this a much more interesting exercise.

### STOCKS HAVE REBOUNDED FROM THEIR LOWS

In addition to the rebound of share prices, a lot of water has now passed under the bridge, and where we once had just theories, we now have substantially more facts. Many of the MENA economies, and the banking sectors therein, are still very much “amidst the maelstrom”. Nevertheless, after a turbulent twelve months, we believe it is now time for a re-evaluation of the MENA banking sector.

**Figure 2: Share Price Movements Since 01/10/08**

%, unless otherwise stated



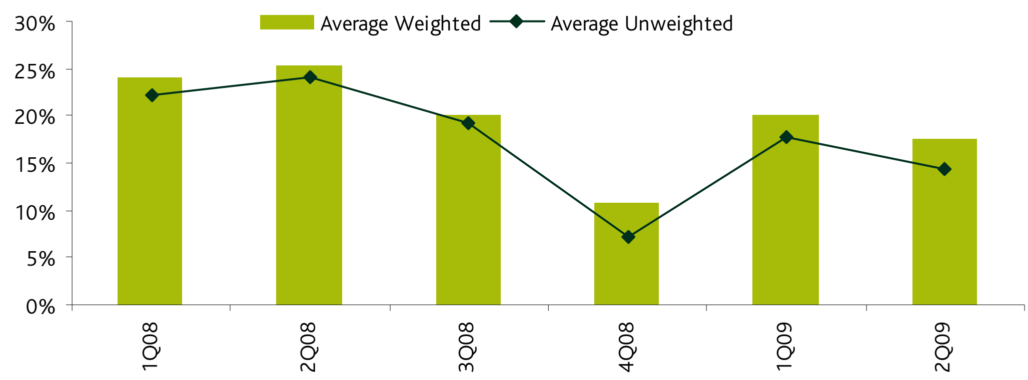

Source: Zawya, EFG-Hermes

### RE-EVALUATING MENA BANKS: STILL GOOD ABSOLUTE VALUE & COMPARED TO GLOBAL PEERS

Our primary reason for such a re-evaluation is our belief that the sector as a whole represents good value compared to global peers. While the rebound does mean prices have risen dramatically, all of the MENA banks are still trading at prices well below those of a year ago, which were perhaps expensive but were not outrageous. Were we wrong? Has the outlook changed so dramatically? Is risk so much higher than it was before? We offer a little "yes" to each of these questions, but even allowing for this, valuations seem far from stretched.

Even with a conservative approach, we believe that the sector shows good value. For comparison purposes, we take as a very simple valuation benchmark a company with zero growth, a 20% sustainable return on equity (ROE) and a cost of equity of 10%. Using a simple Gordon’s growth model, this company would be worth two times book. Are our banks able to earn and maintain these returns? Are they able to grow profitably? Is this a fair discount rate for our countries? With many of the banks in our universe historically earning ROEs substantially in excess of 20%, this benchmark seems eminently achievable. Indeed, even over the last six quarters, the sector ROE has only dipped below 15% for one quarter. Meanwhile, although we use a modestly higher discount rate than 10% (much higher for Egypt and Lebanon), the prospects for continued long-term profitable growth in the region are solid. As such, we believe the sector P/B valuations, generally clustered around 1.0 - 2.0, show significant upside potential.

**Figure 3: MENA Banks Return on Average Equity, Quarterly (ex Morocco*)**
%, unless otherwise stated



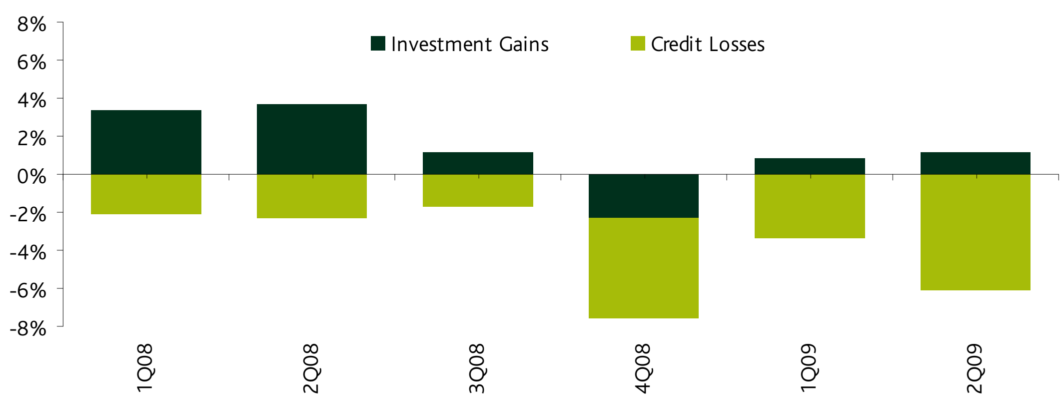

*Moroccan banks do not report quarterly financial statements
Source: Company Reports, EFG Hermes estimates

## INVESTMENT GAINS REVERSING, CREDIT PROVISIONING RISING

Of course there are a number of issues that need to be addressed, the first of which is to examine to what extent banks are going to be negatively affected by current market conditions. As we can see from Figure 3, returns declined sharply in 4Q2008 as investment portfolios were battered by market conditions. Furthermore, while investment returns suffered, this reflected a marking to market of only the tradable assets held in the trading portfolio. Tradable assets not held in the trading portfolio, as well as non-tradable assets, such as unlisted investments, property investments and associates, are also likely to be worth less than accounting numbers currently suggest.

In general however, while there should have been greater mark downs (from a mark-to-market point of view), we have found that the impact of this would be fairly contained. The issue is clearly greater in the UAE, where stocks such as DIB, ENBD and ADCB have seen their shares suffer partially as a result of this, but even there the impact is limited.

**Figure 4: Credit and Investment Losses**
Impact on ROAE (percentage points)




Source: Company Reports, EFG Hermes estimates

## CREDIT QUALITY UNDER THE SPOTLIGHT

The biggest item on the balance sheet, however, is customer loans, and the fair valuation of these has also been the greatest contributor to valuation uncertainty. Up until 2Q2009, provisioning has been largely restricted to retail sector lending, especially in the UAE, as corporate sector lending takes longer to materialise. In addition, 'Name Lending' has turned out to be a fragile area of the loan book for the UAE, Omani and Saudi banks, with the revelation of systemic exposure to the Saad and Algosaibi Groups totalling perhaps as much as USD22 billion, although some of this is shouldered by international banks. Egyptian banks stand out for the very benign credit quality conditions up until 1H2009. While forecasting inflection points on provisioning with any level of accuracy is still difficult, the level of clarity is improving. Although provisioning is yet to stabilise, the key point on provisioning is not that it continues to deteriorate, but that its glide path is no worse than we had expected. For most MENA economies we expect the end of 2009e will see banks through the worst, and for normalised levels of provisioning to be reached around the end of 2010e.

### Settlement by the Saad Group - Glass Half Full or Half Empty?

The biggest shock so far to MENA banks' asset quality has come from two of the largest business groups in Saudi Arabia - the Saad and Algosaibi Groups. Unconfirmed media reports suggest that the Saad Group has reached a settlement with banks in Saudi Arabia. While this settlement is restricted to Saudi banks only, we believe that any settlement will eventually include international and regional banks as well. We believe that any selective debt settlement would significantly impact the Middle East's access to funding via international markets.

Progress towards reaching some kind of an agreement by the Saad Group with Saudi banks has cheered investors, showing up in strong price performance in the banking stocks. However, the Algosaibi Group has yet to make any visible progress on debt restructuring. The issue of legal cases filed against and by the Algosaibi Group further complicates the issue, in our opinion, and means that progress in the short term is unlikely unless there is some sort of political resolution to the dispute between the Saad and Algosaibi Groups.

### Outlook on Loan Quality

Why are we so sanguine on loan quality? One reason is because in the most leveraged economies - the well-funded economies of the GCC - there are deep reservoirs of liquidity that act as control rods, mitigating systemic risk by guaranteeing jobs for nationals and the solvency of public sector entities. For the less well-funded economies, in the case of Egypt and Lebanon loan deposit ratios are fairly low, with banks obtaining significant revenue from government sources. In Morocco, the global crisis has so far affected most significantly those sectors directly dependant on external demand (textiles and tourism), but private consumption continues to be a main driver of banking sector growth. In addition, throughout the region, banking sector operating and financial leverage is low, as can be seen from the low cost-income ratio and high capital adequacy ratios. Consequently, there is substantial earnings power to absorb provisioning losses, and even if provisions unexpectedly balloon, the impact on equity would not be catastrophic.

### Provisioning likely to have peaked by 1H2010e

Given that we believe banks will survive the current troubles with little capital destruction and with their franchises largely intact (Dubai remains a risk to some extent), how far off will an earnings recovery be? Not that long, we believe. The primary drag on returns is the level of provisioning, which we think will diminish across the board by 2H2010e. While growth is unlikely to ever reach the stratospheric heights seen before the crash, we believe more limited growth, in line with the reduced ambitions of the banking sector, is likely within a similar time frame.

## EXPECTING RECOVERY IN 2010E

Slowing economic growth, weak demand and funding constraints has had a dampening impact on bank growth, which decelerated sharply over the past year. While some of these trends are likely to persist in the near term, we expect credit growth to start showing signs of recovery towards the end of 2009e, and become more pronounced in 2010e as risk appetite improves. Qatar, Saudi Arabia and Oman are likely to show the quickest recovery, and credit growth is expected to improve to a range of 12-15% in 2010e, after dipping to a range of 4-6% in 2009e.

Reversion to the mean, notwithstanding, a return to peak levels of ROE is far from certain, in our view. Banks regionally, like their international brethren, may well be expected to maintain a higher level of capital, given perceived risks, and this excess weight may turn out to be difficult to shed as risk decreases and leaner operations are required. Slower growth may also impact the sustainability of ROE, as the absence of bull market conditions could encourage volume maximising behaviour amongst banks and price sensitive behaviour in corporate and retail consumers, and perhaps even regulators. Lower growth at home, combined with excess capital, could also encourage banks to deploy capital overseas into risky markets where foreign players have little competitive advantage. While many of these factors are likely to have some impact, we believe the scale of under-penetration in the non-GCC countries should help to offset these risks, while within the GCC the high level of state ownership should protect the markets. Nearby markets are also severely underserved, suggesting - for the banks we cover - access to the markets may be a more immediate challenge rather than profitability.

**UAE - Momentum Shifting**

Within our coverage universe, we believe the UAE represents the highest risk market. The economy has been the hardest hit in the region and asset price deflation has been sharp. In addition, the UAE has made little headway in addressing the problems in its property market, particularly in Dubai. Nevertheless, we believe that it is capable of doing so, and that the restructuring of the "Dubai Inc." property companies may demonstrate this. While provisioning will likely be a feature for the next several quarters, we believe that banks will ultimately return to solid levels of profitability. As such, valuations are at a deep discount to the region at 2009e P/E of 8.3x and P/B of 1.3x, on our conservative estimates. This represents a discount of 40% to the MENA average. ADCB and FGB are our top picks in the UAE, although we also highlight ADIB for those able to invest in restricted stocks.

**Saudi Arabia - Geared for a Recovery, But Valuations are Not Cheap**

We believe Saudi Arabian banks are geared for a strong recovery in 2010e, assisted by robust government investment. While year-to-date credit growth has been negligible, given asset quality concerns from exposure to the Saad and Algosaibi Groups, it has allowed banks time to significantly improve their liquidity. Capital adequacy levels across the sector are strong and, in our opinion, banks will be able to absorb the impact of any deterioration in asset quality. Recent news flow on the debt settlement to Saudi banks by the Saad Group has resulted in a strong rally in banking sector prices, making valuations expensive. We highlight Samba Financial Group as our top pick in the sector, which continues to trade at a discount to its peers - 2009e P/E of 10.9x and P/B of 2.3x. We also highlight Arab National Bank, a quality retail franchise and Banque Saudi Fransi, having a strong corporate franchise, as attractive.

**Egypt - A Safer Play, Potential for Long-term Asset Growth**

Egyptian banks are, in our view, a safe play in the short term, with the potential for strong asset growth in the medium to long term. Banks have been generally conservative in growing their loan books over the past three years, and lending exposure is primarily to the large corporate sector. NPL ratios have remained stable so far this year. While we expect them to increase, we do not believe that this will cause a significant shock to profitability. Low loan-to-deposit ratios provide room for asset growth, and we expect the retail sector to gradually impact on the banks' lending growth in the medium term. We like the three largest cap banks in Egypt, NSGB, CIB and Credit Agricole Egypt, with NSGB being our top preferred pick as it offers the highest upside potential to our LTFV estimate of EGP38.2 and the cheapest valuations at a 2009e P/E of 7.3x and P/B of 2.1x, with an ROE of 29.3%.

**Qatar - Lower Risk, Rich Valuations**

Qatar presents the strongest macro backdrop and the lowest risk profile. Banks have received strong support from the government, which has essentially bought out the main areas of balance sheet concern. Unsurprisingly, stock price recovery has been the sharpest in the region, with banks now trading at an average 2009e P/E of 11.7x and P/B of 2.4x. While medium-term credit and earning drivers are strong, we have difficulty awarding a premium to long-term growth, given the strong possibility of slowing public sector loan growth post-2012e. As such, we see valuations offering no better upside potential to other countries in the region. While we prefer the positioning of QNB, from a valuation perspective we now rate CBQ as our preferred pick in the country, despite lower visibility levels. The stock trades at a 2009e P/E of 11.2x and P/B of 1.7x.

### Oman - Overplayed Risk Perceptions, Attractive Valuations

With banking sector loan growth expected to start showing some recovery towards 4Q2009, we believe that Oman's banking sector dynamics are favourable. Funding issues have been largely managed, while domestic asset quality is holding up well. The pickup in government spending in 2Q2009 is improving general business confidence. For a dominant player with market share 3x as big as its closest competitor, Bank Muscat's valuation at a 2009e P/E of 8.9x and P/B of 1.2x looks extremely attractive, and we highlight it as our top pick.

### Lebanon - Resilience in a Volatile Environment

We expect Lebanese banks' earnings to show moderate growth in 2009e, with cost control and deposit-driven asset growth compensating for spread pressure. Lebanese banks' conservative lending policies and low loan-to-deposit ratios make credit quality risks less of an issue vs. some of their regional peers. However, growth opportunities are somewhat limited and dependant on political stability. Lebanese banks have been expanding into neighbouring markets, especially in countries with either low penetration levels and/or low competition. We like Lebanese banks for their strong management teams, their already proven ability to expand outside of Lebanon. Our top pick is BLOM, trading at a 2009e P/E of 7.3x and P/B of 1.4x.

### Morocco - Capital Controls, Rich Valuations

Moroccan banks continue to trade at a premium to the MENA average, despite lower levels of profitability. The Moroccan equity market premium relative to other MENA markets has to be seen in the context of capital controls, which mean that most domestic liquidity is invested in domestic assets, primarily equities and real estate. We expect banks to post a considerable slowdown in earnings growth in 2009e, due to rising funding costs in an environment of tighter liquidity, slowing loan growth and our expectations of rising provisioning charges. While Morocco presents higher lending penetration levels than other North African countries with similar per capita incomes, we believe that there is significant long-term growth potential, particularly in the retail and SME sectors. Another key driver of medium- and long-term growth will likely be the banks' operations in Sub-Saharan countries. Our top pick in Morocco is Attijariwafa bank, trading at a 2009e P/E of 16.1x and P/B of 2.4x.

### Kuwait - Negotiating with the Political Stalemate

Kuwaiti banks are strongly capitalised, and we expect this capital cushion will absorb credit losses over the next two years. The current turmoil at Kuwait's investment companies, and the potential of contagion effects to the wider corporate sector, poses a significant risk to credit quality. We expect high provisioning charges to remain up until the end of 2010e. We also believe the long-term prospects for asset growth are more limited in Kuwait relative to other GCC countries, given the little impetus in government spending. Kuwaiti banks trade at high multiples relative to their MENA peers (ex Morocco). Burgan Bank is our top pick in Kuwait, and trades at a large discount to the sector at a 2009e P/E of 18.1x and P/B of 1.2x.

**Figure 5: Model Portfolio**

| | Price | LTFV | | Recommendation | | | P/E | | | P/B | | Yield |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | LC | LC | Upside | ST | LT | 09e | 10e | 11e | 09e | 10e | 11e | 09 |
| **Model Portfolio** | | | | | | | | | | | | |
| FGB | 16.80 | 26.31 | 57% | Acc. | Buy | 8.6 | 7.5 | 5.6 | 1.4 | 1.2 | 1.1 | 1.7% |
| ENBD | 4.40 | 7.17 | 63% | Buy | Buy | 7.8 | 6.9 | 5.4 | 1.2 | 1.1 | 1.0 | 4.0% |
| Samba | 57.50 | 72.10 | 25% | Buy | Buy | 10.9 | 10.0 | 8.6 | 2.3 | 2.0 | 1.8 | 3.7% |
| NSGB | 28.50 | 38.19 | 34% | Buy | Buy | 7.3 | 6.6 | 6.3 | 2.1 | 1.7 | 1.4 | 3.5% |
| BLOM (GDR) | 84.00 | 104.2 | 21% | Acc | Buy | 7.3 | 6.4 | 5.6 | 1.4 | 1.2 | 1.1 | 4.1% |
| CBQ | 80.60 | 113.5 | 41% | Acc. | Buy | 11.2 | 11.0 | 8.8 | 1.7 | 1.6 | 1.5 | 7.3% |
| **Reserve List** | | | | | | | | | | | | |
| Bank Muscat | 0.93 | 1.24 | 38% | Buy | Buy | 8.9 | 10.2 | 7.9 | 1.2 | 1.1 | 1.0 | 2.2% |
| ADIB | 3.15 | 5.78 | 84% | Buy | Buy | 6.8 | 5.6 | 4.2 | 1.1 | 1.0 | 0.9 | 8.7% |

Note: Pricing dates as in Figure 1
Source: EFG-Hermes estimates

## I. STARTING AT THE BEGINNING

The start of the crisis was marked by a period of indifference, followed by denial, confusion, panic (in some cases), and redemption, over a period of about six months. Riding the rollercoaster most enthusiastically were UAE banks although others, especially in the GCC, were also affected. The initial impact was to create large investment losses, as well as severe funding and liquidity issues. The latter were broadly resolved at a systemic level by the action of Central Banks. Nevertheless, some banks still had to scramble for deposits, as they attempted to lower loan-to-deposit ratios, and in some cases address difficulties with rolling over wholesale and capital market funding.

### A. ASSESSING BALANCE SHEET STABILITY

*Market-related issues have dominated so far…*

There have been two large sources of red ink on the balance sheet, market-related losses and counterparty-related losses. With markets dropping across all geographical areas and across all asset classes, there has been a resultant impact on the current value of balance sheets. Some of these market-related losses have been booked to the income statement and balance sheet, some to the balance sheet only through the revaluation reserve, while some - such as those related to property, associates, unlisted equity and held to maturity investments - are not yet reflected on either.

*… But credit quality is now becoming the critical issue*

While market-related losses have stolen the show so far, counterparty-related issues are now getting more of a look. The principle counterparty-related issue for a bank is, of course, credit quality. While many of the banks took precautionary provisions in 4Q2008, provisioning intensified in 2Q2009. For GCC countries it began in earnest following the start of the Algosaibi and Saad disclosures.

*Strong capital ratios for most banks suggests capacity to absorb provisioning shocks*

Non-performing loan (NPL) ratios across the MENA banking sector, which still remain low, were particularly restrained going into the crisis. The strong economic environment over the past few years meant that there was little incremental flow of NPLs for most countries. This, coupled with strong loan growth, meant the bulk of loans were unseasoned. Deteriorating credit quality, exacerbated by the effect of loan book seasoning in an environment of slowing loan growth, poses a risk to asset quality. However, banks across the region have generally strong capital ratios, suggesting relatively high capacity to absorb shocks to the quality of the loan portfolio.

*Funding issues not quite so critical*

Balance sheet stability also requires stability of funding. Any mark-down in liabilities is not, of course, a concern, although some banks have benefited by buying back long-term debt. Instead, the concern is over the sustainability of funding and the risk that refinancing needs pose for the income statement and for the ability to maintain leverage.

While the liability side of the balance sheet seemed critical during much of 1H2009, with liquidity remaining tight in some economies (notably the UAE and Oman), MENA Central Banks have taken a number of steps to significantly ease this tight liquidity environment. In addition, in response to concerns over losses and liquidity, many of the Central Banks sought to either limit the damage to the banking sector, or to pump capital into the banking sector prior to any capital destruction.

#### CREDIT QUALITY

**NPLs Rising in GCC; non-GCC Credit Quality Conditions Remain Benign**

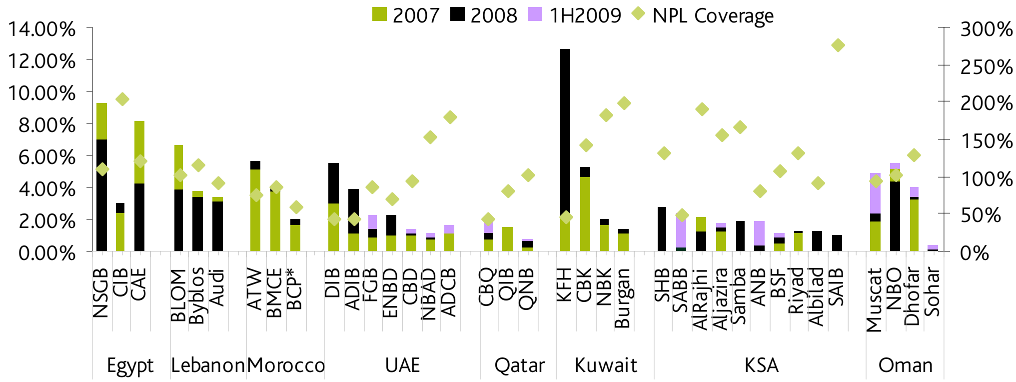
*NPLs started to rise in GCC in 2008/1H2009, but we are still at the beginning of the provisioning cycle*

NPLs started to rise in some countries in 2008 or in 1H2009. However, we believe that we are generally still at an early stage in the rising NPL cycle. Our view is based on the fact that credit quality tends to deteriorate first in the retail sector, with corporate-related NPLs taking longer to come through owing to the time-lag between deteriorating economic conditions and rising corporate defaults.

Across the region, NPL coverage is generally close to 100% barring a few exceptions. However, we believe that the incremental flow of NPLs is likely to push coverage lower and it is likely to take a year or two before coverage levels are back up to 100%. However, in almost all of the GCC countries, a coverage ratio of 100% is a general guideline, and this dictates precisely what provisioning will be.

*NPL coverage ratios high, but expect downward trend*

**Figure 6: Non-Performing Loans as a % of 2008 Gross Loans and Coverage**
%, unless otherwise stated




Source: Banks Financials, EFG-Hermes

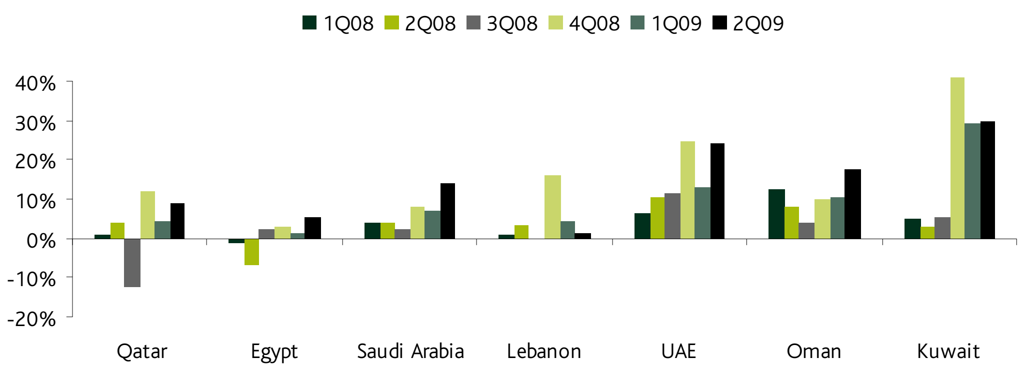
**General Portfolio Provisions & Retail Segment Driving Initial Increase**

*Retail sector new NPLs restricted to UAE and Qatar*

Provisioning increases have been the most severe in Kuwait, Oman and the UAE. In Kuwait and Oman rising provisioning has predominantly been the result of booking precautionary provisions, despite no documented increase in NPL ratios. In contrast, the UAE and Qatar have seen a pick-up in provisioning in the consumer sector, particularly the personal unsecured and credit markets. Mortgage defaults have not been an issue so far, and even for UAE banks the exposure is small at no more than AED5 billion for any bank.

In most of the other GCC countries, including Saudi Arabia, Kuwait and Oman, consumer loan portfolios exhibit significantly lower risks. The practice of salary assignments against loan facilities is the primary source of comfort, coupled with the fact that the majority of consumer loans in these countries are sourced from nationals who tend to be employed by the government, and hence face a fairly low risk of unemployment. In Egypt and Lebanon, the consumer segment remains significantly less developed. In contrast, Moroccan banks' retail loan books have grown rapidly in recent years, with growth particularly driven by mortgage lending. However, the relative stability in employment so far has led to stability in retail NPLs in Morocco.

**Figure 7: Loan Loss Provisioning as % Banking Income, Quarterly**
%, unless otherwise stated




Source: Banks Financials, EFG-Hermes

**Corporate NPLs - The Next Leg**

*Corporate NPLs; highest risks in the GCC*

The second quarter of 2009 also saw the first large corporate defaults, driven by Saudi's Saad and Algosaibi Groups. We believe this was the main reason for the 1H2009 increase in NPL ratios for some of the Saudi and UAE banks. Our understanding is that most MENA banks with lending exposure to the groups (Saudi, UAE, and Oman) have only partially provided for this exposure, and we expect related provisioning charges to continue to rise over the coming quarters. "Name lending" –lending without adequate security or adequate cash flow analysis – is an area that banks are aiming to move rapidly away from, but as yet no other names have come to light.

*Dubai is the focal point for all these risks*

In Dubai, the property boom has led to weak and unethical management practices across parts of the economy, and bad business models have been allowed to flourish. Consequently, we would expect significant stress in the corporate sector. In addition, with the construction sector accounting for a disproportionate portion of the labour force, the weak construction market is also likely to mean a weak labour market. Amongst the retail segment, higher expatriate populations will mean that weak labour markets are more likely to be reflected in provisioning. Finally, while investment losses are not restricted to Dubai, we would again expect them to fall disproportionately in Dubai, particularly with reference to the property sector. With Dubai itself not being an oil-rich emirate, and with the public sector also leveraged, the solvency of many Dubai enterprises is (and will continue to be) very dependant on the willingness of Abu Dhabi to provide funding.

*Corporate NPL risk relatively contained in Egypt and Morocco*

Corporate defaults in non-GCC countries, particularly Egypt and Morocco, have been minimal so far. While we expect NPLs to rise over the next two years for non-GCC banks, this increase should be relatively contained as banks have focused primarily on the prime corporate sector and their corporate loan books are largely diversified. Furthermore, loan growth was not as exuberant prior to September 2008 as it had been in some of the GCC countries.

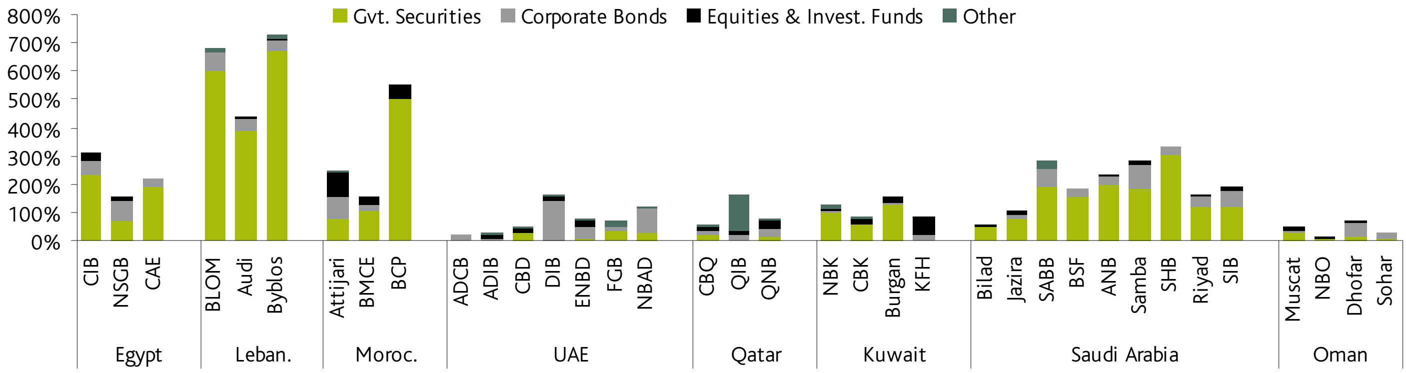
We believe the coming quarters will see an increase in provisioning levels, in particular as corporate provisions continue throughout the rest of 2009e and into 2010e. We currently expect the peak in the provisioning cycle, for some banks, to be reached possibly as late as 1H2010e. While we expect the situation will continue to worsen for many banks, there would have to be an extremely sharp rise to push any bank into losses. We do not currently believe that is likely owing to i) the high level of returns on assets; ii) the low loan-to-assets ratios in the non-GCC countries; and iii) significant state support within the oil-rich countries.

## INVESTMENT BOOKS RISKS ADDRESSED

Over the last 12 months there has been a progressive shift in the general profile of the investment books of banks, although this is truer in the GCC than for the rest of the region. Equities and funds represent a smaller portion of the overall amount. We believe this change is largely accounted for by mark-to-market losses on equities or derivative products within the investment book, although in some places such as Qatar, the main effect has been disposal of its equity portfolio.

As well as marking down their trading books, as required, we believe that banks have generally been timely in marking to market their available-for-sale portfolios (AFS), and current values are reflective of market values. These losses have either been booked in the income statement, or have been adjusted in shareholders' equity as part of the AFS portfolio adjustment. Indeed, during 2Q2009, total investment returns were again positive, with corporate credit and equity values making a positive contribution.

**Figure 8: Investment Books as % of Equity (December 2008)**
%, unless otherwise stated




Source: Banks Financials, EFG-Hermes estimates

The main uncertainty, we believe, relates to unlisted equity and unlisted corporate bond exposure, and to some extent we also keep an eye on the state of Dubai-based semi-public debt. Falling credit spreads locally and internationally have reduced the need for any markdowns, but we note that any exposure is likely to be concentrated. As for unlisted equity, we do not expect any bank in our universe to have significant exposure, with the exception of Attijariwafa Bank and Kuwait Finance House.

## PROPERTY & ASSOCIATES – RISKS STILL EXIST

Exposure to the property sector, particularly in Dubai, has been a particularly sensitive issue for the market. In contrast, rather surprisingly, exposure to associates has been much less so. In general, associates are valued at acquisition price, in the same way as property, and like property they are marked down if there has been a permanent impairment of value. Consequently, with the property market generally down 30-50% from its peaks and the equity markets broadly the same, scope exists to write-down a significant chunk of value. However, this must be looked at on a case-by-case basis. In addition, the impact of any write-down on overall valuation is relatively minor. Generally, it will not affect cash flows as we have already adjusted downwards yields on these assets. Consequently, a write-down of 5% or even 10% would push up book value multiples, but this would be compensated by boosting ROE from current forecast levels.

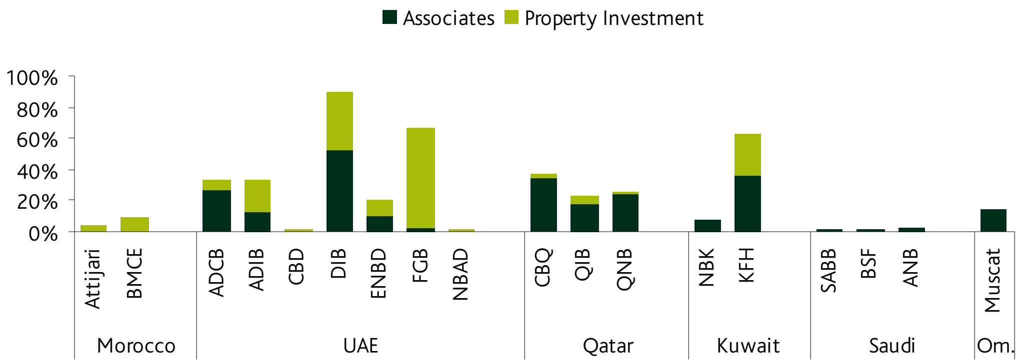
### Dubai Islamic Bank (exposure amounts to 89% of equity)

DIB has a number of associates, including banking operations in Sudan and Bosnia, and property operations in Dubai and Turkey. In 2008, these generated a yield of 9%, but Y-o-Y returns for 1H2009 are down 76%, with no particular bounce-back expected. The largest asset is Dubai-based property company Deyaar, which accounts for over half the associate portfolio. The stake is booked at AED2.6 billion, but is currently traded at AED2.13 billion. As for the property portfolio, approximately AED700 million was acquired at the peak of the market, while AED300 million represents property still under construction. Overall, if the market was to flat-line from here, a write-down amounting to AED700 million would seem plausible, amounting to 8% of equity.

### First Gulf Bank (exposure amounts to 66% of equity)

FGB's exposure in the segment is predominantly to property, and within that, it is mostly commitments. We continue to expect FGB to be able to liquidate its Abu Dhabi-based property portfolio. However, there is also a rump of exposure to lower quality Dubai assets, amounting to perhaps AED800 million, much of which is unlikely to see any returns in the foreseeable future and could in principle be written down. This would amount to approximately 5% of equity.

**Figure 9: Property and Associate Exposure, including Commitments (2008)**
As % of Common Equity, excluding banks with zero exposure




Source: EFG-Hermes estimates

**Kuwait Finance House (exposure amounts to 63% of equity)**
Perhaps the most problematic of KFH's associate exposure is Gulf Investment House (GFH), one of Kuwait's largest investment companies. GFH is in the process of restructuring its debt and is currently trading at a trailing PBV of 0.6x. KFH's investment in GFH dates back to the late 1990s. We estimate that the potential write-down could be equivalent to 4% of KFH's equity base. We are not, however, overly concerned by this as KFH's capital adequacy ratio is well above 15%, even after accounting for the implementation of Basel II for Islamic banks in Kuwait this year.

**Commercial Bank of Qatar (exposure amounts to 38% of equity)**
CBQ has two main exposures, to National Bank of Oman (NBO) and to United Arab Bank (UAB). The longstanding AED1.4 billion investment in NBO is underwater by approximately AED300 million. Meanwhile, the AED2.2 billion investment in UAB is currently in the black, but only because UAB continues to be richly valued at 4x book and 23x TTM PE. We believe there is a combined downwards revaluation risk of perhaps AED800 million, amounting to 8% of equity. Going forwards, we have assumed only a 5% yield on the current book values.

**Abu Dhabi Commercial Bank (exposure amounts to 33% of equity)**
ADCB made a rather unfortunately timed venture into the Malaysian market, buying a 25% stake in RHB Capital Berhad for AED4.3 billion in 2Q2008. The acquisition is currently about AED1.4 billion underwater, equivalent to 9% of equity. While the RHB Capital stake currently yields just 5% (1H2009), we understand that this was largely driven by a weak 1Q2009, from which earnings have significantly recovered.

**Abu Dhabi Islamic Bank (exposure amounts to 33% of equity)**
ADIB's most recent investment was the 49% stake in National Bank for Development of Egypt, an underperforming franchise with extensive turnaround possibilities. However, other significant associates include AD National Takaful, recently launched Paradigm Investment Bank and two Bosnian financial sector holdings. In addition, ADIB owns an Abu Dhabi-based property portfolio, which is primarily for development. In all cases, it is unclear how much downside risk there is, but ADIB for its part seems bullish on the valuations.

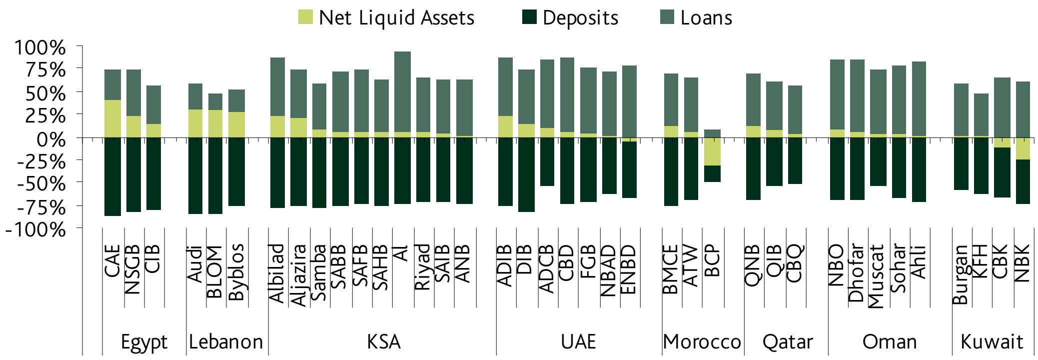
**Emirates NBD (exposure amounts to 21% of equity)**
ENBD's principle associate is Union Properties, although it also has a stake in National General Insurance. The combined market valuation of these entities falls approximately AED1 billion short of their book value, equivalent to about 4% of equity. Property assets, including a substantial portion of 'fixed assets not commissioned', amount to a further 10% of equity. Combined, this amounts to mark-to-market exposure of perhaps as much as 10% of equity, making ENBD one of the more exposed banks to property and associate risk.

### SECURITY OF FUNDING - RECENT TRENDS

With the liquidity situation deteriorating towards the end of 2008 and early 2009, the biggest risk that surfaced on the liability side of the balance sheet has been the security and sources of bank funding. While most of the banks in the region have been largely deposit funded, banks in the UAE and Oman have come under the spotlight due to their higher reliance on capital market and wholesale funding. Since the onset of the financial turmoil in 3Q2008, capital market and wholesale funding for banks has became scarce or more expensive.

This liquidity crunch was exacerbated, in some cases, by the upcoming maturities of capital market liabilities. Central Banks throughout the region stepped in to cushion the impact of the liquidity squeeze through a combination of deposit placements by government institutions, capital injections, and providing a USD swap facility to those banks facing funding issues. We believe that the immediate impact of the liquidity squeeze on banks has now passed. Slowing asset growth has allowed banks to focus on improving the composition of their funding, with banks now relying on raising deposits to meet their funding requirements.

**Figure 10: Sources of Funding and Use (2Q2009, except Morocco 4Q2008)**
%, unless otherwise stated



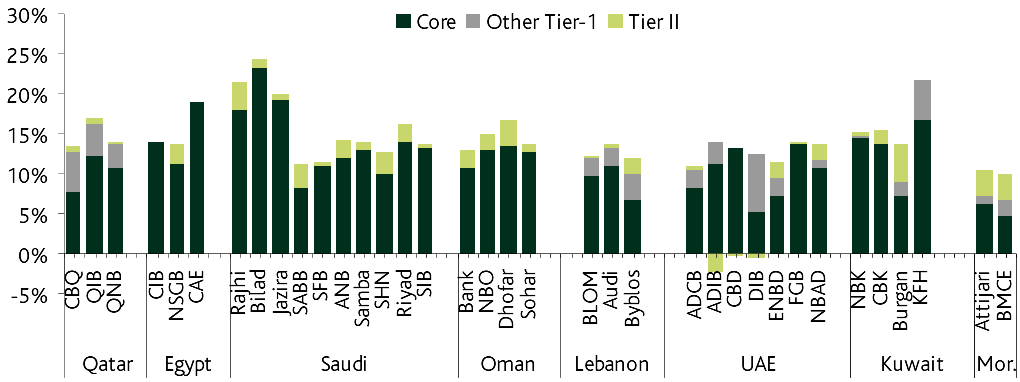

Source: Company reports, EFG-Hermes estimates

Most MENA banks, as of 2Q2009, have a strongly positive net liquid position (net interbank plus cash). The exceptions are ENBD in the UAE and NBK in Kuwait, both of which also maintain high loan-to-deposit ratios, in the region of 120%-plus. During a period of stress, this will have resulted in higher funding costs. However, in current market conditions, with interbank rates falling to around those of USD Libor rates, this is less of an issue. Only in Dubai is there still a differential, although it seems unlikely that this will be maintained.

### CAPITALISATION LEVELS HAVE BEEN STRENGTHENED

Significant threats to capital remain primarily from the potential write-down of property and associates, as well as a potential shock affecting loan quality. However, banks are well-capitalised: with the core tier 1 ratio generally over 10%. In addition, many banks have obtained further capital injections since the end of 2008. In particular, the Abu Dhabi banks (and ENBD) have issued tier 1 debt, while the Qataris are expected to complete the second capital issuance to QIA in 4Q2009e. With strong capital ratios, banks are well-placed to withstand any volatility that hits their balance sheets without needing further capital.

**Figure 11: Capital Adequacy 2008**
%, unless otherwise stated




Source: Banks financials, EFG-Hermes estimates

## B. RECENT TRENDS - WHERE ARE WE IN THE GROWTH CYCLE?

*Risky asset growth has dramatically slowed*

Loan growth, on a Q-o-Q basis, has slowed down to low single-digit numbers, or virtually zero in some cases. Banks have either focused on financing government projects, or diverting excess liquidity to government securities. This is helping banks to maintain or slightly improve their capital adequacy due to slow risk asset growth.

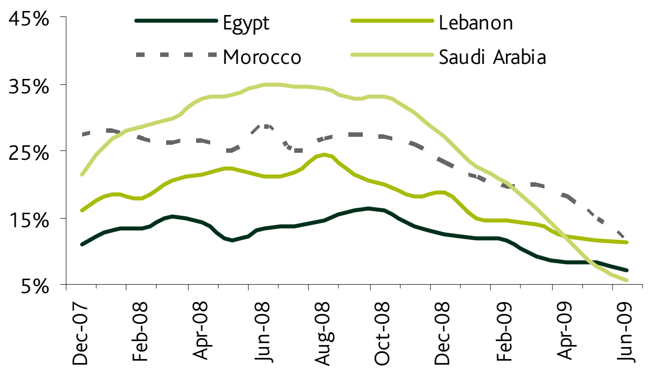
Banks are also paying particular attention to the sources and composition of their funding. Capital markets and wholesale funding have become more difficult and expensive, creating a strong restraining influence on balance sheet growth. On the other hand, banks are seeking to improve the composition of demand and saving deposits in their overall deposit mix to lower their deposit funding costs.

**Recent loan Growth Trends**

For Oman and Qatar, recent Y-o-Y credit growth rates have remained at around the 20% level, compared to the 30-55% growth rates witnessed during the late 2007 peak. In Qatar, public sector lending, on an underlying basis at least, has been a major driver. In Oman, banks have focused on growing their salary-backed consumer loan portfolios. In Kuwait, loan growth rates started to soften early in 2008 following several measures by the Central Bank to restrict loan growth, particularly in the real estate and consumer sectors. In the UAE, Central Bank data cannot be relied upon, but we understand that most banks are considering loan growth slightly exceeding 10%. Growth rates in Saudi have decelerated sharply to 5% Y-o-Y as incremental lending has been virtually minimal since the start of 2009.

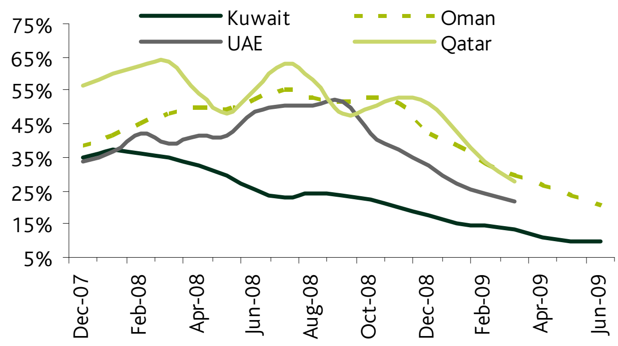
Within the non-GCC countries loan growth has also eased to around 10% Y-o-Y in June 2009 compared to a range of 15-25% in late 2007. Egypt's banking sector loan growth rate has been well below the other MENA banking systems throughout 2007 and 2008, at just 15% Y-o-Y. In Egypt's case, however, these figures are distorted in the 2006-2008 period as a result of large loan write-offs at the state-owned banks, which account for around 45% of system assets. The growth rate at private sector banks during the period was close to 25% Y-o-Y.

**Figure 12: Loan Growth (Y-o-Y) - Moderate Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

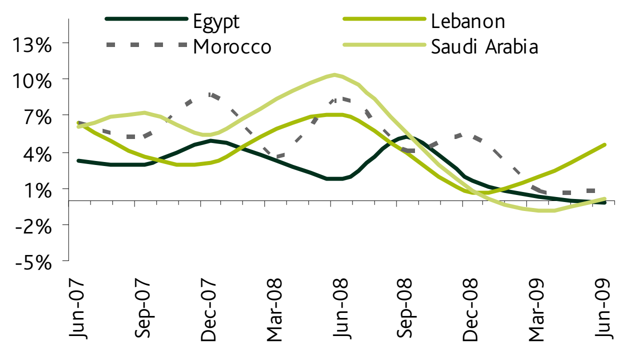
**Figure 13: Loan Growth (Y-o-Y) - High Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

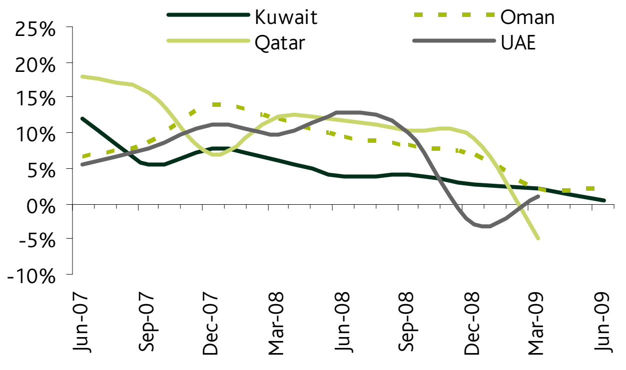
Since 3Q2008, Q-o-Q credit growth has remained at or below a still respectable 5%, with Saudi Arabia experiencing a slight contraction in aggregate credit. Qatar is also underwater in 1Q2009, but this was not a reflection of underlying trends. Loan growth rates for Lebanon and Morocco appear to have seen a slight recovery in 2Q2009. In Lebanon's case, this was driven by strong retail lending, with economic growth aided by strong tourism. The main driver in Morocco continues to be mortgages and, to a lesser extent, lending to the real estate and construction sectors, particularly infrastructure.

**Figure 14: Loan Growth (Q-o-Q) - Moderate Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

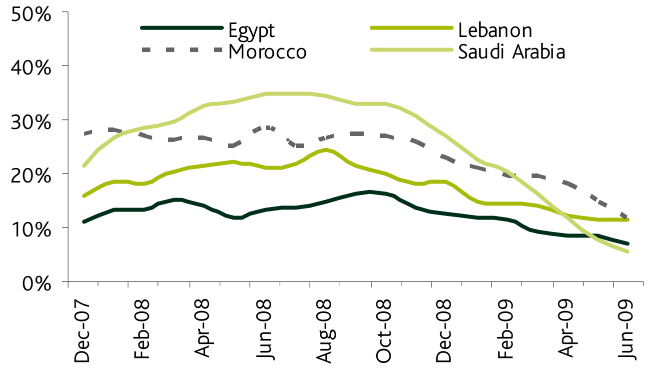
**Figure 15: Loan Growth (Q-o-Q) - High Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

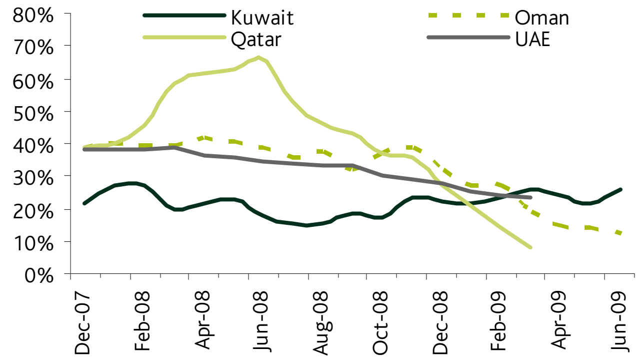
**Recent Deposit Growth Trends**
At the end of last year we were concerned for those banking systems that depended to a greater (Lebanon) or more moderate extent (Morocco) on remittances, as we expected transfers from non-resident depositors to suffer in the global economic environment. Against all expectations, deposit growth in Lebanon has remained fairly strong throughout this year, partly driven by a very large interest rate differential between local currency deposit rates and global interest rates. Morocco's deposit growth has softened since the end of 2008, partly due to lower transfers from Moroccans living abroad, but also owing to lower levels of liquidity in the system as a result of weaker macro-economic conditions (lower exports, lower tourism receipts).

**Figure 16: Deposit Growth (Y-o-Y)- Moderate Growth Countries**
in % unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

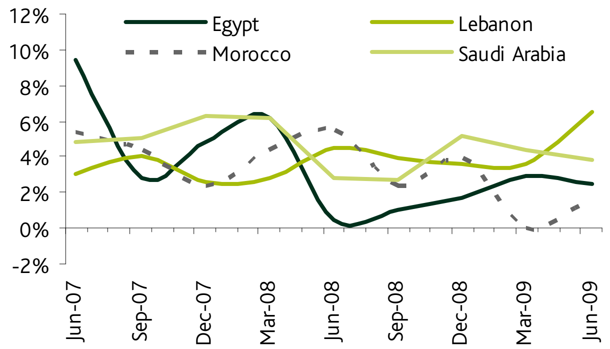
**Figure 17: Deposit Growth (Y-o-Y) - High Growth Countries**
in % unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

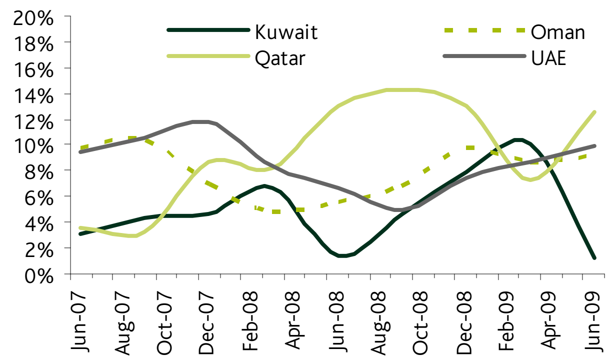
Within GCC countries, bank deposits have been generally supported by public sector injections into the system, diverting funds from international bank accounts. This has helped to replace the withdrawal of speculative deposits from mid-2008 that had been betting on the de-pegging of regional currencies from the then weak US dollar. In addition, in countries such as the UAE, there is some evidence that HNW deposits fled the system as concerns peaked about the liquidity of local banks.

**Figure 18: Deposit Growth Q-o-Q - Moderate Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

**Figure 19: Deposit Growth Q-o-Q - High Growth Countries**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes estimates

## II. MEDIUM-TERM GROWTH

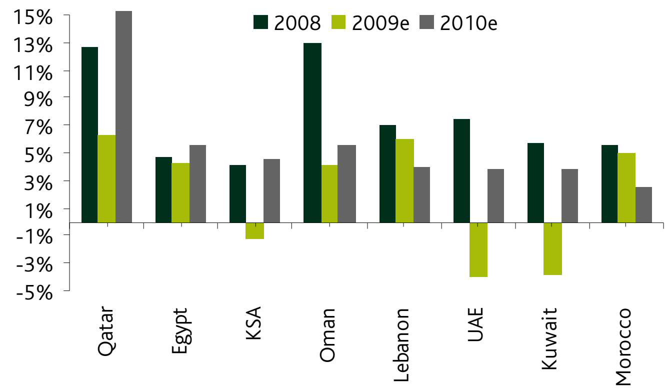
### A. MACRO PICTURE - SHORT-TERM PAIN

The drop in oil prices and the slowdown in the global economy has had a dampening impact on the economies in the MENA region. While a slowdown is evident throughout the region, it is much more severe in the oil-rich GCC countries due to the high share of hydrocarbons in the overall GDP. We however, see non-hydrocarbon GDP continuing to post decent growth, except for in the UAE and Kuwait, where non-oil GDP is expected to decline. Years of strong oil prices has led to a significant level of wealth accumulation in the GCC economies. However, this has been accompanied by reforms and diversification of the economy, and the governments are much better equipped financially to withstand the downturn.

*Slowing economy, funding constraints putting brakes on credit growth momentum*

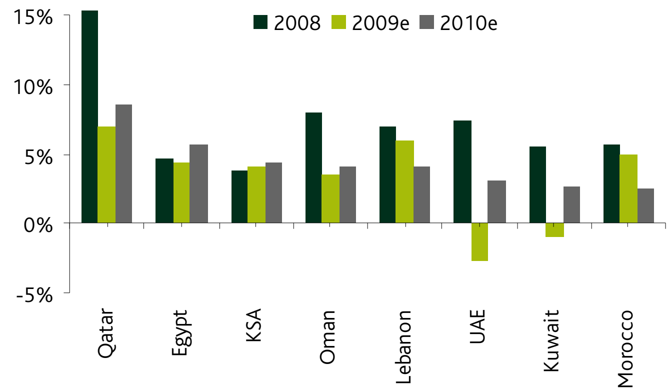
The slowdown in the economy and deflation of asset prices has translated into strong headwinds for the banking sector. Credit growth has decelerated sharply across the region, driven by a combination of slower economic activity, weaker demand and funding constraints. Although credit growth is likely to remain slow in 2009e, we expect a recovery in 2010e as the macro backdrop improves and risk appetite recovers. From a medium- to long-term perspective, favourable demographics and low penetration points towards a strong potential for credit growth.

**Figure 20: Real GDP Growth Estimates**
% growth, unless otherwise stated




Source: Central Bank Bulletins, EFG-Hermes Research estimates

**Figure 21: Real GDP Growth Estimates, Ex-Oil**
% growth, unless otherwise stated




Source: Central Bank Bulletins, EFG Hermes Research estimates

**Qatar to be the star performer medium term**
On a country basis, we see by far the fastest medium-term growth in Qatar, with the rapid expansion of LNG exports between 2010e-2011e being a major driver of the economy. However, increased government spending is likely to continue to drive GDP into the medium term. Consumer and business confidence has taken a bit of a dip in 2009, but not to the same extent as elsewhere in the GCC, and we expect a recovery in 2010e. Population growth has also dipped modestly in 2009, but we forecast a re-acceleration in 2011e.

**Egypt recovering fast**
While we initially had significant reservations about Egypt, we have seen much less weakness in the tourism and trade sectors than we had expected. The result is that we no longer expect the deceleration to continue into 2010e. Indeed, with the stimulus coming from infrastructure spending proving significantly more effective than had been assumed, we now expect the economy to be amongst the strongest in 2010e, with further progress being driven by investment spend. With tourism and trade being a significant driver of growth, an earlier recovery in Europe would be positive. Productivity gains due to improved infrastructure should lift potential growth in the medium and long-term.

**Saudi Arabia boosted by Public Sector spending**
Although we expect real GDP growth (including natural resources) to be negative in KSA this year, excluding natural resources we expect KSA growth to be one of the strongest in the region. This is in spite of the negative influence of the Saad and Algosaibi Groups. Particularly strong growth drivers are i) the

strong net foreign asset position, ii) the strong commitment to the investment program, and iii) the need to upgrade infrastructure. Longer term, the young population should ensure that the focus is on creating jobs, and we believe this is likely to be a future driver of growth.

**Abu Dhabi spending to bring UAE economy back to growth**
The UAE has seen the biggest decline in fortunes over the last two years. The collapse of the Dubai property market has been the main contributor, but tourism, trade and retail have also come under pressure. Immigration has also abated and, we believe, significantly reversed. Nevertheless, government spending (focused mostly in Abu Dhabi) is continuing, and this should help lead to an economic recovery in 2010e.

**Oman's recovery likely to be more gradual**
Oman has struggled to develop its non-oil sector as concerns rise over the long-term contribution of oil. In 2008, with construction expenditure increasing for both infrastructure and residential segments, non-oil GDP growth peaked at 8.0%. However, with fewer resources to throw behind a large government stimulus package, the deceleration in 2009 has been sharp. As elsewhere, we expect a gradual recovery into 2010e and beyond.

**Lebanon dancing to its own tune**
Lebanon and Morocco are the only economies where we expect decelerating economic growth going into 2010e. In Lebanon's case this reflects the economy's strength in 2009, as it continues to benefit from the peace dividend, and particularly strong tourism as well as resilient remittances. We believe fiscal and other economic reforms are unlikely, which means that inflows from non-resident Lebanese will be critical to rolling over debt and financing high fiscal deficits.

**Strong harvest disguises Moroccan weakness in 2009**
In Morocco, on the other hand, we see weak non-agricultural growth dragging down GDP, although this has been offset in 2009 by the impact of a record harvest. As the latter is not expected to recur next year, the weak phosphate market, lower European demand and falling consumer strength are likely to weigh on growth, notwithstanding a public sector stimulus package. Continuing current account deficits are a concern. However, as the European economy recovers, an improving investment environment and low inflation will likely mean a recovery in FDI flows.

**Kuwaiti politics restraining recovery**
Despite a strong ability to continue spending, the weakest of the GCC countries is likely to be Kuwait, with a political impasse blocking key national projects. In addition, we expect the fiscal stimulus to be more limited than elsewhere. The financial sector stabilisation package is important, but is unlikely to directly drive shorter-term growth. While in principle these problems are temporary, experience has shown that they are likely to be difficult to resolve.

**Figure 22: Key Macro Indicators**

| | KSA | | UAE | | Kuwait | | Qatar | | Oman | | Egypt | | Lebanon | | Morocco | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f | 2009f | 2010f |
| Nominal GDP (USD bn) | 349.2 | 401.9 | 194.4 | 217.9 | 109.7 | 116.4 | 92.1 | 123.3 | 51.6 | 58.7 | 194.5 | 206.6 | 31.1 | 33.6 | 88.0 | 89.1 |
| Real GDP Growth Rate, % | (1.3) | 4.5 | (4.0) | 3.8 | (3.8) | 3.8 | 6.4 | 17.9 | 4.1 | 5.6 | 4.0 | 3.0 | 4.0 | 3.0 | 5.0 | 2.5 |
| CPI Inflation, Annual Average % | 4.8 | 5.0 | (5.3) | 1.0 | 5.2 | 5.0 | (3.0) | 5.0 | 2.5 | 8.3 | 9.9 | 8.5 | 4.0 | 5.0 | 1.1 | 1.5 |

*Fiscal Year ends in June for Egypt, March for Kuwait, and December for all other countries
Source: EFG-Hermes estimates

## B. BALANCE SHEET GROWTH - EXPECTING RECOVERY IN 2010E

*Credit growth to recover on fiscal stimulus, improving risk appetite*

After a sharp slowdown in 2009, we expect balance sheet growth momentum to pick up pace in 2010e. The increased risk averseness of banks, coupled with a pullback in corporate expansion plans are likely to have been the major factors dampening credit demand in 2009. However, the recovery in oil prices has boosted the GCC governments' ability to continue with their planned investment spend, although ambitions have been scaled back. While banks are likely to spend much of 2009 in reassessing the risk profile of their customers, the continuing strength of government spend is likely improve confidence levels, and we expect loan growth to recover in 2010e.

Lack of visibility on the health of the corporate sector, together with the impact of the global slowdown on businesses, has been a major factor constraining banks from adding credit risk to their balance sheets. The risk perception of the banking sector was particularly affected by liquidity crunch experienced at the Saad and Algosaibi Groups, two of the largest family business groups in Saudi Arabia. We believe that banks will have improved visibility on the health of the private sector by the end of 2009e, and are likely to selectively start looking at credit growth opportunities.

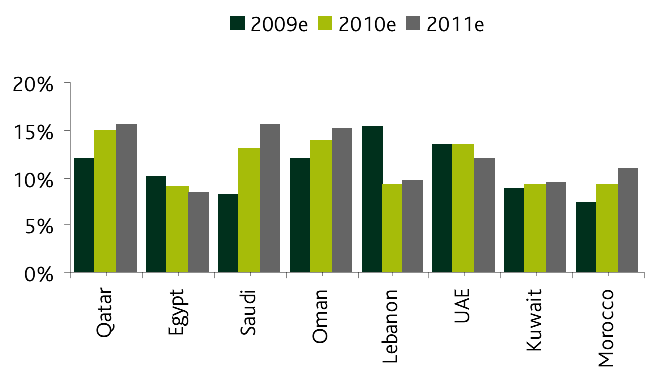
*UAE to experience de-leveraging, Kuwait constrained by political deadlock*

While we expect credit growth to recover to double-digit levels in most of the MENA economies in 2010e, we expect slower growth momentum in the UAE - where we expect de-leveraging to continue to have a dampening impact on net credit growth, and Kuwait - where the pace of credit growth is likely to be constrained by a lack of political consensus on the government's investment plans. We expect a faster recovery in Qatar and Saudi Arabia, where governments have adopted a counter-cyclical stance, and have stepped up their investment spend. Although Oman ranks lower in terms of resources compared to Saudi and Qatar, it has fewer issues to deal with. This will enable the government to resume its development spending at a faster pace compared to the UAE and Kuwait. We expect lending growth momentum in both Egypt and Morocco to resume at the end of 2010e, owing to an expected recovery in corporate investment following an anticipated resumption of growth in most European economies.

**Figure 23: Loan Growth Estimates**
%, unless otherwise stated


Source: EFG-Hermes estimates

**Figure 24: Deposit Growth Estimates**
%, unless otherwise stated




Source: EFG-Hermes estimates

## QATAR, SAUDI AND OMAN LIKEY TO POST QUICKER RECOVERY

*Government adopting a counter-cyclical stance*

In the near term, we believe that government financial stimulus remains a key driver for improving credit demand. Continued investment spend by the governments is improving business confidence, and is creating opportunities for growth. In addition, the level of governmental support to the banking sector is increasing the confidence of banks to look at selective credit growth opportunities.

While we expect a recovery in credit growth across the board, we are of the view that it is likely to be quicker in GCC - particularly in Qatar, Saudi Arabia and Oman. In Qatar and Saudi Arabia, this recovery is likely to be supported by the relatively strong financial position of both governments, which enables them to adopt a counter-cyclical stance as the private sector slows down. Excesses committed by Oman have been few, and represent relatively manageable challenges for the government. The recovery in oil prices has boosted government confidence, which has translated into renewed vigour in investment spending.

## GROWTH IN UAE AND KUWAIT TO REMAIN SUBDUED

*Dubai deleveraging is likely continue in to 2010e*

We believe that credit growth in 2010e will be constrained by continued de-leveraging in the UAE, particularly in Dubai. The slowdown in Dubai, which had the highest leverage in the UAE, has been severe and is likely to be prolonged. We believe that the unwinding of liabilities from both the corporate and the consumer sector is likely to keep credit growth restrained. Although corporates in resource-rich Abu Dhabi is better managed and less leveraged, banks have exposure across the UAE. The slowdown in Dubai is therefore likely to have a dampening effect on the credit growth of banks across the country.

*Political deadlock constrains government spending*

Government spending in Kuwait continues to be constrained by the political deadlock. The current turmoil in Kuwait's investment companies, and the potential of contagion effects to the wider corporate sector, poses a significant risk to credit quality, and hence the risk appetite of banks. We believe that this is likely to keep recovery in credit growth restrained.

## MODERATE LEVELS OF GROWTH TO SUSTAIN IN EGYPT AND MOROCCO

*Egypt's loan growth recovery geared to the corporate sector*

Banks in Egypt remain relatively well-funded, and have had to bear less stress than their peers in the region in the current downturn. Corporate lending demand has eased after the very strong momentum in 2007-2008, leading to slower credit growth in 2009. We expect loan growth to recover in 2010e, but the most significant pick-up in growth will take place, in our view, from 2011e, when we expect corporate investment growth to resume. Consumer lending is a potential area of long-term growth, but we expect it to have a gradual impact on the banks' asset growth.

*Residential mortgages continue to drive credit growth in Morocco*

Morocco's credit demand has softened in 2009, following the slowdown in growth in the non-agricultural sectors. Lending demand remains nevertheless solid in the retail segment, and particularly driven by mortgages. The Moroccan government's ongoing focus on infrastructure spending will likely also be a source of credit growth in the short and medium term.

## LEBANON IMPACTED BY SLOWDOWN IN THE REGION

*Regional credit demand was a driver of credit growth*

Credit growth at Lebanese banks over the past two years has been driven by the banks' increasing focus on lending to regional corporates using the ample foreign currency liquidity in their domestic balance sheets, as well as by their growing regional subsidiaries. The slowdown in economic growth in the region has resulted in a significant slowdown in lending growth this year. Lebanon's economic growth is, by contrast, very robust in 2009 and it is driving retail lending growth in Lebanon. However, this will not likely be enough to compensate for the slowdown in regional corporate loan growth. We nevertheless believe that Lebanese banks are well-positioned to post a recovery in loan growth once wider MENA economic growth picks up.

## OVERCOMING FUNDING CONSTRAINTS

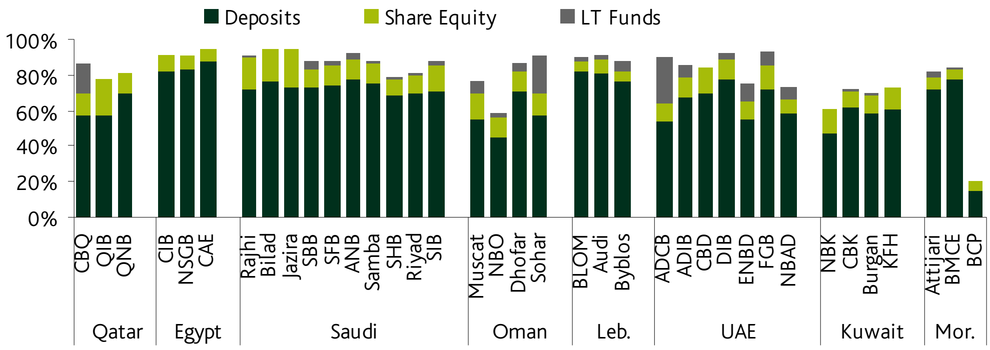
*Wholesale funding to remain limited; shift towards domestic deposit driven liability mix*

Improving domestic deposit funding will be a key factor driving credit growth, as liquidity from international wholesale funding markets is unlikely to return to pre-crisis levels. While banks in the region are largely deposit funded, previously buoyant credit growth had forced banks to tap into wholesale funding. For the UAE, Oman and, to some extent, Qatar, the drying-up of the wholesale funding market over the past year has been a major factor constraining growth. In the short term, we believe that those banks with higher wholesale funding will have more limited growth as they de-leverage and shift towards a higher deposit-driven liability mix.

*Funding issues were exacerbated by buoyant credit growth*

More moderate levels of credit growth, however, will allow banks to maintain a high level of deposit funded liability structure. For GCC countries specifically, a key upside risk to loan and deposit growth is the level of oil prices, and their impact on government spending plans. Clearly, this is likely to be the single most important driver of growth in the short term. We expect a normalisation in deposit growth rates in Lebanon from 2010e onwards, as the high interest rate differential between LBP deposits rates and global interest rates has boosted 2009 deposits. We also expect a slight softening in deposit growth in Egypt, although these estimates might be conservative if cross-border deposits regain momentum perhaps due to an improvement in liquidity levels in the GCC region.

**Figure 25: Capital and Long-Term Funding (December 2008)**




Source: Company Reports, EFG-Hermes estimates

## C. DRILLING DOWN TO INDIVIDUAL SEGMENTS OF THE ECONOMY

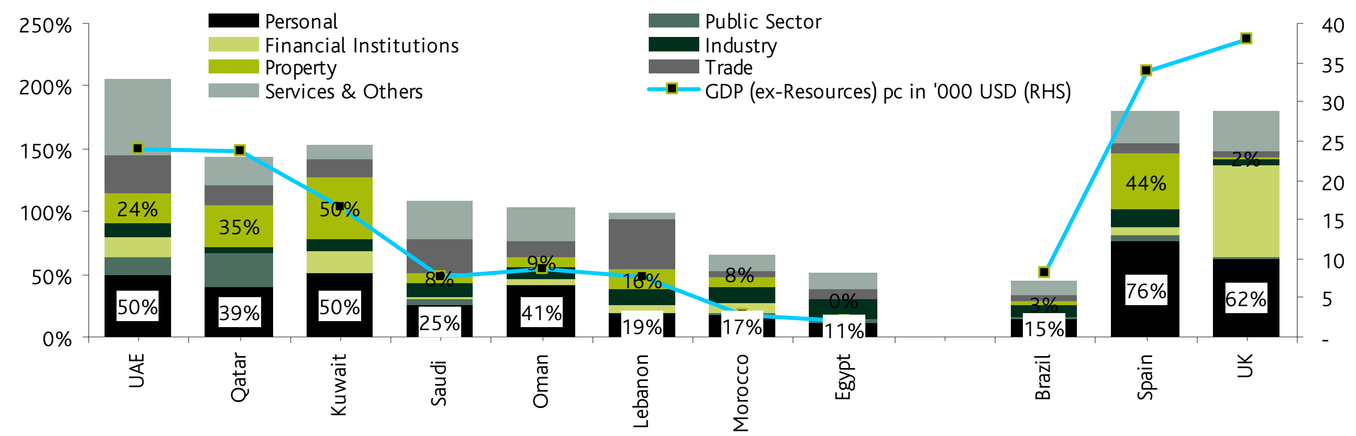
*Credit penetration supports long-term structural growth*

From a structural point of view, credit penetration remains a strong argument, in our view, determining the long-term potential of the region. We are of the view that favourable demographics and a growing population are key long-term drivers for credit growth. However, the diversification drive of the oil-rich GCC region is also a major structural driver for credit growth in the medium term. Infrastructure remains under-developed in the region as a whole, and we believe high government spending will continue to be a major credit demand driver.

*Kuwait, UAE, Qatar and Oman's retail sectors over-penetrated*

Although bank credit to GDP levels still look benign, we believe a more appropriate approach is to look at bank credit to GDP ex energy, as the energy sector utilises relatively little bank credit, but provides a large contribution to GDP. On this measure, Qatar looks relatively indebted. Consumer credit also appears over-penetrated in Kuwait, the UAE and Oman, with most of the lending exposure being consumer and related to stock market purchases. Mortgage lending in these countries is either small or non-existent.

**Figure 26: Lending Penetration by Sector, As a % GDP ex Resources**
Property Sector, Personal Lending Split out




Source: Central Banks, EFG-Hermes estimates

Property exposure for Qatar at first sight looks significantly over-penetrated, even compared to the troubled UAE market. However, this includes both real estate and contracting loans, with contracting exposure amounting to just 9% of GDP. While this is clearly quite high compared to a more developed country such as the UK, it is significantly lower than the UAE's figure of 24%. Similarly, construction exposure in Kuwait is limited to a more sustainable 10% of ex energy GDP, with the balance of property loans being real estate related.

**Saudi Arabia** - Penetration in Saudi Arabia remains well below its GCC peers even after adjusting for the large share of hydrocarbons to GDP. Part of this is explained by the role of government institutions, which provide long-term funding to industrial projects. While consumer penetration appears to be on the higher side, mortgage penetration is extremely low. Low home-ownership in the country points to significant potential for mortgage lending. However for that to occur, a foreclosure law must be clearly defined and implemented.

**Oman** - Consumer lending, which accounts for almost 40% of the banking sector's loan portfolio in Oman picked up substantially after the Central Bank relaxed the limits imposed on the size of the banks' consumer portfolios. In the early part of the decade, the Central Bank gradually increased the limit on the size of the banks' consumer loan portfolios, raising the ceiling from 25% of loans in 1999 to 40% by 2003. This was done to boost lending in the country and to increase consumer spending. Corporate lending picked up during 2005, as the government increased its spending on developing the infrastructure of the country. The other major segment of the loan portfolio is services, which notably includes the tourism industry.

**Non-GCC countries, Egypt and Morocco** - are perhaps the most directly comparable countries within our non-GCC universe, given their similar GDP per capita levels and large populations. Egypt's banking sector appears under-penetrated compared to Morocco, both in the corporate and retail sectors. Lending penetration in Morocco has increased over the past ten years, while Egypt's share of loans to total GDP has been declining over the same period, with lending growth in Egypt being below that of inflation, especially over the past three years. There are several reasons behind these trends: (i) the Egyptian system has been de-leveraging since the late 1990s, following the banks' significant accumulation of exposure to the real estate sector and the subsequent bursting of the property market in Egypt in the earlier part of the decade; (ii) government securities were offering high interest rates up until 2005, with banks having little incentive to lend to the private sector; (iii) Morocco's lending growth has, to a great extent, been a function of very low interest rates over the past six years; and (iv) Moroccan banks have been more aggressive in capturing the retail market.

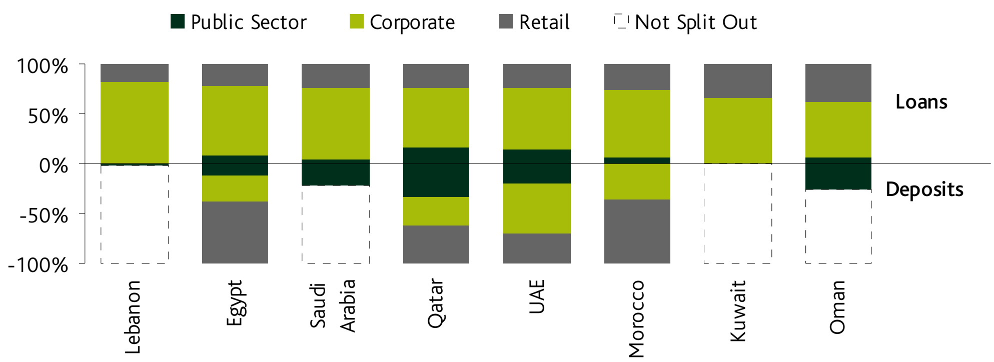
Lebanon's loan-to-GDP ratio of slightly above 100% is relatively high, but it also denotes an economy below its potential output.

## D. CUSTOMER SEGMENTS

*Retail deposits funding corporate loans*

Across most of the region, it is the corporate sector, which dominates the loan book. However, in many cases the principle source of funding is the retail segment. Indeed, Central Bank statistics suggest the banking sector acts as a conduit for retail deposits to the corporate sector in Egypt, Qatar and Morocco, although we believe the same is true in Lebanon, Saudi Arabia, Kuwait and Oman. In most of the oil-driven economies the public sector is also a net provider of liquidity to the system, although on a smaller scale. Indeed, the only place where this relationship does not seem to hold is in the UAE, where each segment is more self-funded.

**Figure 27: Split of Loans and Deposits by Counterparty**
%, unless otherwise stated




Source: Central Banks, EFG-Hermes

*Corporate sector risk driven by management quality*

Within the corporate sector, as one bank mentioned to us, loan quality is not necessarily a reflection of the sector of exposure or the degree of leverage of the borrower, but more often than not a reflection of good versus bad business practices from management. While this may be true, bad practices seem more prevalent in the property sector, particularly in Dubai, and businesses related to immigration, luxury goods and consumer durables seem to be suffering across the board. By contrast sectors such as services and trading are so far relatively untouched.

The worst business practices largely relate to segments such as "name lending", loans for share purchases and the property sector. In all three segments, some banks have closed their books to new lending, and in some cases decided to exit the segments entirely. While the concerns on loans for share purchases are obvious and those related to the property sector are covered elsewhere, the issues related to "name lending" only became fully apparent in May 2009 with the difficulties faced by the Algosaibi/Saad Groups in Saudi Arabia.

*Retail sector risk: nationals versus expatriates*

One of the clearest segmentations seen, at least for the small oil-rich countries, is between nationals and expatriates, where the latter are considered significantly higher risk than the former. This is for a number of reasons, the two most frequently quoted being the fact that nationals tend to have much greater job security, and expatriates always have the option of re-exporting themselves should the situation become uncomfortable. In addition, it is likely that nationals have recourse to broader social and familial support networks should things go wrong.

This differentiation also extends to products. Auto loans have a surprisingly low default rate, probably because it is a product primarily taken up by nationals. Meanwhile, credit cards and unsecured personal loans, which are primarily taken up by expatriates, are expected to show higher default rates. In addition, Islamic banking, which is sometimes more closely linked to nationals, has seen a lower default rate than might have been otherwise expected.

*Public sector revenues - money for nothing?*

Although banks are now beginning to re-price lending to the public sector, this remains a low-risk, low-reward area within the GCC. Outside the GCC, this does not necessarily seem to be the case, particularly for Lebanon, but also to a lesser extent Egypt. Lebanese banks have played a key role since the early 1990s (post several decades of civil war) in financing government budget deficits. Public debt accounts for around 30% of Lebanese banks' total assets (or around 50%, if the banks' deposits at the Central Bank, in turn, an important creditor to the government, are considered).

While ratios such as high public debt to GDP (165%) denote significant fiscal imbalances in the Lebanese economy, it should be noted that the Lebanese system has a few peculiarities that make it stronger compared to other countries with high public debt-to-GDP ratios: (i) the majority of government debt is held by Lebanese banks and Lebanese investors; (ii) the high deposit base at the system level, with deposits accounting for around 300% of GDP enables Lebanese banks to support the government financing needs; (iii) the high level of FX reserves at the Central Bank (c55% of GDP) enables the Central Bank to maintain the stability in the Lebanese pound relative to the USD; and (iv) Lebanon has the support of international donors.

## III. ISSUES OF TIMING

### A. EARNINGS MOMENTUM - FINDING THE BOTTOM

*Investment returns bottom in 3Q2008, but only partial recovery*

The most important determinant of actual net income, looking backwards, is almost always investment and trading returns. With investment returns plunging deep into the red in 4Q2008, it is unsurprising that earnings also took a hit during that quarter. Since then, markets have recovered strongly in the first half of the year, putting investment returns back on track. Going forwards, we've assumed the rates of return are normalised, implying higher annual returns in the future, in spite of the fact that in many cases equity exposure has decreased. In addition, with revaluation reserves often in the red, there are some stores of earnings still in the system.

*Spreads benefiting from repricing*

While investment returns may be the most dramatic of revenue lines, the rest follow a largely independent path. Spreads across the board have been re-pricing throughout 2008, and we believe for many products this has continued into 2009. However, as risk perceptions abate, the pressure against these supernormal profits is increasing, and we expect them to come off slightly from 3Q2009e onwards. In addition, with balance sheet growth significantly less than pre-crisis levels, but capitalisation significantly higher, we expect price competition to eventually erode spreads, at least in relatively penetrated places like the UAE, as risk tolerance improves.

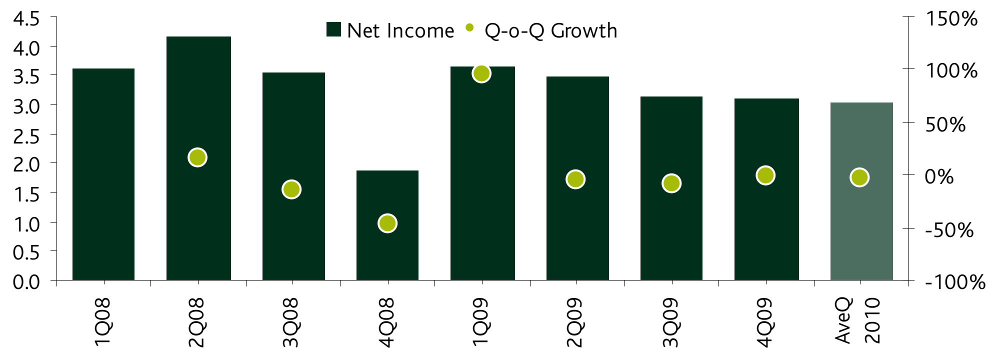
*Other non-interest income also under pressure*

Fees and commissions are more problematic however. Capital market commissions are down sharply, while arrangement fees and other fees related to balance sheet growth have also come under pressure. In addition, trade finance and forex income have decreased for many banks, with import volumes sharply down, particularly in the GCC.

*...but protected by changing fee schedules*

However, increased bank charges have, to some extent, offset this. Furthermore, as public sector activity continues and consumer sentiment stabilises, perhaps over 4Q2009e, we are likely to see some recovery in trade finance and forex revenues. Capital market returns should recover as transaction volumes, and eventually prices, recover. Returns on property portfolios (largely a problem restricted to the UAE) are likely to be problematic at least until the second half of 2010e.

**Figure 28: Aggregate Net Income (MENA Banks ex Morocco)**
USD billion, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

*Cost control peaking*

While revenues have been under pressure, in many cases banks have had better control of costs than we might have expected. Clearly capital market-related costs are down and continue to fall and the absence of bonuses (where applicable) has also helped to keep a lid on expenses. In addition, lower marketing and consulting expenditure, and aggressive housekeeping will likely ensure that there will be little in the way of increases in 2009e. Beyond that, we believe that costs will again rise as and when growth prospects return, and that will happen over an extended time period.

*Provisioning not yet affected by deterioration of corporate balance sheets*

The main uncertainty to date has come from provisioning, with current provisioning numbers scarcely different from international banks in mid-cycle. We expect provisioning to peak in 2H2009e, remaining high in 1H2010e before coming down later in the year. So far, beyond very specific names, we have seen little in the way of corporate provisioning, but we expect the impact of deterioration to come through over coming quarters. As a result, provisioning increases to date have been to some extent restricted to countries such as the UAE with high exposure to the retail segment.

*Protracted flat earnings*

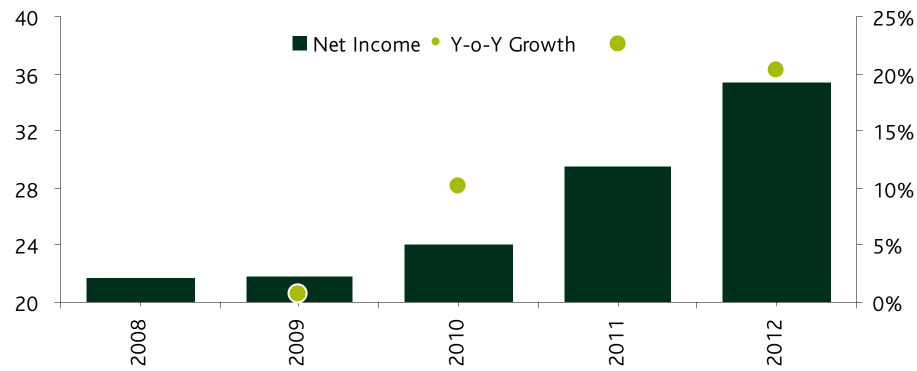
Overall, we are currently at a mini-peak, with spreads reflecting high levels of risk and markets recovering, but without provisioning having much of an impact. In 2Q2009, provisioning began to pick up, but spreads remained high and the benefits of short-term cost control were in evidence. Going into the third quarter, with constrained incremental growth in spreads, elevated provisioning and few offsetting factors, we feel the sector will be entering a protracted flat period for earnings.

## B. ESTIMATING THE POINT OF NORMALISATION

*All bad things must come to an end*

With earnings in 2008 hit primarily by investment losses and write-downs and those in 2009e-2010e hurt by provisioning, the sector is still at the beginning of a period of high provisioning and minimal growth. We nevertheless forecast that by 2011e-2012e, banks will have two years of significant earnings momentum.

**Figure 29: Aggregate Net Income (MENA Banks including Morocco)**
USD billion (RHS) and Y-o-Y Growth, unless otherwise stated




Source: EFG-Hermes estimates

*2012e: A time to think about quality*

In addition, we expect that by 2012e, most of the banks will be back to a steady state of growth. We do not expect, of course, a return to the historic "steady" state of growth, which saw balance sheet items growing at up to 80% per year, and a proliferation of bull market investment strategies. Consequently, from 2012e we are likely to see increasing differentiation between the banking sectors in the different countries across the region.

## C. SYSTEMIC RISK & THE PROPERTY CRASH: DIGGING OUT DUBAI

*Systemic risk vs. normalisation: are problems being resolved?*

The largest source of systemic risk in the region is the collapsing property market, which is a particularly acute issue in Dubai. Dubai was until recently the king of the construction industry, but its fall from grace has been as impressive as its rise. Consequently, it may seem unreasonable to believe that an economy so dependent on an industry in such turmoil can regain its poise over any reasonable time horizon. Indeed, it is often a failing of equity research to presume that markets will normalise over time. Normalisation can often be a painful process, which doesn't necessarily end up in the same "normal" state expected. For normalisation to occur, we need to establish that problems will be solved over time.

*The property market bubble in Dubai*

We have seen Dubai house prices decline by as much as 50%, while transaction volumes have more or less collapsed (setting aside some recent recovery). This has caused problems for the home-ownership market, and has had a knock-on impact causing severe disruption in the construction industry. Within the UAE, the home-ownership market has been largely financed by private individuals, and Amlak and Tamweel, which are currently being restructured, leaving banks with relatively little exposure. As a result, the difficulties within the construction industry are likely to have the greater repercussions on banks.

*Working capital build-up in the construction sector*

We believe the key factor from a banking sector point of view is not that there is a slack property market with falling prices, but rather the amount of stress that construction industry participants are having to suffer, the ability of those participants to absorb the stress and how much of that stress will be passed onto banks. We believe the distinguishing feature of the Dubai construction market is the high level of pre-crisis leverage, measured not just by the high level of debt financing to equity financing, but also by the low level of equity financing provided by developers or investors as a proportion of trade and financial debt plus future commitments.

*Projects plagued by lost equity*

With falling end prices, it is apparent that either the developers (for unsold property) or the investors (for sold property) will see their equity diminish. At the point this gets to zero, the relevant party no longer has a financial interest in providing further financing for the development. Generally speaking, at this point the project is either abandoned or renegotiated, redistributing whatever equity remains. If it is abandoned of course, trade creditors and financiers often bear the consequences. Even when trade creditors suffer the consequences, if they themselves don't have sufficient equity to absorb them, the shortfall will be passed onto banks (or their own employees in the form of missing wages). In many cases, it is not just weak pricing that has reduced the equity in projects, but also poor or occasionally fraudulent use of liquidity within developers, as well as poor business practices.

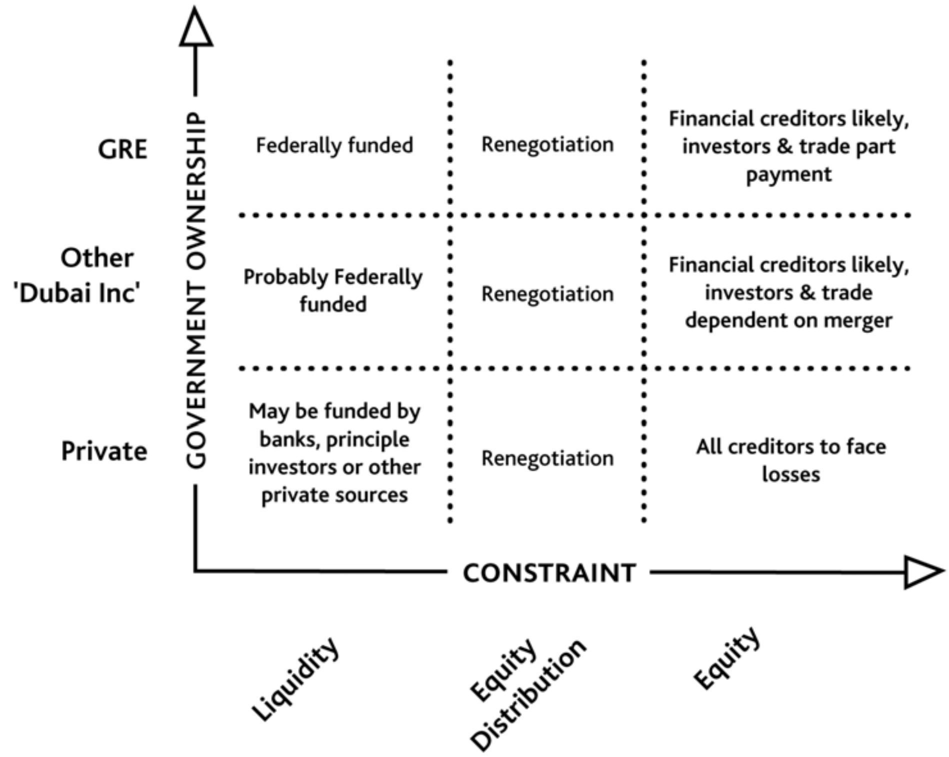
*Projects also suffering from liquidity issues*

The lack of transparency makes the whole situation worse. If the developer thinks the investor won't pay, or the investor thinks the developer won't build, then trust begins to break down and liquidity evaporates. In many cases, trade creditors have not been paid in full, and so have been less willing to provide trade credit. With the investor squeezing the developer for liquidity on the one side, and the trade creditor squeezing the developer for credit on the other, the developer needs to find financing to prevent the project stopping, not for lack of equity, but for lack of liquidity.

*Level of state support a key ingredient*

It is clear that for those projects where the primary issue is a lack of liquidity, state support could provide a win-win scenario. However, for those projects where the fundamental problem is a lack of equity, the main question is whether the federal government is willing to absorb some or all of the losses. A degree of state support for the property development sector has already taken place, and we believe that a further degree of state support is likely. However, we believe this may be limited to fulfilling financing obligations for GRE developers, which may also extend to those within Dubai Holding, if necessary. Consequently, unless prices rise sufficiently to restore equity, and trust rises to restore liquidity, we believe that stress will be shared equally or otherwise amongst stakeholders.

Figure 30: Dubai Property Development Sector - Problem Projects & Probability of Payment




Source: EFG-Hermes estimates

*Losses for banks will depend on state support*

We believe that the market is currently expecting a comprehensive federal solution, at least for the GREs and Dubai Inc. The USD10 billion (so far) federal bailout for Dubai-based GREs does go some way to addressing that. Furthermore, the promise to pay the USD300 million Sama Dubai three-year loan facility, and the improved outlook for the USD3.5 billion Nakheel bond maturing in December both suggest that wholesale financiers may be relatively protected. However, the rise of debt collection agencies such as “Financial Solutions”, and the complaints of organisations such as UK-based ACE (Association for Consultancy & Engineering) are a testament to the difficulties faced by trade creditors. Some of this pain will eventually be passed onto banks.

We believe that the level of leverage attained in Dubai has been partly the result of bubbly economics, but also partly the result of a complete misunderstanding of the level of stakeholder protection. While the going was good, investors were willing to anticipate improvements in the law and ignore issues about the lack of enforceability of the law. Similarly, stakeholders such as trade creditors were willing to finance significant working capital build up, without adequate protection, secured on little more than the promise of infinite (yet unobserved) liquidity. As the backstop of unlimited liquidity proved to be an illusion, investor and stakeholder protection evaporated, and the lack of an adequate institutional framework proved to be expensive for everyone concerned. We believe it will be difficult to recapture this benefit of “Brand Dubai”.

But does this matter? We project four phases necessary for Dubai's property sector stabilisation: i) providing funding and/or improved regulation for liquidity constrained projects, and renegotiating contracts where appropriate; ii) clearing the inventory backlog, by completion or write-off; iii) re-establishing normal trade terms, by establishing adequate contract enforcement procedures; and iv) rebuilding profitability in developers and reducing risk by improving planning and control and reducing leverage

We believe that Dubai will be able to make progress along this path, albeit in a slightly unsteady way. As such, we believe that the background economic environment will continue to look ugly, although improving. Visible milestones in the near future include the successful resolution of Nakheel's debt obligations, and the merger between Emaar and the property companies within Dubai Holding. Within our valuation we use a significantly elevated discount rate for Dubai stocks, but believe provisioning will stay at elevated, but manageable levels.

### OTHER COUNTRIES HAVE MAJOR PROPERTY SECTOR EXPOSURES TOO

*In Qatar (and Abu Dhabi), projects have a broader financing base*

The situation in Qatar (and Abu Dhabi) is fundamentally different, we believe. In these markets, after some initial uncertainty, developers have generally been willing and able to finance further working capital investment. This has meant that projects have been able to make progress, and trade creditors have been able get an adequate return on their efforts. With developers in both markets having invested greater money in the first place, there has also been less of a tendency to use financing liberally, which has so undermined the construction market in Dubai.

*Kuwait has less commitment*

Kuwait also has significant bank exposure to the property sector, and the property sector accounts for a large chunk of non-oil GDP. However, the difference between Dubai and Kuwait is the scale of projects in progress. We understand that in Kuwait there are far fewer projects at the early stages of completion, resulting in a far smaller commitment required to complete these projects. As such, there is significantly less leverage in the property development market, and significantly less potential supply to worry potential investors. We also believe the level of malpractice has been proportionately lower in Kuwait, although this is difficult to quantify.

## IV. POST RECOVERY

### A. DUPONT ANALYSIS OF MENA BANKS

#### REVENUE RETURNS/REVENUE PROFITABILITY

Our medium-term assumptions (2011e forecasts) factor in stable to slightly declining revenue returns (measured by total banking income as a percentage of average interest earning assets) for most MENA banking sectors relative to their 2009e levels. Generally, our forecasts imply: (i) slightly narrowing net interest spreads, and (ii) declining non-core non-interest income (all non-interest income, excluding fee and foreign exchange income) to interest earning assets. We also expect Qatar and Egypt to continue exhibiting above average revenue profitability.

#### NET INTEREST SPREADS - FUNDING COSTS TO RISE ON INCREASING COMPETITION

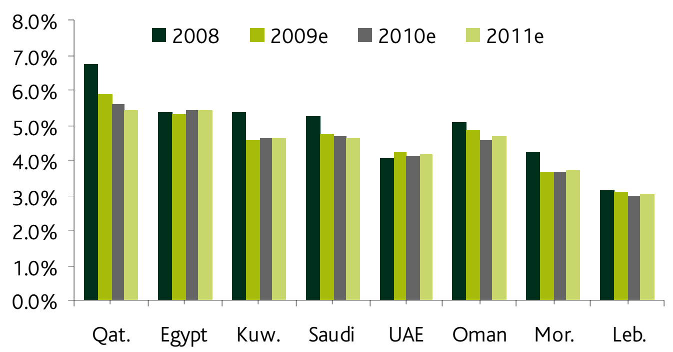
Trends in net interest spreads will be dependant not only on interest rate changes, which are fairly difficult to forecast beyond a certain time horizon, but also on changes in the asset mix, funding mix and competition levels. Our base assumption for the slight decline in spreads that we expect for most MENA banking sectors is increasing competition. This is despite generally assuming an improvement in the banks' loan mix, thanks to increasing retail lending exposure across the larger markets. We expect Saudi banks to continue to enjoy high net interest spreads based on low-cost deposits. Qatar's spreads are higher, but this is due to partially excluding zero-spread interbank exposure from the calculation.

We nevertheless see a few areas of positive surprises relative to our forecasts:

**Egypt** - with the current loan book predominantly comprised of large corporates, and considering the banks' focus on growing retail and SME lending, we see scope for widening net interest spreads if there is a significant change in the loan mix.

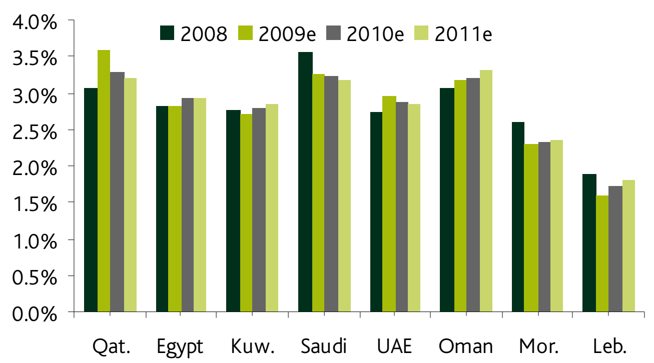
**Lebanon** - we only assume a very slight recovery in spreads in 2011e from 2009e. However, a key element determining the direction of spreads will be interest rates on USD. Lebanese banks have a high proportion of USD-denominated interbank assets, and a significant jump in short-term rates would have a considerable positive effect on the banks' asset margins. As Lebanese banks' USD deposits are already priced well above LIBOR, we do not expect a major upwards re-pricing of the banks' liabilities.

**Figure 31: Revenues to Ave Interest Earnings Assets**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

**Figure 32: Net Interest Spreads**
%,unless otherwise stated



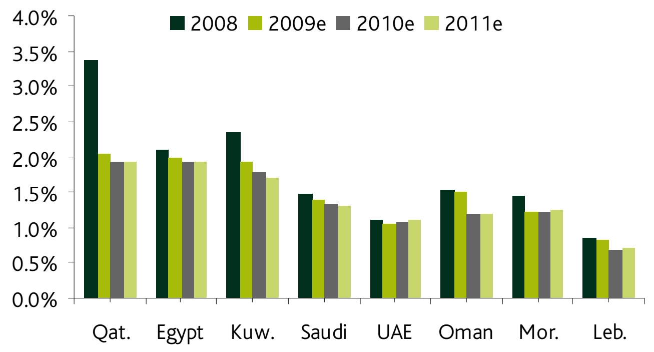

Source: Company reports, EFG-Hermes estimates

#### NON-INTEREST INCOME

We expect most banks to experience a recovery in core non-interest income profitability compared to 2009e. We assume a recovery in global trade that should lead to a recovery in fee income from letters of guarantee and letters of credit, as well as a pick-up in lending growth rates. Additionally, and especially for Egyptian banks, fee income should be boosted in the medium-term by retail banking operations, that currently only account for a very small proportion of total fee income.

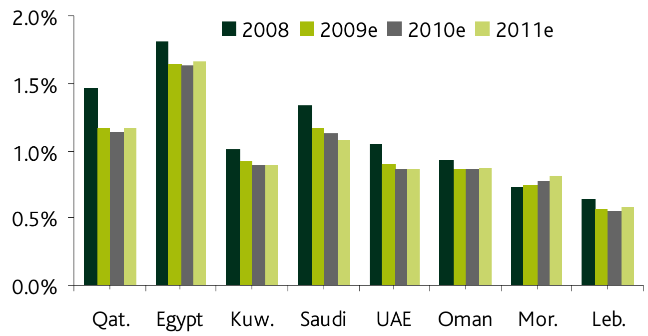
For Saudi banks, brokerage commissions are likely to remain a wild card. We forecast an almost 20% decline in brokerage commission in 2009e and expect it to remain flat in 2010e. However, a recovery in domestic investor sentiment and an opening up of the market to foreign investors could lead to increased trading volumes, and hence brokerage fees for Saudi banks.

**Figure 33: Non-Interest Income to Ave Interest Earning Asset**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

**Figure 34: Core Non-Interest Income to Ave IEA**
In % unless otherwise stated




Source: Company reports, EFG-Hermes estimates

## COST TO INCOME AND OPERATING PROFIT MARGIN

We generally see a slight deterioration in cost-to-income ratios across our universe, over the medium term. However, we expect cost-to-income ratios to remain fairly low, especially within the GCC, when compared to international standards.

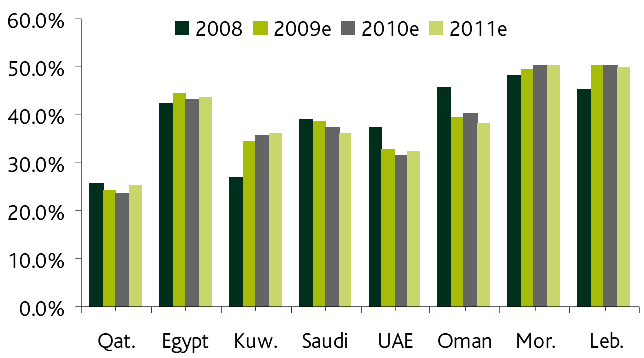
Our forecasts for Moroccan banks are on the conservative side, taking into account the fact that in 2006 banks embarked on a very aggressive branch expansion program that will taper off in 2010e. Consequently, we expect cost-to-income ratios to peak in 2010e, and start improving thereafter.

We believe the Egyptian banks' slight deterioration in cost-to-income ratios are the result of the banks' developing their retail banking operations.

Within the UAE and Qatar, little improvement in the cost-to-income ratio seems possible, and none of the banks are forecasting a decline. Indeed, we expect the cost-to-income ratios to rise. This is largely because we believe that banks will have to compete harder for client revenues going forwards, and banks will seek to differentiate themselves from their competitors with an improved service proposition. While we believe that banks will successfully move themselves away from balance sheet-based revenues, this will come at a cost.

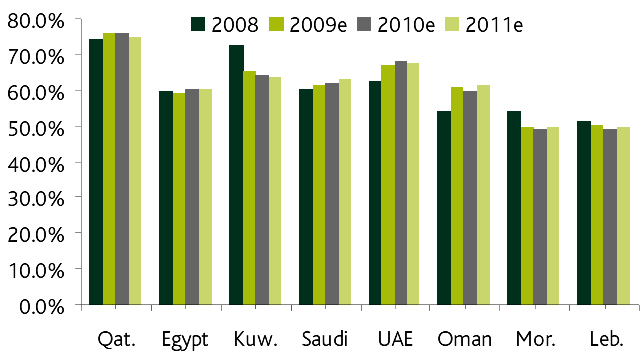
In Saudi and Oman, cost-to-income ratios have deteriorated with revenue stream contracting, and loan growth virtually coming to a standstill. Banks have responded to this by streamlining their operations and cutting back on expansion. We believe that there is relatively limited room for further reductions in absolute costs. A recovery in revenue streams is likely to lead to an improvement in cost ratios in 2010e, however increased demand for expansion in the retail segment is likely to lead to a further deterioration in cost-to-income ratios in the medium term.

**Figure 35: Cost-to-Income Ratio**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

**Figure 36: Operating Profit Margin**
%, unless otherwise stated

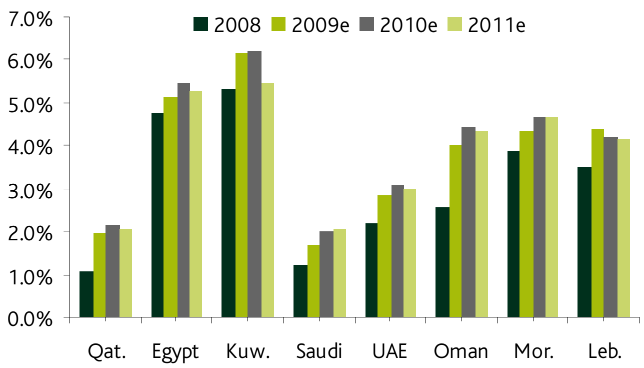



Source: Company reports, EFG-Hermes estimates

## SHORT-TERM DETERIORATION IN ASSET QUALITY; RISING PROVISIONS

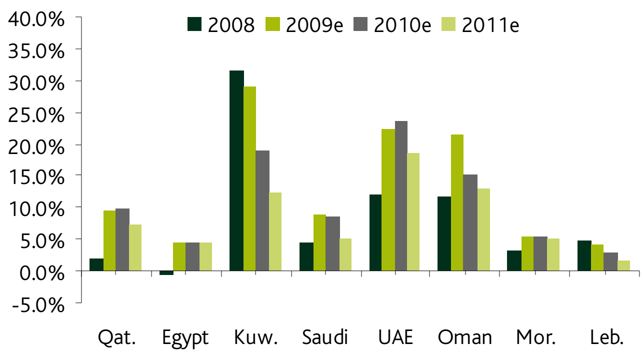
We are generally expecting the peak year for NPLs and provisioning for MENA banks to be 2009e, but to remain high until 2010e, with the actual peak during 1H2010e. We expect substantially lower levels of provisioning for non-GCC banks relative to GCC banks, and especially compared to the UAE and Kuwait. Our forecasts are justified by non-GCC banks' higher diversification in lending portfolios and generally conservative credit practices, although we do expect corporate NPLs to rise starting in 2009e. Egyptian banks' exhibit higher NPL levels than most MENA banks (ex Kuwait) but this reflects legacy NPLs from the previous economic downturn in the late 1990s.

**Figure 37: NPL Ratio**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

**Figure 38: Provisioning Margin (LLPs to Revenues)**
%, unless otherwise stated

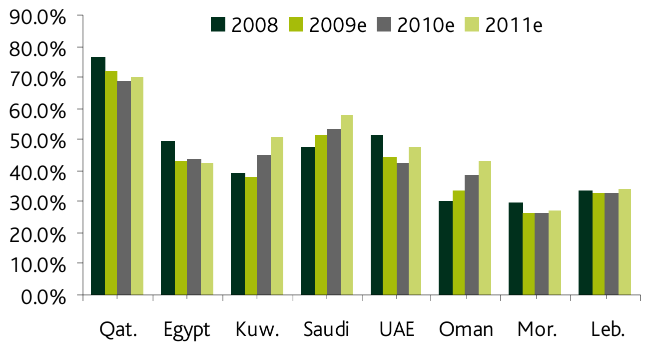



Source: Company reports, EFG-Hermes estimates

## RETURNS LIKELY TO REMAIN HEALTHY DESPITE PRESSURES

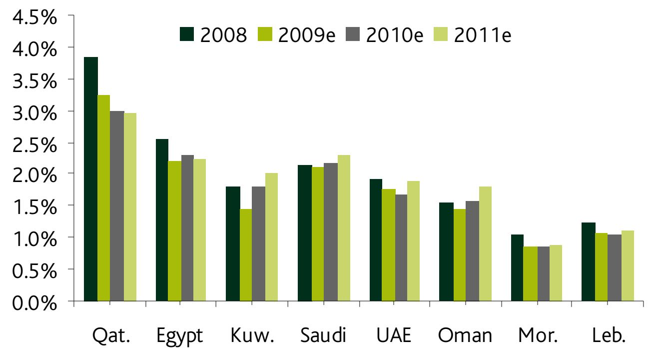
We expect MENA banks' return on assets to remain in excess of 2% for most countries, ex Morocco and Lebanon. It is important to highlight that, while a lower return on assets for Moroccan and Lebanese banks stems from below average levels of revenue profitability and costs efficiency, returns on assets are further penalised by taxes; the average effective tax rate is 32% for Moroccan banks and 17% for Lebanese banks. Furthermore, the high balance sheet liquidity of Lebanese banks (the ratio of interbank assets, mainly in USD, to total assets is high at around 25%) further depresses returns on assets. Our expectation is for the loans-to-total assets ratio to rise in the medium term, but only progressively.

**Figure 39: Net Profit Margin**
%, unless otherwise stated




Source: Banks Financials, EFG-Hermes

**Figure 40: Return on Assets**
%, unless otherwise stated

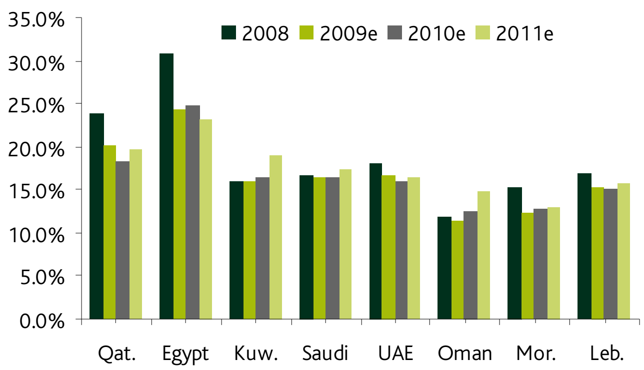



Source: Banks Financials, EFG-Hermes

### LOWER GEARING TO DEPRESS RETURNS ON EQUITY

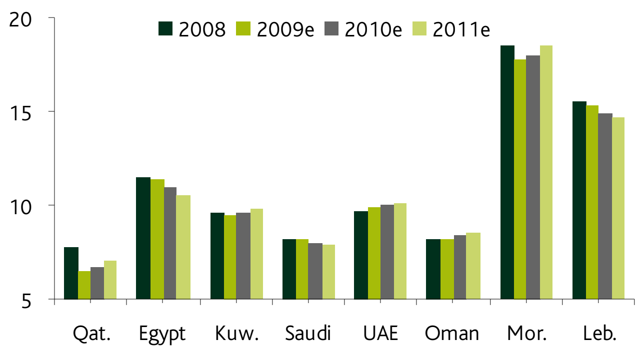
Overall, we expect a slight decline in returns on equity (ROE) over the medium term, as a result of fading revenue returns and deterioration in cost efficiency. ROE has to be seen in the context of balance sheet leverage. As such, Qatari banks have the lowest levels of balance sheet gearing within MENA banks (or the highest level of shareholders' equity relative to total assets), but are amongst the most profitable by ROE in MENA. We also expect Qatari banks' to continue exhibiting above sector revenue profitability and cost efficiency and to maintain ROEs at around 20%. Egyptian banks' ROE is also expected to remain high and in excess of 20%, despite our assumptions of declining balance sheet gearing.

**Figure 41: Return on Equity**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

**Figure 42: Gearing (Total Assets to Common Equity)**
%, unless otherwise stated




Source: Company reports, EFG-Hermes estimates

## B. CHALLENGES & UNCERTAINTIES

### SUSTAINABILITY OF ROE IN A LOW-LEVERAGE, LOW-GROWTH ENVIRONMENT

*Supernormal ROAEs driven by structural and temporary factors*

One of the key questions we need to understand is why ROEs have been so good over the last few years, and whether those returns are sustainable going forwards. Indeed, given how well-capitalised most of the banks in the region have been, the already high ROAEs perhaps understate the level of profitability amongst MENA banks. In general, we believe there are a few structural reasons why banks in the region have high returns, but we also believe there are some temporary factors, which will not be recurring.

*Restricted competition and poor information*

Structural factors include the restricted nature of bank licenses, exacerbated by the fact that most of the large banks have concentrated ownership structures. In some countries, foreign-owned banks have to pay a taxation charge and this improves the level of market clearing pricing. Uncertain legal rights and relatively untested legal systems also contribute to structurally higher returns. However, the biggest reason is likely to be the lack of adequate information for customers to make decisions on pricing, largely as a result of weak regulation. This is exacerbated, in some cases, by the lack of an efficient credit system, further limiting account portability. Finally, to a greater or lesser extent, brand has had an impact on pricing. In particular, spreads of Islamic banks in general, and Saudi Islamic banks in particular, are stronger than we would otherwise expect.

*Boosted by asset inflation, benign economics, high growth & lack of price sensitivity*

While these structural reasons are likely to be eroded over time, there are a number of other reasons why previously high historic returns are unlikely to be maintained. Most obviously, with rising asset prices, capital market and property-related earnings directly boosted the banks' profitability. Furthermore, enterprises also benefited from rising asset prices and this helped to keep provisioning charges below what we might think of as mid-cyclical levels. Finally, with high growth and capital shortages, there was ample room for many competitors. Going forwards, we believe that in several MENA countries growth will be restricted to the 10-20% range, and with most banks bursting with capital the result may be that competition picks up. Finally, with a general perception amongst customers that opportunities for investment vastly exceeded the cost of financing them, customers were previously price insensitive.

*Superior Returns to Stay, but Some Erosion Likely*

Overall, with a general lack of will to drive financial sector competition, it is unlikely that returns will drop to the level of the cost of capital. Nevertheless, some sources of excess return are probably gone forever, competition may well increase, and acceptable levels of capital will be higher than they were. Consequently, we believe that in the medium to long term, returns will be eroded, although not so much that value ceases to be accreted.

## THE ROLE OF THE EMERGING MIDDLE CLASS: EGYPT, SAUDI, OMAN & MOROCCO

There is an expectation that the "middle classes" will become the backbone, or at least the main driving force, of private consumption in emerging market countries, as they are in developed countries. Given the size of their populations and the current, sometimes large, inequalities in wealth distribution, Egypt, Saudi Arabia and Morocco would be prime beneficiaries of any such trend. Mortgage financing represents a significant growth opportunity in this context, particularly in Saudi Arabia where, according to official estimates, more then 70% of the population lives in rented accommodation. A young and growing population is likely to lead to higher demand for consumer and mortgage financing over the medium term.

While we believe that the size and living standards of the middle classes should increase in the medium and long term, especially for Egypt and Morocco, there is a considerable risk that this process will be slower than expected. In Egypt for example, over the past four years of strong economic growth, we have seen mixed signals of an up and coming middle class. On the one hand, sales of foreign brands have increased, shopping malls have multiplied and car sales grown, all of which suggest an increasingly affluent sector. On the other, there is evidence of a diminishing middle class, impacted by constrained purchasing power because of high inflation. Overall, we feel that the middle classes in Egypt have grown over the past few years, but not as rapidly as seems to have been the case in other emerging economies, such as China or Brazil.

We believe the most important pre-requisites for a stable middle class are a regular job (with formal employment) and, to reach that, an effective education. With young populations across these countries, job creation has become a key target of governments across the region. The Egyptian government's economic agenda has focused on attracting FDI that can then create job opportunities for the local population. However, much needs to be done in improving the set of skills of the domestic labour force, and we believe this could be a lengthy process.

### IMPLIED EXCHANGE RATE DEVALUATION AND THE CROWDING OUT OF CORPORATE BORROWING

The crowding-out of private investment by government demand for domestic credit has been a reality in Lebanon since the late 1990s, and to some extent in Egypt in the earlier part of this decade. Thanks to higher demand for credit, governments offer high interest rates on government securities, making lending to the private sector unattractive for banks or borrowing costs unaffordable for corporates.

Our medium- and long-term assumption for Lebanon is that the government will implement some of the necessary reforms needed to reduce the need to borrow from the banking sector, such as privatisation of public assets and the restructuring of loss-making public entities. This, coupled with a scenario of political stability, should create investment opportunities for the private sector and hence, domestic lending opportunities for Lebanese banks. However, the process towards economic reform in Lebanon has been almost non-existent over the past few years and there is a risk that the government's debt burden will not be significantly reduced, leading to a continuation of the "crowding-out" effect.

### MAKING RESOURCES WORK FOR THE ECONOMY

Perhaps the biggest challenge for the MENA economies remains the efficient utilisation of resources. High oil prices have led to an unprecedented wealth accumulation, particularly in the GCC countries, where sovereign wealth funds have emerged as an important player in the global economy. The challenge is now the efficient deployment of this wealth to the benefit of the domestic population.

In the short term, the government is using this as a means to absorb the impact of the global recession. Thus, the role of public sector has become much bigger, and is likely to remain so in the near term. However, this means that the private sector is likely to take longer to develop. While most of the GCC countries are working to diversify their economies, most of this is being done by the governments themselves, leading to an increased share of public sector ownership of businesses. Coupled with this, GCC nationals have a developed a risk/leverage-taking attitude, believing that the government will eventually step in to bail them out in times of trouble.

# V. VALUATION

## A. COMPETITION, GROWTH AND RETURNS

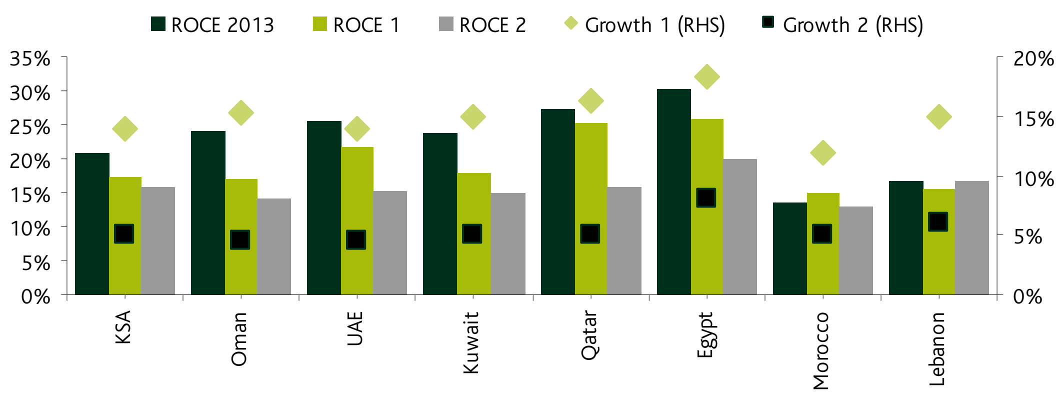
While short-term forecasts are particularly important for current valuations, long-term fair value (LTFV) estimates are primarily driven by long-term forecasts, the most important of which are exit multiples. While our actual models use a partially forecast trend-based Discounted Value to the Firm model, we can arrive at the same point with a two-stage Gordon's Growth model, which is easier to use for comparisons between countries.

**Gordon's Growth Model Input Variables**
Our methodology for this is firstly to strip out excess capital, and then to split the horizon beyond 2013e into two periods, each with a flat return on capital employed (ROCE) and growth rate. The first period, which we call the long term, lasts for an amount of time between five and ten years, and incorporates the period of supernormal growth and supernormal returns. Our ROCE estimates fall in the range between 15-30%, and are a reflection of the ROCEs we forecast/calculate for 2013e, based on ROAE and excess capital, and the long-term trends we expect in the years beyond that. Growth rates fall in the range of 10-20%.

Even in the *very* long- term, stage 2 of our model stretching into perpetuity, we believe that the banking sector will continue to earn excess returns, due to the nature of banking with its high barriers to entry and restricted competition. However, we have assumed that stage 2 growth is only 0-1% above nominal GDP growth, implicitly assuming a relatively small impact from rising penetration. We base our assumptions on real GDP ex oil growth of 2.5%, and an inflationary impact of 2.0%. If we had assumed that Saudi, given its lower level of penetration could maintain a 1% higher penetration benefit than otherwise, the impact of this on fair value would be approximately 5%.

We flex these assumptions slightly in the non-GCC countries, however. In Egypt, we base even our long-term assumptions on a higher interest rate, partially due to higher inflation, which boosts terminal returns and growth, but compensate this with a higher discount rate. In Morocco, we also have a fractionally higher inflation rate compared to GCC countries, but maintain a low discount rate to reflect elevated valuations as a result of capital controls.

**Figure 43: Two-Stage Gordon Growth Model (GGM) - Input Variables**




Source: EFG-Hermes

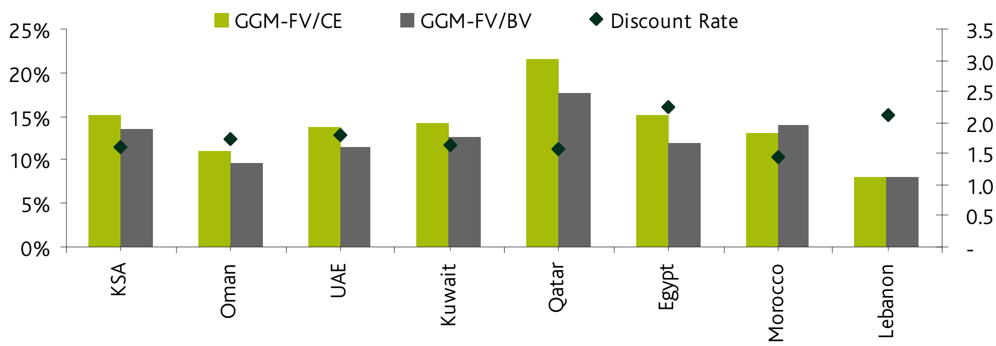
In terms of returns, we expect a general decline in the long term (stage 1). This forecast decline is due to the negative impact of increasing competition on spreads, combined with generally slower growth, which tends to boost returns. Offsetting this will be increased penetration of the retail segment, and the increased introduction of value-added services, which will shift revenues away from capital intensive balance sheet lending.

We see the sharpest declines in long-term returns in Egypt and Kuwait. In Egypt's case this is mostly a reflection of the very high returns up to 2013. In the case of Kuwait, it largely a reflection of the competitive nature of the banking sector and our assumption of the resultant limited growth opportunities in the domestic market. Meanwhile, for Lebanon and Oman we see little change in returns, with the former benefiting from potential expansion into other markets in the surrounding region with low levels of banking penetration (Sudan and Syria), and the latter seeing little in the way of competition given its concentrated market. In Morocco, we believe returns will actually increase, albeit only slightly, as financial services are increasingly extended to the emergent middle classes and as banks grow their operations in lower-penetrated Sub-Saharan African countries. In addition, within countries, we believe the Islamic banks will continue to maintain a return differential given a less price sensitive client base.

## B. DISCOUNT RATES AND TERMINAL VALUES

We attribute the highest terminal value multiple to Qatar, which has the twin blessing of the highest returns and low discount rates. We also believe Qatar will enjoy above average growth rates even in the medium term, in spite of a significant public sector slowdown after 2012e. From an operational point of view however, the best market is Egypt, with high returns and good growth, even in the very long term. However, this is undercut by a higher discount rate, in turn driven by the much higher risk-free rate and inflation. In addition, the Egyptian banks are carrying a fair amount of excess capital, which reduces their fair multiple to book value.

**Figure 44: GGM Fair Terminal Values to Capital, Capital Employed (CE) & Book Value (BV)**
Based on 2013e Book Values




Source: EFG-Hermes

For Moroccan banks, it is almost the opposite situation. They are expected to be undercapitalised over the coming years, compared to regional banking norms, which means strong capital efficiency. We model weaker returns and growth into the long term and this will weigh on valuations. However, this is counterbalance by our ascribing a low discount rate, reflecting the impact of capital controls, despite a few reservations that these may not continue forever. For Lebanon we model lower long-term returns, like Morocco, but the real damage to fair exit multiples comes from the higher discount rate.

Saudi Arabia is our most favoured GCC play, other than Qatar, when it comes to the long term numbers, although we assume a large amount of variance between banks. Long-term profitability is clearly one reason, with little sign of ROCE erosion in the long term. However, the greater visibility of long-term growth also caps our discount rate and boosts valuations. Kuwait is perhaps surprisingly mid-ranking, thanks to higher returns than average and a lower discount rate. For the UAE, better than average returns, based on operating efficiency, counteract the impact of higher discount rates. In Oman, lower hydrocarbon endowment, and hence constraints on the capacity of the government to maintain high spending, translates into a lower growth profile for banks, and hence returns. The upside risk, however is the successful diversification of the economy away from the hydrocarbon sector.

Figure 45: Where is Growth to Come From?

| | Real GDPpc | Inflation | Population | Penetration |
|---|---|---|---|---|
| **UAE** | Continuing to have a positive if weaker influence, beyond that caused by emigration | Sharply down, and likely to be restrained by global inflation | Falling, but mostly in the non-bankable sector. Return to positive influence 3Q2010e? | Penetration levels already high, but excess liquidity may keep it there. |
| **Qatar** | Ex resources, real GDP is likely to be gearing up as Qatar works out new ways to invest. | As elsewhere constrained by the pegged exchange rate. | Immigration still positive, although sharply down on recent years. | Penetration levels are high, but there is still upside to this, mostly in corporate excluding property |
| **Kuwait** | We do not expect the non-oil sector to be a major driver of GDP growth, unless there is a clear improvement in Government spending | Down from last year, mainly due to a sharp deceleration in rental prices | Falling slightly due to job losses in the financial and non-financial sectors | Lending penetration high, particularly in the retail sector, upside in the corproate sector but contigent on government's investment plan |
| **KSA** | Infrastructure continues to be a driving force with the government stepping up the momentum utilising its accumulated wealth. | Trending down, but global commodity prices are a latent threat. | Largely stable with a slight increase in labour force due to increased government spend on the infrastructure projects. | Penetration level relatively moderate, with a sizable young population generating further demand. |
| **Oman** | Likely to slow as government spending slows in the short term | Trending down | Impact has been limited, though immigration levels have slowed down. | Pentration levels are the lowest in the region, with potential largely on the corproate side |
| **Lebanon** | Political stability will be key; skilled labour force is a main asset for Lebanon | Contrained by the pegged exchange rate | Stable, although differentiation between non-resident and resident population is hard in Lebanon | Lending penetration levels are high, but potential for growth if economic reforms are implemented |
| **Morocco** | Internal demand will continue to be a main source of economic growth. Development of tourism and activities related to phosphates will also be key drivers of long-term growth | After a slight spike in mid-2008, inflation is back to very low levels | Driven by internal dynamics (high birth rates) | Lending penetration higher than other emerging markets with similar per capita levels; further upside exists in SMEs and households |
| **Egypt** | Levels should be rising in the medium term. Emergence of middle class will be a key element in loan growth | Lower global food prices are pushing down inflation to 10%. Expected to remain in the 8%-10% range. | Driven by internal dynamics (high birth rates) | Penetration levels particulary low in the households sector; expect penetration to increase in paralell with increases in per capita income |

Source: EFG-Hermes

## C. VALUATIONS AND IMPLIED 2011E MULTIPLES

**Figure 46: MENA Banks Coverage Universe**

| | P/E (x) | | | P/B (x) | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2009e | 2010e | 2011e | 2009e | 2010e | 2011e | FV (PE 11) | FV (PB 11) |
| **UAE** | | | | | | | | |
| ADCB | 8.5 | 8.9 | 7.4 | 0.8 | 0.8 | 0.7 | 11.7 | 1.2 |
| ADIB | 6.8 | 5.6 | 4.2 | 1.1 | 1.0 | 0.9 | 7.8 | 1.7 |
| CBD | 6.7 | 6.7 | 6.2 | 1.3 | 1.2 | 1.1 | 9.8 | 1.7 |
| DIB | 8.4 | 9.0 | 6.9 | 1.3 | 1.3 | 1.2 | 8.7 | 1.5 |
| ENBD | 7.8 | 6.9 | 5.4 | 1.2 | 1.1 | 1.0 | 8.9 | 1.6 |
| FGB | 8.6 | 7.5 | 5.6 | 1.4 | 1.2 | 1.1 | 8.8 | 1.7 |
| NBAD | 9.2 | 8.4 | 5.8 | 1.7 | 1.4 | 1.3 | 8.0 | 1.7 |
| **Saudi Arabia** | | | | | | | | |
| Al Rajhi | 17.1 | 15.7 | 13.5 | 4.1 | 3.6 | 3.1 | 13.8 | 3.1 |
| Al Bilad | 77.1 | 41.2 | 23.4 | 2.0 | 1.9 | 1.8 | 18.9 | 1.4 |
| Al Jazira | 13.5 | 10.8 | 8.6 | 1.2 | 1.1 | 1.0 | 9.5 | 1.1 |
| Saudi British | 13.6 | 11.8 | 9.7 | 2.8 | 2.4 | 2.1 | 11.2 | 2.4 |
| Saudi Fransi | 11.5 | 10.1 | 8.4 | 2.2 | 1.9 | 1.7 | 11.0 | 2.0 |
| ANB | 12.5 | 11.2 | 9.7 | 2.2 | 1.9 | 1.6 | 11.0 | 1.9 |
| Samba | 10.9 | 10.0 | 8.6 | 2.3 | 2.0 | 1.8 | 10.8 | 2.2 |
| Saudi Hollandi | 17.0 | 11.0 | 8.9 | 1.9 | 1.6 | 1.4 | 10.1 | 1.6 |
| Riyad Bank | 15.4 | 11.7 | 9.2 | 1.8 | 1.6 | 1.5 | 10.4 | 1.7 |
| Saudi Inv. Bank | 10.4 | 8.8 | 7.5 | 1.1 | 1.0 | 0.9 | 8.6 | 1.1 |
| **Egypt** | | | | | | | | |
| CIB | 11.3 | 9.7 | 8.6 | 2.6 | 2.1 | 1.8 | 9.6 | 2.0 |
| NSGB | 7.3 | 6.6 | 6.3 | 2.1 | 1.7 | 1.4 | 8.4 | 1.9 |
| CAE | 10.6 | 8.1 | 7.1 | 2.1 | 1.9 | 1.7 | 9.3 | 2.2 |
| **Lebanon** | | | | | | | | |
| BLOM (GDR) | 7.3 | 6.4 | 5.6 | 1.4 | 1.2 | 1.1 | 6.9 | 1.3 |
| Audi (GDR) | 9.8 | 9.3 | 8.1 | 1.4 | 1.3 | 1.2 | N/A | N/A |
| Byblos Bank | 8.4 | 7.8 | 6.8 | 1.1 | 1.0 | 0.9 | 9.3 | 1.3 |
| **Qatar** | | | | | | | | |
| CBQ | 11.2 | 11.0 | 8.8 | 1.7 | 1.6 | 1.5 | 12.4 | 2.2 |
| QIB | 13.2 | 13.9 | 11.8 | 2.5 | 2.4 | 2.3 | 14.3 | 2.8 |
| QNB | 11.2 | 10.0 | 10.4 | 2.6 | 2.3 | 2.0 | 11.4 | 2.2 |
| **Oman** | | | | | | | | |
| Bank Muscat | 8.9 | 10.2 | 7.9 | 1.2 | 1.1 | 1.0 | 10.5 | 1.3 |
| NBO | 13.0 | 9.2 | 7.8 | 1.4 | 1.3 | 1.2 | 9.6 | 1.4 |
| Dhofar | 17.3 | 15.2 | 12.4 | 2.2 | 2.0 | 1.8 | 10.8 | 1.6 |
| Sohar | 17.3 | 15.2 | 12.4 | 2.2 | 2.0 | 1.8 | 10.4 | 1.5 |
| **Morocco** | | | | | | | | |
| Attijariwafa | 16.1 | 14.9 | 13.6 | 2.4 | 2.2 | 1.9 | 15.7 | 2.2 |
| BMCE Bank | 53.3 | 42.3 | 37.2 | 5.8 | 5.4 | 5.0 | 23.8 | 3.2 |
| BCP | 13.5 | 12.1 | 11.7 | 2.5 | 2.2 | 1.9 | 13.0 | 2.1 |
| **Kuwait** | | | | | | | | |
| NBK | 15.2 | 13.6 | 12.0 | 2.5 | 2.3 | 2.1 | 11.8 | 2.1 |
| CBK | 112.1 | 24.9 | 13.3 | 2.8 | 2.7 | 2.4 | 10.4 | 1.9 |
| Burgan Bank | 18.1 | 7.3 | 4.9 | 1.2 | 1.1 | 1.0 | 8.3 | 1.7 |
| KFH | 24.3 | 18.7 | 12.7 | 2.5 | 2.3 | 2.0 | 13.4 | 2.2 |

Note: Pricing dates as in Figure 1
Source: EFG-Hermes estimates

## D. GLOBAL COMPARATIVES

**Figure 47: Global Valuation Comparatives***

| | | P/E (x) | | | P/B (x) | | |
|---|---|---|---|---|---|---|---|
| **Bank** | **Country** | **2009e** | **2010e** | **2011e** | **2009e** | **2010e** | **2011e** |
| Sector Average | UAE | 8.3 | 7.8 | 5.9 | 1.3 | 1.2 | 1.1 |
| Sector Average | Saudi | 15.6 | 13.1 | 10.8 | 2.8 | 2.4 | 2.1 |
| Sector Average | Egypt | 9.9 | 8.5 | 7.6 | 2.4 | 2.0 | 1.7 |
| Sector Average | Lebanon | 8.5 | 7.6 | 6.5 | 1.4 | 1.2 | 1.1 |
| Sector Average | Qatar | 11.7 | 11.1 | 10.4 | 2.4 | 2.2 | 2.0 |
| Sector Average | Oman | 14.0 | 12.0 | 9.2 | 1.5 | 1.4 | 1.3 |
| Sector Average | Morocco | 29.0 | 24.2 | 21.7 | 3.6 | 3.3 | 3.0 |
| Sector Average | Kuwait | 33.7 | 17.0 | 12.1 | 2.5 | 2.3 | 2.1 |
| | | | | | | | |
| Halbank | Turkey | 8.1 | 7.4 | 6.7 | 2.6 | 2.0 | 1.7 |
| Akbank | Turkey | 10.7 | 10.1 | 8.5 | 2.3 | 1.9 | 1.7 |
| Garanti | Turkey | 8.9 | 8.5 | 6.8 | 2.4 | 1.9 | 1.6 |
| | | | | | | | |
| ICICI | India | 25.9 | 24.2 | 19.8 | 2.1 | 2.0 | 1.9 |
| State Bank of India | India | 14.6 | 13.4 | 11.5 | 2.7 | 2.3 | 2.0 |
| MCB Bank | Pakistan | 10.5 | 9.5 | 8.8 | 2.9 | 2.2 | 1.9 |
| | | | | | | | |
| China Merchants Bank | China | 17.3 | 14.2 | 11.3 | 3.8 | 3.1 | 2.7 |
| Bank of China | China | 13.5 | 11.3 | 9.4 | 2.2 | 2.0 | 1.9 |
| | | | | | | | |
| Banco Do Brasil | Brazil | 10.6 | 10.1 | 8.9 | 2.8 | 2.2 | 2.0 |
| Itau Unibanco | Brazil | 14.7 | 12.0 | 9.8 | 3.2 | 2.9 | 2.5 |
| Grupo Financiero Banorte | Mexico | 14.9 | 12.0 | 8.8 | 2.2 | 2.1 | 1.8 |
| Grupo Financiero Inbursa | Mexico | 20.6 | 20.4 | 20.3 | 2.2 | 2.2 | 2.0 |
| | | | | | | | |
| Bank Pekao | Poland | 18.6 | 17.6 | 12.9 | 2.4 | 2.2 | 2.0 |
| OTP Bank | Hungary | 10.7 | 9.7 | 7.4 | 1.3 | 1.2 | 1.1 |
| Komercni Banka | Czech Rep. | 12.7 | 12.2 | 10.5 | 2.1 | 2.1 | 2.0 |

*Pricing dates for MENA banks as in Figure 1. For all other comparative countries, pricing date as of 01 October 09
Source: Reuters, EFG-Hermes estimates

## VI. CONCLUSIONS AND RECOMMENDATIONS

### CONCLUSION VERSUS GLOBAL PEERS

We believe that banks in the MENA region are strongly positioned to weather the current downturn with limited negative impact compared to their global peers.

**Banks are Well-positioned to Deliver High Double-Digit ROEs.** We believe that the MENA banks are well-positioned to report high double-digit ROEs in the medium term. Banks are likely to report a drop in ROEs in the short term, but we believe that they have the potential to recover sharply as the global economy stabilises.

**MENA Banks Continue to Remain Profitable.** The global economic downturn has had an impact on all banks in the MENA region, but they have been able to withstand the shock. All major banks in the region continue to remain profitable, with earnings at worst posting a decline in the current year as banks provision on possible deterioration in asset quality.

**Capitalisation Levels are Adequate.** In comparison to their global peers, banks in the MENA region are decently capitalised, with capital adequacy well in excess of the minimum required for most banks. This is partially explained by the relatively conservative regulations, which have required banks to maintain capital adequacy in double digits. Although the need for incremental capital injection has been limited, where it has been required governments have been quick to step-in to ensure that banks remain adequately capitalised to absorb any shocks.

**Penetration Remains Low.** With the exception of the UAE, Qatar and Kuwait, penetration across the region remains significantly below that of global peers. Even after adjusting for the high contribution from the hydrocarbon segment, the under-penetration argument continues to hold. Coupled with this, countries across the MENA region possess favourable population demographics, which underpin the strong structural growth story of the banking sector.

**Funding is a Short Term Issue.** While funding of the balance sheet has been highlighted as a key issue affecting the growth prospects of banks, we are of the view that it is a short-term issue. Moreover, funding constraints have been exacerbated by the high loan growth requirement that has persisted in the region for the past few years. The slowing balance sheet growth momentum has allowed banks to focus on the sources and security of their funding, as well as optimising their funding mix.

**Investment Requirements to Drive Loan Growth.** Infrastructure investment continues to be a dominant theme across the region in our opinion. While a drop in global oil prices and a slowdown in tourism is likely to lead to budget deficits, governments are well-placed to absorb this without significantly scaling back their investment programs. We believe that this will be a key driver for loan growth in the medium term, as banks remain a vital source of funding for this investment in infrastructure.

**Earnings Growth Should Follow.** While earnings are expected to remain depressed in 2009e and possibly 2010e, primarily driven by provisioning and slower balance sheet growth, we believe that they are likely to recover in 2011e-2012e on the back of reduced provisioning, improved loan growth and better cost management.

## CONCLUSION BY COUNTRY

### UAE - A TALE OF TWO CITIES

The banking sector really is exposed to two completely different economies, Dubai and Abu Dhabi. In both cases, the economy is significantly exposed to the construction sector, and in both cases the value of property has come ratcheting back. However, there the similarity ends. The obvious difference is that Abu Dhabi is resource rich, enabling it to absorb losses and, within the property sector, provide funding where required. In addition, better and less leveraged business practices help, and the greater role of infrastructure investment also makes Abu Dhabi more secure. On the retail side, we believe lending in Abu Dhabi is also more secure. This is predominantly due to the lower level of unsecured lending, more stable labour markets particularly due to the higher proportion of government lending and the larger national percentages.

However, from a banking sector perspective, most banks, and many corporates and individuals, have exposure across the UAE. Consequently, we expect the troubles of Dubai to affect the country as a whole. On the one hand, this is a positive thing, as it guarantees that Abu Dhabi will not simply close its doors to Dubai's malaise. On the other hand, however, it implies some discount is justified for the UAE as a whole.

Going forwards, we believe that the expansion of Abu Dhabi and more general infrastructure spending will ensure positive growth. However, the trend for de-leveraging businesses in Dubai, at least in a relative sense, is will likely to weigh on balance sheet development. As elsewhere, non-interest income will be a growth area, although this is likely to be offset ultimately by higher costs. We also are concerned that high capitalisation and lower growth may lead to stronger competition, and an increase in required service standards. Nevertheless, with the UAE standing at a discount to other markets in the region, resolution of Dubai risk may provide strong short-term appreciation opportunities.

### SAUDI ARABIA - UTILISING THE ACCUMULATED WEALTH

In our opinion, years of under-investment in infrastructure, coupled with a relatively large and young population, are key long-term growth drivers for the banking sector in Saudi Arabia. Although balance sheet growth has picked up strongly over the last two years, earnings have been muted due to a combination of investment losses and a decline in broking volumes at the Saudi stock market, which until 2006 had been a strong contributor to bank earnings. More recently, concerns emanating about the state of family businesses in the wake of the economic downturn have made banks extremely risk averse. Loan books have been stagnant since the end of 2008, with banks focusing much more attention on risk management than balance sheet growth.

However, government finances are in extremely good shape, with accumulated wealth in excess of 100% of 2008 nominal GDP. The government has adopted a counter-cyclical stance to the slowdown in the private sector, and is continuing to invest in major infrastructure projects. Though banking sector earnings growth is likely to remain muted owing to possible provisioning in the corporate sector, resumption in loan growth in 2010e, supported by the government infrastructure investments, should set the stage for recovery in earnings. Although valuation multiples appear to be at the top end of the range in the region, the premium valuations will continue to be supported by the strong and relatively liquid balance sheets of banks, and prospects of sustainable balance sheet growth.

### EGYPT - STANDING OUT IN THE DOWNTURN

Egypt remains one of the most attractive countries in the region from a long-term perspective, given its large domestic population, low banking penetration and our expectation that income per capita levels should rise progressively.

The banking sector has remained unscathed by the global liquidity crunch, with banks relying almost entirely on domestic deposits to fund balance sheet growth and with their investment books primarily focused on domestic government securities. Lending growth has slowed down considerably in 2009, following only two years of moderate lending growth. While we expect NPLs to continue to rise until 2010e, the banks' diversified loan books and their focus on the prime large corporate sector (at least for the Egyptian banks we cover) lead us to assume that ROE contraction up to 2010e will not be significant. We still expect Egyptian banks to post ROEs of 25% on average in the medium term, with upside potential for the long term as the loan mix shifts in favour of higher representation of retail and SME lending.

### LEBANON - RESILIENCE IN A VOLATILE ENVIRONMENT

Lebanese banks' earnings performance in both 2008 and 1H2009 has been resilient, with loan loss provisioning charges rising only moderately. Deposit growth has been well ahead of expectations so far this year, and this is particularly important as it will enable the banks to continue acting as the main source of funding for the government's deficit. In particular, Lebanese pound (LBP) deposits have been strong, highlighting confidence in the stability of the LBP vs. the USD as well as high interest rates in LBP vis-à-vis global interest rates. Spreads are under pressure given the high proportion of USD-denominated interbank assets to total assets for Lebanese banks. We nevertheless expect that strong asset growth, funded through deposits, will compensate slightly for the effect of lower spreads. In addition, we expect provisioning charges will remain low this year, with banks traditionally having been fairly conservative in their lending practices.

Growth opportunities for banks in Lebanon are somewhat limited, considering the already high lending penetration, and dependant on political stability. Lebanese banks have been expanding into neighbouring markets, especially into those countries with either low penetration levels and/or low competition, such as Egypt, Syria, Sudan and Jordan. This has been an increasingly important source of earnings growth over the past two years, and we expect earnings to become increasingly diversified and less dependant on domestic political developments. We like Lebanese banks for their strong management teams, their already proven ability to expand outside of Lebanon and their strong corporate lending franchise not only in Lebanon.

### QATAR - STRONG GOVERNMENT MUSCLE

Qatar presents the strongest macro story in the region. Among the GCC countries, Qatar has taken the most aggressive stance in dealing with the impact of the global economic downturn. With its large accumulated cash flows relative to the size of the economy, the government has responded to any and every stress on local banks. The government has bought out the DSM-listed equity portfolio of banks, taken over their troubled real estate portfolios, and injected capital into banks to address any liquidity shortage. Unsurprisingly, the recovery in bank stock prices has been the sharpest in the region.

We believe that the industrial investment plan of the government will remain a strong medium-term driver for loan and earnings growth of banks, while government actions have addressed any kind of balance sheet risks that existed for them. Beyond 2012, however, we expect growth to be linked to the private sector. Consequently, over the longer term, we have some concerns about the visibility of growth momentum. Key risks remain, in our opinion, on the execution of the plan. Much of the growth story in Qatar has been built around the immigration theme, similar to the UAE. While the government certainly has the resources to build the required infrastructure, we believe that investment spend will slow down sharply, while the immigration story is still to play out.

### OMAN - HYDROCARBON RESOURCE ENDOWMENT UNDER THE SPOTLIGHT

Among the GCC countries, Oman presents a relatively stable operating environment, with valuations one of the most inexpensive in the region. However, our concern on the magnitude of recovery is due to constraints on government finances. Oman has been able to weather the immediate impact of the global economic downturn particularly well compared to its peers. However, medium-term growth prospects are weaker compared to its GCC peers, primarily due to the lower hydrocarbon resource endowment of the country. While the macro drivers are similar to the rest of the GCC - utilising hydrocarbon resources to diversify the economy - the magnitude is smaller.

While the larger domestic population base and lower reliance on immigration sets Oman apart from its similar sized peers, we believe that the smaller investment scale is likely to act as a constraint on banking sector growth prospects. However, prospects of a stronger oil price is likely to be a key driver for government finances and investment spend, and hence balance sheet growth in the near to medium term.

### MOROCCO - CAPITAL CONTROLS, RICH VALUATIONS

Moroccan banks continue to trade at a premium to the MENA banks average, by both PE and PBV, and despite lower levels of profitability. This premium, and that of the Moroccan equity market generally, relative to other MENA or emerging markets, has to be seen in the context of capital controls. These controls mean that most of the domestic liquidity is invested in domestic assets, primarily equities and real estate.

We expect banks to post a considerable slowdown in earnings growth in 2009e, due to rising funding costs in an environment of tighter liquidity, slowing loan growth and our expectations of rising provisioning charges. Morocco's GDP growth is estimated to reach 5% in 2009e, following a record harvest leading to strong growth in agricultural GDP. However, economic growth in the non-agricultural sectors is expected to slow down considerably, particularly in these areas more dependant on external demand. Lending growth rates have also softened but still remain solid at c10% Y-o-Y in June 2009, with mortgages, especially for first-time buyers, continuing to be a main driver of lending demand. We expect credit quality to deteriorate, particularly in the corporate sector, tourism and textiles, and retail defaults to remain low. The Moroccan consumer is not highly leveraged, with most retail exposure relating to mortgages.

While Morocco presents higher lending penetration levels than other North African countries with similar per capita incomes, we believe that there is significant long-term growth potential, and particularly in the retail and SME sectors. Banking penetration levels have improved over the past ten years, but still remain low with 25% of the adult population currently using bank accounts. Another key driver of medium- and long-term growth will be the banks' operations in Sub-Saharan countries, where Attijariwafa bank and BMCE have expanded via greenfield investments and/or acquisitions.

**KUWAIT – NEGOTIATING WITH THE POLITICAL STALEMATE**

Kuwait should be in one of the best positions to deal with the current economic downturn given the slower increase in government spending and substantial accumulated wealth. However, given the on-going political stand-off between the parliament and the government, we do not expect investment spending to be a main driver of non-oil economic growth, and therefore of the banks' lending growth, over the short and medium term. We have little visibility regarding a material change in the current political stalemate in Kuwait.

Kuwait banks are generally strongly capitalised, and we expect that the banks' capital cushion will absorb credit losses over the next year and half. Kuwait banks have shown the largest increases in provisioning effort and hence the largest deterioration in ROEs. The current turmoil at Kuwait's investment companies, and the potential of contagion effects to the wider corporate sector, pose significant risks to credit quality. We expect provisioning charges to remain high up until the end of 2010e. The poor outlook for domestic non-oil economic growth, coupled with weak visibility for ROE improvement in the medium term and the banks' high multiples relative to MENA peers (ex Morocco) lead us to assign an underweight rating to Kuwait.

## CONCLUSION BY STOCK

Figure 48: MENA Banks Coverage Universe*

| | Price | LTFV | Recommendation | | |
|---|---|---|---|---|---|
| | LC | LC | ST | LT | |
| **UAE** | | | | | |
| ADCB | 2.44 | 3.85 | Acc. | Buy | Improving Visibility, Stabilising Franchise & Cheap |
| ADIB | 3.15 | 5.78 | Buy | Buy | Company Guidance is for accelerating revenues |
| CBD | 3.93 | 6.22 | Neu. | Buy | Mid-market player with average valuations |
| DIB | 3.10 | 3.90 | Neu. | Acc. | Premium valuations but ordinary quality |
| ENBD | 4.40 | 7.17 | Buy | Buy | Merger process provides upside, Dubai risk abating |
| FGB | 16.80 | 26.31 | Acc. | Buy | Too much emphasis put on property portfolio |
| NBAD | 13.35 | 18.40 | Neu. | Acc. | Increasingly confident franchise, but not cheap |
| **KSA** | | | | | |
| Al Rajhi | 73.50 | 74.70 | Neu. | Neu. | Strong deposit franchise, but premium valuations |
| Al Bilad | 21.60 | 17.50 | Red. | Red. | Growth restrained by lower capitalisation |
| Al Jazira | 19.85 | 21.80 | Neu. | Neu. | High exposure to volatile brokerage revenue stream |
| Saudi British | 52.00 | 59.80 | Acc. | Acc. | Strong management |
| Saudi Fransi | 44.50 | 53.30 | Acc. | Acc. | Good growth, Low Risk, Hidden Upside |
| ANB | 48.20 | 55.80 | Acc. | Acc. | Strong retail presence, |
| Samba | 57.50 | 72.10 | Buy | Buy | High liquidity providing room for growth |
| Saudi Hollandi | 34.20 | 39.00 | Neu. | Acc. | A strong franchise constrained by capital |
| Riyad | 29.90 | 34.00 | Acc. | Acc. | Underutilised network providing retail opportunity |
| Saudi Inv. Bank | 18.55 | 21.50 | Acc. | Acc. | High concentration risk |
| **Egypt** | | | | | |
| CIB | 56.05 | 62.70 | Acc. | Acc. | Strong corporate franchise, retail an upside risk |
| NSGB | 28.50 | 38.19 | Buy | Buy | Low risk profile, valuations at a discount to the sector |
| Credit Agricole Egypt | 12.71 | 16.65 | Acc. | Buy | Significant potential to leverage balance sheet |
| **Lebanon** | | | | | |
| BLOM (GDR) | 84.00 | 104.2 | Acc. | Buy | Low risk, above-sector average returns |
| Audi (GDR) | 72.90 | N/R | N/R | N/R | An emerging regional player |
| Byblos Bank | 1.90 | 2.60 | Acc. | Buy | Strong consumer franchise, low risk profile |
| **Qatar** | | | | | |
| CBQ | 80.60 | 113.55 | Acc. | Buy | Less visibility, but the discount promises opportunity |
| QIB | 90.00 | 108.79 | Neu. | Acc. | Rich valuations, and not ideal business exposures |
| QNB | 154.00 | 169.40 | Acc. | Acc. | Good visibility, good earnings, low risk, high price |
| **Oman** | | | | | |
| Bank Muscat | 0.93 | 1.24 | Buy | Buy | Oman's dominant franchise at discounted valuations |
| NBO | 0.33 | 0.41 | Acc. | Acc. | Focusing on deposit franchise to create value |
| Dhofar | 0.61 | 0.53 | Red. | Red. | Losing market share to competition |
| Sohar | 0.22 | 0.20 | Neu. | Neu. | Stronger growth, but higher valuations |
| **Morocco** | | | | | |
| Attijariwafa Bank | 269.00 | 309.82 | Neu. | Acc. | Domestic leader; Africa, the next leg for growth |
| BMCE Bank | 235.00 | 150.34 | Red. | Red. | An entrepreneurial bank at very rich multiples |
| BCP | 267.00 | 296.92 | Neu. | Neu. | Focusing on corporate lending |
| **Kuwait** | | | | | |
| NBK | 1.28 | 1.27 | Neu. | Neu. | Deteriorating returns on equity remains a key concern |
| CBK | 0.99 | 0.78 | Red. | Red. | Focusing on "surviving" the downturn |
| Burgan Bank | 0.38 | 0.63 | Neu. | Buy | Low valuations, but low capital position is the key risk |
| Kuwait Finance House | 1.32 | 1.39 | Neu. | Neu. | Rising NPLs but capital cushion can absorb shocks |

*Pricing dates as in Figure 1
Source: EFG-Hermes

## APPENDIX A SOME APPENDARY ASSUMPTIONS

**Commodity Prices**
We presume that commodity prices will be fairly stable going forwards. In particular, oil and gas prices are clearly important for the GCC and for Egypt, while downstream gas industries such as aluminium and fertilizer are important for Qatar. In addition, phosphate - a premium fertilizer product - is important for Morocco. The cost of phosphate production is closely linked to energy prices and saw a 700% increase between 2000 and 2008. While commodity revenues are largely sterilised, in monetary terms, they are believed to have a significant impact on public sector expenditure and to affect business confidence.

**Currencies and Interest Rates**
The key currency we are concerned about is the dollar, due to strong links between it and each of the currencies in the region (less so for Morocco). We base our banking forecasts on the presumption of steady currency rates. Nevertheless, a falling dollar is likely to provide liquidity for many of the economies in the region as currency speculation returned, and would make housing cheaper for international buyers, potentially assisting local property markets. On the negative side, import companies, such as those in the construction industry, would see higher raw material costs, and the more open economies would experience an inflationary impact.

For interest rates, we assume interest rates are flat going forwards, although this is probably an excessively cautious view point. Rising interest rates in line with current implied forwards rates would improve the return on free funds. Furthermore, an actual interest rate rebound would be key for Lebanon, with its high proportion of USD-denominated interbank assets.

**Trade Volumes**
Many of the banks in the region benefit from client-related foreign currency transactions linked to trade, as well as fees and commissions on trade letters. This has been impacted significantly by the crisis, we believe, and recovery will be gradual throughout 2010e. In addition, from an economic point of view, non-import trade particularly impacts Egypt through Suez Canal revenues, although these have not been affected as much as expected. The UAE (Dubai) also obtains worthwhile revenues from re-export business enabled by its deep-water port facilities. A number of other such facilities are under construction across the region.

**Tourism and Remittances**
Tourism is a significant source of revenue particularly for the UAE, Egypt and Morocco, although Qatar is also hoping to benefit from transportation through New Doha International Airport. Broadly we have seen tourism numbers hold much steadier than we previously anticipated. Nevertheless, we believe that tourism spend is down significantly, and recovery will be gradual. We believe tourism-related businesses are likely to continue to be under pressure.

Remittances are a significant factor for both Lebanon and Morocco, with the latter being hit hard by unemployment in the European economies, and particularly in Italy and Spain, from which significant remittances are obtained. We believe that this will affect private consumption and will result in lower deposit growth, with around 30% of deposits in the Moroccan banking system being sourced from the "Moroccans living abroad segment".

**Global Business Confidence**
Finally and most importantly, we do not presume to forecast global business and consumer confidence but use as our backdrop a shallow recovery throughout 2010e. This will only partially impact local business and consumer confidence that tends to be driven by the sum of international and local uncertainty.

## APPENDIX B TERMINAL VALUE ASSUMPTIONS

**Figure 48: Two Stage Gordon's Growth Models Assumptions**

| | Stage 0: 2013e | | | | Stage 1: 2014e – Stage 2 | | | Stage 2: Perpetuity | | General | Implied Terminal | | Modelled 2013e |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | ROAE | Tier 1 Ratio | Excess Capital | ROCE | ROCE | Growth | Period | ROCE | Growth | Discount Rate | TV/CE | TV/BV | FV/BV |
| **UAE** | | | | | | | | | | | | | |
| ADCB | 15.5% | 16.2% | 38% | 21% | 20% | 15% | 8 | 15% | 4.5% | 12.5% | 1.83 | 1.51 | 1.54 |
| ADIB | 18.9% | 15.5% | 35% | 25% | 22% | 18% | 10 | 17% | 4.5% | 13.9% | 2.16 | 1.75 | 1.76 |
| CBD | 20.3% | 14.6% | 38% | 29% | 26% | 15% | 7 | 15% | 4.5% | 12.5% | 2.10 | 1.68 | 1.79 |
| DIB | 21.8% | 12.0% | 17% | 25% | 20% | 10% | 8 | 16% | 4.5% | 13.0% | 1.63 | 1.52 | 1.39 |
| ENBD | 19.7% | 17.8% | 44% | 30% | 20% | 10% | 7 | 15% | 4.5% | 13.3% | 1.45 | 1.25 | 1.38 |
| FGB | 18.6% | 15.9% | 37% | 26% | 23% | 15% | 8 | 15% | 4.5% | 12.3% | 2.11 | 1.70 | 1.79 |
| NBAD | 18.9% | 15.4% | 35% | 25% | 22% | 15% | 8 | 15% | 4.5% | 11.9% | 2.17 | 1.76 | 1.87 |
| | **19%** | **15%** | **35%** | **26%** | **22%** | **14%** | **8** | **15%** | **4.5%** | **13%** | **1.92** | **1.59** | |
| **Saudi Arabia** | | | | | | | | | | | | | |
| Al Rajhi | 23% | 18% | 33% | 31% | 25% | 14% | 8 | 20% | 5.0% | 12% | 3.37 | 2.58 | 2.11 |
| Al Bilad | 13% | 20% | 38% | 17% | 15% | 12% | 8 | 15% | 5.0% | 12% | 1.71 | 1.44 | 1.12 |
| Al Jazira | 14% | 17% | 29% | 17% | 15% | 12% | 8 | 15% | 5.0% | 12% | 1.71 | 1.51 | 0.92 |
| Saudi British | 21% | 13% | 8% | 22% | 18% | 14% | 8 | 15% | 5.0% | 12% | 2.02 | 1.94 | 1.54 |
| Saudi Fransi | 20% | 13% | 8% | 21% | 17% | 14% | 8 | 15% | 5.0% | 12% | 1.95 | 1.88 | 1.42 |
| ANB | 18% | 15% | 20% | 21% | 17% | 14% | 8 | 15% | 5.0% | 12% | 2.03 | 1.82 | 1.32 |
| Samba | 20% | 14% | 14% | 22% | 18% | 16% | 8 | 17% | 5.0% | 12% | 2.56 | 2.33 | 1.51 |
| Saudi Hollandi | 18% | 13% | 8% | 18% | 16% | 14% | 8 | 15% | 5.0% | 12% | 1.89 | 1.82 | 1.32 |
| Riyad | 19% | 16% | 25% | 23% | 17% | 15% | 8 | 15% | 5.0% | 12% | 2.02 | 1.76 | 1.16 |
| Saudi Inv. Bank | 15% | 14% | 14% | 16% | 15% | 14% | 8 | 15% | 5.0% | 12% | 1.82 | 1.70 | 0.89 |
| | **18%** | **15%** | **20%** | **21%** | **17%** | **14%** | **8** | **16%** | **5.0%** | **12%** | **2.11** | **1.88** | |
| **Egypt** | | | | | | | | | | | | | |
| CIB | 22.2% | 16.9% | 41% | 30% | 25% | 18% | 8 | 20% | 8.0% | 16.0% | 2.03 | 1.61 | 1.31 |
| CAE | 25.0% | 17.4% | 43% | 35% | 28% | 19% | 8 | 20% | 8.0% | 16.0% | 2.27 | 1.73 | 1.88 |
| NSGB | 20.4% | 15.7% | 36% | 26% | 25% | 18% | 8 | 20% | 8.0% | 16.0% | 2.03 | 1.65 | 1.47 |
| | **23%** | **17%** | **40%** | **30%** | **26%** | **18%** | **8** | **20%** | **8.0%** | **16%** | **2.11** | **1.66** | |
| **Lebanon** | | | | | | | | | | | | | |
| Bank Audi | 14.3% | 10.3% | 3% | 15% | 16% | 15% | 8 | 17% | 6.0% | 15.1% | 1.18 | 1.18 | N/R |
| BLOM | 17.7% | 13.6% | 27% | 22% | 16% | 15% | 8 | 17% | 6.0% | 15.1% | 1.18 | 1.14 | 1.13 |
| Byblos Bank | 14.1% | 10.0% | 0% | 14% | 15% | 15% | 8 | 16% | 6.0% | 15.1% | 1.02 | 1.02 | 1.11 |
| | **15%** | **11%** | **10%** | **17%** | **16%** | **15%** | **8** | **17%** | **6.0%** | **15%** | **1.13** | **1.11** | |
| **Qatar** | | | | | | | | | | | | | |
| CBQ | 21.5% | 12.7% | 21% | 25% | 25% | 17% | 8 | 15% | 5.0% | 11.5% | 2.76 | 2.38 | 2.36 |
| QIB | 23.6% | 12.7% | 22% | 28% | 25% | 17% | 8 | 18% | 5.0% | 11.5% | 3.42 | 2.90 | 2.99 |
| QNB | 20.3% | 16.2% | 38% | 29% | 26% | 15% | 8 | 15% | 5.0% | 11.0% | 2.92 | 2.18 | 2.21 |
| | **22%** | **14%** | **27%** | **27%** | **25%** | **16%** | **8** | **16%** | **5.0%** | **11%** | **3.03** | **2.49** | |
| **Oman** | | | | | | | | | | | | | |
| Bank Muscat | 17% | 15% | 33% | 22% | 18% | 17% | 8 | 15% | 4.5% | 13% | 1.79 | 1.53 | 1.06 |
| NBO | 20% | 16% | 38% | 27% | 18% | 18% | 8 | 15% | 4.5% | 13% | 1.84 | 1.53 | 1.10 |
| Dhofar | 19% | 15% | 33% | 24% | 16% | 13% | 8 | 13% | 4.5% | 13% | 1.25 | 1.16 | 1.19 |
| Sohar | 18% | 13% | 23% | 22% | 16% | 13% | 8 | 13% | 4.5% | 13% | 1.25 | 1.19 | 0.97 |
| | **18%** | **15%** | **32%** | **24%** | **17%** | **15%** | **8** | **14%** | **4.5%** | **13%** | **1.53** | **1.35** | |
| **Morocco** | | | | | | | | | | | | | |
| Attijariwafa Bank | 14.3% | 8.7% | -15% | 13% | 15% | 12% | 8 | 13% | 5.0% | 10.3% | 1.83 | 1.96 | 1.73 |
| BMCE Bank | 15.0% | 7.3% | -36% | 13% | 15% | 12% | 8 | 13% | 5.0% | 10.3% | 1.83 | 2.13 | 1.80 |
| BCP | 14.0% | 10.2% | 2% | 14% | 15% | 12% | 8 | 13% | 5.0% | 10.3% | 1.83 | 1.81 | 1.96 |
| | **14%** | **9%** | **-17%** | **13%** | **15%** | **12%** | **8** | **13%** | **5.0%** | **10%** | **1.83** | **1.97** | |
| **Kuwait** | | | | | | | | | | | | | |
| NBK | 19.4% | 14.4% | 24% | 23% | 18% | 15% | 8 | 15% | 5.0% | 11.5% | 2.07 | 1.82 | 1.65 |
| Burgan | 20.1% | 9.6% | -15% | 18% | 18% | 15% | 8 | 15% | 5.0% | 12.0% | 1.89 | 2.02 | 1.63 |
| CBK | 20.1% | 14.8% | 26% | 25% | 18% | 15% | 8 | 15% | 5.0% | 12.0% | 1.89 | 1.66 | 1.36 |
| KFH | 19.1% | 19.9% | 45% | 29% | 18% | 15% | 8 | 15% | 5.0% | 11.5% | 2.07 | 1.59 | 1.67 |
| | **20%** | **15%** | **20%** | **24%** | **18%** | **15%** | **8** | **15%** | **5.0%** | **12%** | **1.98** | **1.77** | |

## APPENDIX C GOVERNMENT CRISIS PREVENTION MODE

Government responses in the GCC were much more active than those outside the GCC. Although this may have been partially due to having the ability to provide liquidity, funding and capital, it is important to highlight also that non-GCC banks (Egypt, Lebanon and Morocco) have traditionally funded their balance sheets through stable resources, particularly retail deposits, and did not experience the outflow of capital seen in most of the GCC countries in the second-half of 2008.

Government responses to the liquidity crunch were varied, although they were generally timely. In the GCC, the aim was to comprehensively address any emerging problems, with a "belt and braces" approach. A wide variety of measures were taken (or just promised) ranging from funding, deposit and capital injections to buying off troubled assets from banks and adjusting laws and regulations.

**Figure 49: Government Support Measures for Banks in the Region**

| | Deposit Injection | Funding Facilities | Capital Injection | Regulatory Changes | Buying Off Troubled Assets |
|---|---|---|---|---|---|
| **Saudi Arabia** | The central bank injected USD deposits into the system while government insitutions stepped in with LC deposits | No | No | No | No, but government supported expected to resolve Saad/Algosaibi issue |
| **Oman** | The central bank and the Government Pension Fund placed medium-term deposits in banks | The government provided USD Swap facilities for banks facing maturities of capital market or wholesale funding | No | No | No |
| **Kuwait** | Government entities made deposit injections into the banking system | The central bank introduced repo agreements | No | CBK raised the minimum loan-to-deposit ratio to 85% from 80% | No |
| **Qatar** | No | No | Selective 10% capital injection at a premium by QIA, over two tranches | | Buy-out of DSM-listed portfolio and 20% of property-related assets |
| **UAE** | AED50 billion of deposits delivered during 4Q2008 (AED70 billion promised), eligible as Tier 2 capital | Emergency AED50 billion funding facility provided, but with little drawdown | A total of AED20 billion of preferred equity provided to AD banks and ENBD | Minimum capital ratios have changed frequently, bond & deposit guarantee laws promised | No |
| **Lebanon** | No; deposit growth continues to be supported by non-resident Lebanese | No | No | No | No |
| **Morocco** | No | The central bank is providing short-term funding facilities to banks | No | No | No |
| **Egypt** | No | No | No | No | No |

Source EFG-Hermes

The first measure taken was an emergency liquidity facility, on fairly prohibitive terms, in the UAE. This echoed similar global facilities, but failed to address the funding squeeze, which was more of a systemic issue. This was followed by the announcement by the UAE and Kuwait Central Banks of a deposit guarantee scheme, to reduce the possibility of a deposit crisis, although this was never actually enacted in the UAE. However, shortly afterwards, the critical measure of long-term funding was addressed, with many GCC governments and public sector entities placing USD and local currency deposits with banks replacing lost cross-border funding into the region.

While this addressed the most pressing issue, ballooning investment losses and credit quality concerns started to raise fears over capital erosion of banks. In response, governments stepped in, injecting capital into banks (UAE and Qatar) to improve their capital adequacy, and in the case of the UAE significantly raising the bar for minimum capital requirements. In Qatar, the government also offered to buy the DSM-listed equity portfolios and a large chunk of property-related assets off the banking sector.

While we are not yet out of the woods, we believe that future progress is less time-critical. We would like to see deposit guarantee laws enacted across the region (including in Dubai where it is promised but not yet enacted), and the UAE government has proposed (but not enacted) a guarantee on bonds issued by banks. Unconfirmed reports also abound of a potential buy-out in Saudi Arabia and elsewhere of troubled assets, but in SAMA's case at least they have suggested that nothing is in the pipeline.

## APPENDIX D SUMMARY OF COMMERCIAL BANK RESPONSES BY COUNTRY

**Figure 50: Bank Responses**

| | Loans | Investments | Deposits | Wholesale | Capital Market Liabilities |
|---|---|---|---|---|---|
| **Saudi Arabia** | YTD credit growth has been virtually zero, partly also due to high risk averseness of banks post NPL issues at family businesses | Most of the incremental liquidity is channeled to government securities | Banks have been shedding time deposits, and replacing them with demand and savings | Lower loan growth is relieving the pressure and generally leading to lower funding requirements | Banks looking to selectively retire expensive loans and refinance domestic currency borrowings |
| **Oman** | Corporate credit has slowed considerably, while flow of consumer loans is generally steady, but at lower levels | Banks depositing excess liquidity with the central bank | Focus is on improving the demand/saving mix, and reducing the reliance on wholesale funding | Increased initially but normalising now | Have become expensive. Banks selectively looking to raise domestic currency financing |
| **Kuwait** | Retail credit driven by Kuwaiti nationals but corporate credit weak. Plans to boost credit growth awaiting Parliamentary approval | Fewer lending opportunities has increased banks' demand for central bank/government bonds | Deposit mix shifting to cheap government deposits from expensive corporate deposits | Increase in the loan to deposit ratio to 85% from 80% in November 2008 reduces the need for expensive funding sources | Virtually no exposure (ex Burgan Bank) |
| **Qatar** | Loss of zero spread public sector business, and sale of property loans distorts numbers, underlying public sector loan demand until 2012e | DSM-listed equity holdings sold to QIA, boosting government debt positions | Also affected by netting of zero spread public sector loans/deposits | Strong liquidity so little urgent requirement | Strong liquidity so little urgent requirement |
| **UAE** | Banks initially guiding to 10% growth, some products areas targetted for exit | Gradual sell-down of riskier positions. | Rapid scramble for deposits, until wholesale funding returns | Syndicated funding not yet a feature. | After NBAD success, many to push for MTN funding in 2H2009e |
| **Lebanon** | Loan growth driven by domestic retail and by lending to regional corporates | Little change in the investments book; excess LBP liquidity channelled towards LBP T-Bills and Central Bank's CDs | Balance sheet continues to be primarily funded by non-resident retail deposits; growth mainly driven by LBP deposits | Banks have not traditionally relied on this source of funding | Aside from preferred equity, banks do not rely on capital markets to fund balance sheet growth |
| **Morocco** | Loan growth continues to be be driven by mortgages; loan growth significantly above that of deposit growth | No change in investment books mix; domestic equities and government bonds are the main asset classes | Demand deposit growth has slowed considerably since end of 2008; CD issuance will add pressure to funding costs in 2009e | Almost no exposure | Banks have issued subordinated debt primarily placed with domestic investors to strengthen capital position |
| **Egypt** | Loan growth almost zero from December 2008 mainly on lower corporate investments | Banks have not shifted signifcantly their investment books mix. Excess EGP liquidity invested in T-Bills | Deposit growth has slowed but remains at a solid 8% from December 2008, primarily driven by retail deposits | Banks have not traditionally relied on this source of funding | None |

Source: EFG-Hermes

# ABU DHABI COMMERCIAL BANK - DISCOUNT EXCESSIVE

06 OCTOBER 2009

UAE | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: AED 2.44 |
| Long-Term Rec. : Buy | LT Fair Value : AED 3.85 |

• **ADCB's Operations at the Riskier End of the Market**: ADCB operates within two broad divisions, commercial banking and investment banking, which includes the management of investment portfolios. Within commercial banking, ADCB has one of the largest exposures to retail banking in the UAE, which accounts for 31% of the loan book as at 2Q2009, including mortgage and credit card portfolios and loans against shares. Corporate lending is primarily to the construction sector (24% of loan book) and services sector (27%). Direct exposure to property (rental property within the ADCB building) is small, and was recently revalued downwards by 8%.

• **Recent Results Hit by Weak Investment and Provisioning**: The company's latest quarterly results were 5% below expectations on an adjusted basis. However, this was largely due to weakness of investment income, which continued to be affected by weak US credit markets, and the downward revaluation of property. Provisioning was also clearly an issue, with this item being negatively impacted by the AED2.2 billion of the Algosaibi/Saad exposure. The main positives for results were strong deposit growth and spreads driving solid growth in net interest income, as well as strong fee and commission income driven by repricing. Year-to-date results are in line thanks to a strong 1Q2009.

• **We are Nevertheless Raising Our Forecasts**: We are sharply improving our forecasts for net interest income, driven by very strong asset spreads, as well as partially on the back of better deposit and loan growth than we had forecast. Offsetting this will likely be higher cost growth than previously forecast, and provisioning, which we continue to revise upwards.

• **Provisioning the Key Issue (and the Valuation of RHB)**: The main uncertainty is provisioning, with the AED2.2 billion related to Saad/Algosaibi being at the top of the list. We have some concerns that the personal lending and construction exposure will turn more aggressively negative, but, ex-Saad/Algosaibi, the glide path for provisioning seems no worse than expected. Beyond provisioning, the chief balance sheet risk is the 25%-owned Malaysian associate, RHB, acquired in 2Q2008, whose market value is around half the current book value, equivalent to 12% of common shareholders' equity.

• **Valuation and Recommendation**: Although we have become increasingly comfortable with the Macquarie Bank relationship given improved disclosure, we continue to believe that ADCB should trade at a discount to the sector, given balance sheet risk and an unproven ability to avoid blow-ups. We have been encouraged by ADCB's recent success in raising bonds, and expect this to offset the high loan deposit ratio, and therefore the elevated deposit cost, may abate. In the short term, we think ADCB may face provisioning issues, but we believe the discount to the sector is excessive. We adjust our estimated LTFV to AED3.85 from AED2.99 and assign a ST Accumulate / LT Buy rating for the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *3,647* | *4,608* | *5,377* | *5,970* |
| *Cost / Income Ratio* | *42%* | *35%* | *33%* | *32%* |
| *Provisions / Avg. Loans (bps)* | *129* | *128* | *160* | *156* |
| *Net Attributable Income* | *1,400* | *1,610* | *1,533* | *1,842* |
| *ROAE* | *11.6%* | *10.1%* | *9.0%* | *8.4%* |
| *ROAA* | *1.11%* | *1.05%* | *0.90%* | *0.98%* |
| | | | | |
| *EPS (AED)* | *0.26* | *0.29* | *0.27* | *0.33* |
| *P/E (x)* | *9.2* | *8.5* | *8.9* | *7.4* |
| *Dividend Yield* | *4.1%* | *3.9%* | *3.8%* | *3.6%* |
| *P/BV (x)* | *0.9* | *0.8* | *0.8* | *0.7* |
| *Capital Adequacy* | *11.1%* | *19.0%* | *17.7%* | *17.0%* |
| *Loan Growth* | *44%* | *10%* | *11%* | *9%* |
| *Loans / Deposits* | *129.0%* | *131.6%* | *127.4%* | *120.9%* |
| *Provisions / NPLs* | *179%* | *110%* | *105%* | *131%* |

*Figures in AED million, unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(AED mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *2,649* | *2,436* | *3,636* | *2,596* | *3,860* |
| *Total Banking Income* | *3,647* | *3,890* | *4,608* | *4,163* | *5,377* |
| *Pre-Provision Income* | *2,117* | *2,407* | *2,993* | *2,533* | *3,577* |
| *Net Attributable Income* | *1,400* | *1,350* | *1,610* | *1,141* | *1,533* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *AED 0.10 on 09 Apr 09* |
| *Mkt. Cap / Shares (mn)* | *AED13,653 / 5,596* |
| *Av. Mthly Liqd (mn)* | *AED152.9* |
| *52-Week High / Low* | *AED3.53 / 1.35* |
| *Bloomberg / Reuters* | *ADCB UH / ADCB.AD* |
| *Est. Free Float* | *35%* |

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **1,165** | **2,649** | **1,760** | **3,636** | **3,860** | **4,277** |
| Dividend Income | 11 | 11 | 5 | 5 | 5 | 5 |
| Fees & Commissions | 458 | 898 | 470 | 956 | 1,047 | 1,152 |
| Trading & Investments | 148 | (252) | (276) | (179) | 210 | 224 |
| Brokerage & Fund Management | 52 | 84 | 26 | 62 | 79 | 79 |
| Property Income | 178 | 178 | (50) | (50) | - | 38 |
| Other Operating Income | 29 | 79 | 93 | 177 | 177 | 195 |
| **Total Non-Interest Income** | **876** | **998** | **269** | **972** | **1,518** | **1,693** |
| **Total Banking Income** | **2,041** | **3,647** | **2,029** | **4,608** | **5,377** | **5,970** |
| Total Operating Expenses | (667) | (1,530) | (776) | (1,615) | (1,800) | (1,917) |
| **Income before Provisions** | **1,375** | **2,117** | **1,253** | **2,993** | **3,577** | **4,053** |
| Provisions for Loans Losses | (167) | (758) | (536) | (1,491) | (2,075) | (2,264) |
| Associate Income & Adjustments | - | 172 | 108 | 261 | 316 | 339 |
| **Profit before Tax** | **1,207** | **1,530** | **825** | **1,763** | **1,818** | **2,128** |
| Tax, Minorities & Appropriations | (97) | (130) | (11) | (153) | (285) | (286) |
| **Net Attributable Income** | **1,110** | **1,400** | **814** | **1,610** | **1,533** | **1,842** |
| **Headline Income** | **1,081** | **1,237** | **649** | **1,413** | **1,502** | **1,792** |
| **Comprehensive Income** | **1,019** | **891** | **780** | **1,575** | **1,533** | **1,842** |

Source: Abu Dhabi Commercial Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)
In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 4,302 | 3,911 | 3,672 | 5,396 | 5,340 | 5,827 |
| Interbank Assets | 17,343 | 17,528 | 17,878 | 18,733 | 20,856 | 24,764 |
| Loans & Islamic Financing | 90,985 | 108,813 | 114,438 | 119,908 | 133,494 | 145,670 |
| Financial Instruments | 2,795 | 3,423 | 3,636 | 3,936 | 4,448 | 4,937 |
| Other Investments & Associates | 10,237 | 11,263 | 9,651 | 9,674 | 9,893 | 10,060 |
| **Other Assets** | 2,188 | 2,210 | 4,471 | 4,348 | 4,141 | 4,163 |
| Fixed Assets | 495 | 580 | 718 | 638 | 702 | 772 |
| **Total Assets** | **128,346** | **147,728** | **154,465** | **162,633** | **178,873** | **196,193** |
| Customer Deposits & Islamic Funding | 63,137 | 84,361 | 82,555 | 91,110 | 104,776 | 120,493 |
| Capital Market Liabilities | 39,705 | 30,735 | 35,763 | 35,763 | 35,763 | 35,763 |
| Interbank Liabilities | 6,295 | 6,905 | 5,163 | 5,698 | 6,552 | 6,025 |
| Other Financial Liabilities | 4,099 | 6,364 | 4,731 | 4,773 | 4,773 | 4,773 |
| Other Operating Items | 3,127 | 3,448 | 6,279 | 4,555 | 5,239 | 6,025 |
| Proposed Dividend | - | 481 | - | 460 | 441 | 488 |
| **Total Liabilities** | **116,363** | **132,294** | **134,491** | **142,359** | **157,544** | **173,566** |
| **Common Shareholders' Equity** | **11,861** | **15,327** | **15,947** | **16,246** | **17,302** | **18,600** |
| Minorities & Other Equity | 122 | 108 | 4,027 | 4,027 | 4,027 | 4,027 |
| **Total Liabilities & Equity** | **128,346** | **147,728** | **154,465** | **162,633** | **178,873** | **196,193** |

Source: Abu Dhabi Commercial Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.7% | 11.1% | 18.5% | 19.0% | 17.7% | 17.0% |
| Loans / Deposits | 144.1% | 129.0% | 138.6% | 131.6% | 127.4% | 120.9% |
| NPL Coverage Ratio | - | 179.2% | 112.2% | 109.7% | 105.5% | 131.3% |
| Net Interest Spread* | 1.93% | 2.07% | 2.35% | 2.34% | 2.21% | 2.21% |
| Cost / Income Ratio | 32.7% | 41.9% | 38.2% | 35.1% | 33.5% | 32.1% |
| Provisioning (bps) | 0.40% | 1.29% | 0.95% | 1.28% | 1.60% | 1.56% |
| RoAE* | 19.6% | 11.6% | 10.5% | 10.1% | 9.0% | 8.4% |
| RoAA* | 1.9% | 1.1% | 1.1% | 1.1% | 0.9% | 1.0% |
| EPS* | 0.43 | 0.26 | 0.29 | 0.29 | 0.27 | 0.33 |
| BVPS | 2.12 | 2.74 | 2.85 | 2.90 | 3.09 | 3.32 |
| DPS | - | 0.10 | - | 0.10 | 0.09 | 0.09 |

*Annualised for 1H data

Source: Abu Dhabi Commercial Bank, EFG-Hermes estimates

# ABU DHABI ISLAMIC BANK - HOLY SMOKE!

**06 OCTOBER 2009**

**UAE | BANKING**

| | |
|---|---|
| Short-Term Rec.: Buy | Current Price*: AED 3.15 |
| Long-Term Rec. : Buy | LT Fair Value : AED 5.78 |

- **Retail Banking Dominates**: Over the recent past, ADIB has been dominated by its retail division, which accounts for around half of the bank's revenues. Wholesale banking accounts for a segment of the remainder, although its recent profit contribution has been hit by provisioning. Private banking and Paradigm, the recently-launched capital market operations, account for smaller but growing amounts. Meanwhile the real estate division, which accounted for 14% of revenues in 2008 for the moment hardly troubles the revenue line. Revenues amounting to14% of the total came from international operations, including those from ADIB Invest. Other international associates include turnaround story ADIB Egypt.

- **Recent Results Better Than They Seemed:** Whilst 2Q2009 results were disappointing visually, we believe that on an underlying basis there was little to be upset about. Core revenues were below forecasts, but mostly for technical reasons. In addition, provisioning was high as a result of the Saudi exposure. Counterbalancing this aspect were solid investment returns and good cost control. Nevertheless, ADIB's numbers were less transparent than the sector, with one off items creating confusion and weaker disclosure on the Saad/Algosaibi issues going some way to explaining the mixed stock performance.

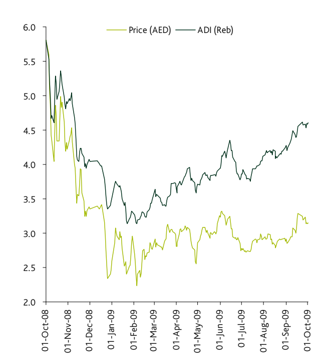
- **Near Term Forecast Changes Limited:** We only make minor modifications to our 2009e forecasts, although with slightly higher revenues, costs and provisioning. However, beyond the immediate horizon, we have adjusted downwards provisioning significantly, on the assumption that personal lending is primarily to nationals and is therefore significantly lower risk. In addition, cross-selling is now expected to be a strong driver of fees and commissions.

- **With its Extensive Branch Network, ADIB Egypt May be an Important Driver Longer Term:** So far, there have been two main challenges, (i) to improve the quality of ADIB Egypt, by isolating the extensive bad debts, (ii) recapitalising the remaining good bank, so that strategic progress can be made. Simultaneously, ADIB Egypt needs to be converted into an Islamic bank, so that parent company ADIB can make an offer to existing shareholders and then consolidate the operation. Whilst assets of the bank were less than 10% of the parent, and revenues were only a little over 3%, ADIB believes this can be a major area of growth..

- **ADIB Has Improved Its Franchise Over the Last Couple of Years, Identifying Areas of Underperformance:** In most cases this will result in improvements to the bottom line, although in some areas, such as Burooj Properties, they were fortuitous in not having expanded further. Whilst we have concerns that we are still taking a lot on faith here, and worry that the level of disclosure for Saad/Algosaibi does not match the sector, we see significant upside in the stock, providing it can come close to matching industry averages. We reduce our estimated LTFV to AED5.78 from AED6.59, but raise our recommendation to ST / LT Buy.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *2,199* | *2,394* | *2,723* | *3,203* |
| *Cost / Income Ratio* | *40%* | *39%* | *37%* | *37%* |
| *Provisions / Avg. Loans (bps)* | *75* | *112* | *97* | *75* |
| *Attributable Income* | *850* | *909* | *1,107* | *1,464* |
| *ROAE* | *15.8%* | *16.2%* | *18.4%* | *17.3%* |
| *ROAA* | *1.80%* | *1.59%* | *1.70%* | *1.97%* |
| *EPS (AED)* | *0.43* | *0.46* | *0.56* | *0.74* |
| *P/E (x)* | *7.3* | *6.8* | *5.6* | *4.2* |
| *Dividend Yield* | *6.9%* | *8.7%* | *9.8%* | *11.8%* |
| *P/BV (x)* | *1.2* | *1.1* | *1.0* | *0.9* |
| *Capital Adequacy* | *11.8%* | *18.8%* | *17.0%* | *16.2%* |
| *Loan Growth* | *38%* | *20%* | *17%* | *13%* |
| *Loans / Deposits* | *91.2%* | *92.9%* | *91.3%* | *90.5%* |
| *Provisions / NPLs* | *44%* | *55%* | *67%* | *74%* |

*Figures in AED million, unless otherwise stated*




**Estimate Changes**

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(AED mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *1,728* | *2,193* | *2,102* | *2,451* | *2,350* |
| *Total Banking Income* | *2,199* | *2,483* | *2,394* | *2,897* | *2,723* |
| *Pre-Provision Income* | *1,311* | *1,481* | *1,461* | *1,729* | *1,728* |
| *Net Attributable Income* | *850* | *931* | *909* | *994* | *1,107* |

**Stock Data**

| | |
|---|---|
| *Last Dividend* | *AED0.216 on 31 Mar 09* |
| *Mkt. Cap/Shares (mn)* | *AED6,207 / 1,971* |
| *Av. Mthly Liqd (mn)* | *AED65.9* |
| *52-Week High / Low* | *AED5.81 / 2.23* |
| *Bloomberg / Reuters* | *ADIB UH / ADIB.AD* |
| *Est. Free Float* | *24%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **808** | **1,728** | **1,017** | **2,102** | **2,350** | **2,710** |
| Dividend Income | - | - | - | - | - | - |
| Fees & Commissions | 49 | 155 | 93 | 208 | 310 | 372 |
| Trading & Investments | 63 | 47 | 21 | 44 | 56 | 59 |
| Brokerage & Fund Management | - | - | - | - | - | - |
| Property Income | 178 | 263 | 33 | 33 | - | 55 |
| Other Operating Income | 2 | 5 | 3 | 7 | 7 | 7 |
| **Total Non-Interest Income** | **292** | **470** | **150** | **292** | **373** | **493** |
| **Total Banking Income** | **1,100** | **2,199** | **1,167** | **2,394** | **2,723** | **3,203** |
| Total Operating Expenses | (380) | (888) | (455) | (933) | (994) | (1,170) |
| **Income before Provisions** | **720** | **1,311** | **711** | **1,461** | **1,728** | **2,033** |
| Provisions for Loans Losses | (200) | (235) | (247) | (486) | (500) | (448) |
| Associate Income & Adjustments | - | (224) | (6) | (6) | - | - |
| **Profit before Tax** | **520** | **851** | **459** | **970** | **1,228** | **1,586** |
| Tax, Minorities & Appropriations | - | (1) | - | (61) | (121) | (122) |
| **Net Attributable Income** | **520** | **850** | **459** | **909** | **1,107** | **1,464** |
| **Headline Income** | **520** | **851** | **462** | **972** | **1,230** | **1,587** |
| **Comprehensive Income** | **475** | **610** | **454** | **904** | **1,107** | **1,464** |

Source: Abu Dhabi Islamic Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 2,837 | 2,824 | 3,482 | 3,273 | 4,066 | 4,596 |
| Interbank Assets | 9,633 | 8,897 | 11,842 | 11,454 | 11,959 | 13,519 |
| Loans & Islamic Financing | 30,140 | 34,179 | 37,447 | 40,906 | 47,834 | 54,076 |
| Financial Instruments | - | - | - | - | - | - |
| Other Investments & Associates | 3,468 | 3,099 | 2,834 | 3,408 | 3,749 | 4,124 |
| Other Assets | 1,694 | 1,890 | 2,146 | 1,665 | 2,063 | 2,049 |
| Fixed Assets | 306 | 322 | 353 | 354 | 389 | 428 |
| **Total Assets** | **48,079** | **51,210** | **58,104** | **61,060** | **70,061** | **78,793** |
| Customer Deposits & Islamic Funding | 33,710 | 37,486 | 43,566 | 44,046 | 52,415 | 59,753 |
| Capital Market Liabilities | 2,938 | 2,938 | 2,938 | 5,138 | 5,138 | 5,138 |
| Interbank Liabilities | 4,142 | 3,576 | 2,196 | 1,999 | 1,730 | 1,972 |
| Other Financial Liabilities | - | - | - | - | - | - |
| Other Operating Items | 1,787 | 1,574 | 1,740 | 1,762 | 2,097 | 2,390 |
| Proposed Dividend | - | 426 | - | 539 | 605 | 735 |
| **Total Liabilities** | **42,577** | **46,000** | **50,440** | **53,485** | **61,985** | **69,988** |
| **Common Shareholders' Equity** | **5,498** | **5,207** | **5,662** | **5,572** | **6,073** | **6,802** |
| Minorities & Other Equity | 3 | 3 | 2,002 | 2,002 | 2,002 | 2,002 |
| **Total Liabilities & Equity** | **48,079** | **51,210** | **58,104** | **61,060** | **70,061** | **78,793** |

Source: Abu Dhabi Islamic Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 15.3% | 11.8% | 15.3% | 18.8% | 17.0% | 16.2% |
| Loans / Deposits | 89.4% | 91.2% | 86.0% | 92.9% | 91.3% | 90.5% |
| NPL Coverage Ratio | | 44.1% | | 54.9% | 66.7% | 74.4% |
| Net Interest Spread* | 3.84% | 3.99% | 3.99% | 3.90% | 3.86% | 3.82% |
| Cost / Income Ratio | 34.6% | 40.4% | 39.0% | 39.0% | 36.5% | 36.5% |
| Provisioning (bps) | 1.37% | 0.75% | 1.20% | 1.12% | 0.97% | 0.75% |
| RoAE* | 19.7% | 15.8% | 16.9% | 16.2% | 18.4% | 17.3% |
| RoAA* | 2.3% | 1.8% | 1.7% | 1.6% | 1.7% | 2.0% |
| EPS* | 0.54 | 0.43 | 0.47 | 0.46 | 0.56 | 0.74 |
| BVPS | 2.79 | 2.64 | 2.87 | 2.83 | 3.08 | 3.45 |
| DPS | - | 0.22 | - | 0.27 | 0.31 | 0.37 |

*Annualized for 1H data

Source: Abu Dhabi Islamic Bank, EFG-Hermes estimates

# COMMERCIAL BANK OF DUBAI - MIDMARKET PLAYER

06 OCTOBER 2009

UAE | BANKING

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: AED 3.93 |
| Long-Term Rec. : Buy | LT Fair Value : AED 6.22 |

• **Mid-Market Player:** CBD operates in three main areas, corporate banking, which accounts for 65% of revenues, consumer banking accounting for 17% of revenues and treasury & investments, accounting for 15% of revenues in 2008. In both the corporate and consumer banking segments, CBD aims at being a mid-market specialist, although it still has a wealth management operation at the top end of retail and provides remittance-based services to the lower end of the retail segment. As elsewhere, the consumer and corporate segments continued to grow through 2008, but the treasury & investments division took substantial impairment losses, damaging profitability.

• **Results for 2Q2009 Indicate No Signs of Instability:** CBD's reported net profit was broadly in line with our expectations, rebounding 14% Q-o-Q, but 10% lower Y-o-Y. Net interest income was a positive due to spread expansion, whilst investment gains slipped modestly back into positive territory. Costs appear to be well under control, and whilst provision jumped to 43 bps YTD from 29bps in 1Q2009, this still represents a pretty good absolute number.

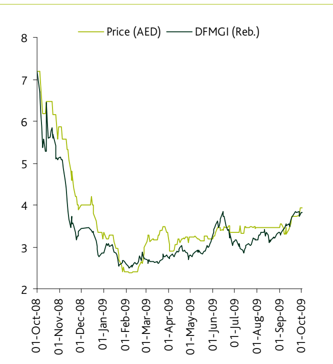
• **Forecast Revisions Minor & Generally in a Positive Direction:** We adjust our forecast for net attributable income down by 5% in 2009e and up by 10% in 2010e. The downwards revision in 2009e is partially due to a less positive assessment of recurring investment income and higher provisioning, although this is offset by the impact of better spreads and lower costs. For 2011e, the main change is lower provisioning, with an earlier likely end to the downturn than previously expected.

• **Little Concern Over the Business Model:** Our main concern continues to be that we might have misunderstood the business model. Traditionally, we would expect that mid-market corporates are amongst the most exposed to an economic downturn. In addition, with large corporates being somewhat sheltered by political associations, the mid-market could be left out in the cold. However, the mid-market is closely linked to the national population, who may have access to further liquidity when the situation requires it. Clearly, with Dubai continuing to suffer, particularly in the property sector, this is a key issue.

• **Valuation and Recommendation:** With CBD bouncing relatively little from recent lows, the stock now trades at the lowest earnings multiples in the country. Furthermore, as greater transparency comes through about its resilience in a down turn, we believe it is likely that investors will look more favourably on the stock. However, with corporate provisioning just beginning its upward trend, we believe that the risks, in relative terms at least, lie on the down side. Consequently, at least until 3Q2009e results, we maintain our ST Neutral / LT Buy recommendation, although we raise the price target to AED6.22 from AED5.11.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *1,280* | *1,728* | *1,879* | *2,068* |
| *Cost / Income Ratio* | *39%* | *32%* | *31%* | *32%* |
| *Provisions / Avg. Loans (bps)* | *8* | *49* | *86* | *85* |
| *Attributable Income* | *765* | *1,037* | *1,030* | *1,116* |
| *ROAE* | *16.3%* | *20.9%* | *18.3%* | *18.3%* |
| *ROAA* | *2.23%* | *2.78%* | *2.53%* | *2.42%* |
| | | | | |
| *EPS (AED)* | *0.43* | *0.59* | *0.58* | *0.63* |
| *P/E (x)* | *9.1* | *6.7* | *6.7* | *6.2* |
| *Dividend Yield* | *3.1%* | *5.7%* | *5.9%* | *6.9%* |
| *P/BV (x)* | *1.5* | *1.3* | *1.2* | *1.1* |
| *Capital Adequacy* | *13.0%* | *14.2%* | *14.5%* | *14.5%* |
| *Loan Growth* | *38%* | *4%* | *9%* | *12%* |
| *Loans / Deposits* | *111.0%* | *104.7%* | *99.6%* | *100.1%* |
| *Provisions / NPLs* | *96%* | *108%* | *136%* | *158%* |

*Figures in AED million, unless otherwise stated*




***Estimate Changes***

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(AED mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *1,144* | *1,282* | *1,320* | *1,396* | *1,417* |
| *Total Banking Income* | *1,280* | *1,809* | *1,728* | *1,993* | *1,879* |
| *Pre-Provision Income* | *787* | *1,193* | *1,182* | *1,315* | *1,301* |
| *Net Attributable Income* | *765* | *1,089* | *1,037* | *938* | *1,030* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *AED0.12 on 26 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *AED6,936 / 1,765* |
| *Av. Mthly Liqd (mn)* | *AED4.85* |
| *52-Week High / Low* | *AED7.20 / 2.39* |
| *Bloomberg / Reuters* | *CBD UH / CBD.DU* |
| *Est. Free Float* | *80%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **512** | **1,144** | **648** | **1,320** | **1,417** | **1,580** |
| Dividend Income | 19 | 19 | 13 | 13 | 15 | 18 |
| Fees & Commissions | 167 | 338 | 172 | 345 | 340 | 381 |
| Trading & Investments | 133 | (236) | (13) | 36 | 95 | 73 |
| Brokerage & Fund Management | - | - | - | - | - | - |
| Property Income | - | - | - | - | - | - |
| Other Operating Income | 7 | 16 | 7 | 14 | 12 | 16 |
| **Total Non-Interest Income** | **325** | **136** | **180** | **408** | **462** | **488** |
| **Total Banking Income** | **837** | **1,280** | **828** | **1,728** | **1,879** | **2,068** |
| Total Operating Expenses | (257) | (494) | (264) | (546) | (578) | (654) |
| **Income before Provisions** | **580** | **787** | **564** | **1,182** | **1,301** | **1,414** |
| Provisions for Loans Losses | (15) | (21) | (62) | (145) | (271) | (298) |
| Associate Income & Adjustments | - | - | - | - | - | - |
| **Profit before Tax** | **566** | **765** | **502** | **1,037** | **1,030** | **1,116** |
| Tax, Minorities & Appropriations | - | - | - | - | - | - |
| **Net Attributable Income** | **566** | **765** | **502** | **1,037** | **1,030** | **1,116** |
| **Headline Income** | **566** | **771** | **502** | **1,037** | **1,030** | **1,116** |
| **Comprehensive Income** | **529** | **283** | **535** | **1,071** | **1,030** | **1,116** |

Source: Commercial Bank of Dubai, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 3,814 | 2,209 | 3,248 | 4,448 | 5,840 | 6,519 |
| Interbank Assets | 305 | 920 | 303 | 890 | 1,622 | 1,811 |
| Loans & Islamic Financing | 25,492 | 28,579 | 29,005 | 29,651 | 32,445 | 36,215 |
| Financial Instruments | 3,123 | 2,233 | 1,952 | 1,831 | 2,069 | 2,297 |
| Other Investments & Associates | - | - | - | - | - | - |
| Other Assets | 1,111 | 1,341 | 1,459 | 936 | 1,047 | 1,283 |
| Fixed Assets | 442 | 476 | 500 | 523 | 576 | 633 |
| **Total Assets** | **34,286** | **35,757** | **36,468** | **38,279** | **43,599** | **48,758** |
| Customer Deposits & Islamic Funding | 24,886 | 25,755 | 27,174 | 28,330 | 32,580 | 36,163 |
| Capital Market Liabilities | - | 1,469 | 1,469 | 1,469 | 1,469 | 1,969 |
| Interbank Liabilities | 2,904 | 2,361 | 1,205 | 1,256 | 1,445 | 1,604 |
| Other Financial Liabilities | - | - | - | - | - | - |
| Other Operating Items | 1,554 | 1,475 | 1,599 | 1,667 | 1,917 | 2,128 |
| Proposed Dividend | - | 212 | - | 398 | 411 | 481 |
| **Total Liabilities** | **29,343** | **31,272** | **31,447** | **33,121** | **37,822** | **42,345** |
| **Common Shareholders' Equity** | **4,943** | **4,485** | **5,021** | **5,158** | **5,777** | **6,413** |
| Minorities & Other Equity | - | - | - | - | - | - |
| **Total Liabilities & Equity** | **34,286** | **35,757** | **36,468** | **38,279** | **43,599** | **48,758** |

Source: Commercial Bank of Dubai, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 13.1% | 13.0% | 13.0% | 14.2% | 14.5% | 14.5% |
| Loans / Deposits | 102.4% | 111.0% | 106.7% | 104.7% | 99.6% | 100.1% |
| NPL Coverage Ratio | 86.9% | 95.9% | 92.7% | 108.2% | 135.5% | 157.7% |
| Net Interest Spread* | 2.94% | 3.19% | 3.37% | 3.39% | 3.29% | 3.19% |
| Cost / Income Ratio | 30.7% | 38.6% | 31.9% | 31.6% | 30.8% | 31.6% |
| Provisioning (bps) | 0.12% | 0.08% | 0.43% | 0.49% | 0.86% | 0.85% |
| RoAE* | 24.4% | 16.3% | 21.2% | 20.9% | 18.3% | 18.3% |
| RoAA* | 3.4% | 2.2% | 2.7% | 2.8% | 2.5% | 2.4% |
| EPS* | 0.64 | 0.43 | 0.57 | 0.59 | 0.58 | 0.63 |
| BVPS | 2.80 | 2.54 | 2.84 | 2.92 | 3.27 | 3.63 |
| DPS | - | 0.12 | - | 0.23 | 0.23 | 0.27 |

*Annualised for 1H data

Source: Commercial Bank of Dubai, EFG-Hermes estimates

# DUBAI ISLAMIC BANK - TOO RICH

06 OCTOBER 2009

UAE | BANKING

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: AED 3.10 |
| Long-Term Rec. : Accumulate | LT Fair Value : AED 3.90 |

• **Real Estate Still a Drain on Profitability:** DIB operates through three roughly equally-sized divisions, retail & business, corporate & investment banking, and treasury & other. In addition, it has a fourth division, real estate, which is currently in the red, with negative revenues contributing to a negative bottom line. DIB's main business is overwhelmingly (97%) based in the UAE. In addition, DIB has a number of associates, including a non-core Sudanese operation, but a very core Pakistani business, which may eventually be a contributor of significant revenues.

• **Strong Quarterly Revenues Beat Expectations by 81%:** DIB reported net income of AED450 million, down 40% Y-o-Y, but up 22% Q-o-Q, and beating our expectations by 81%. Whilst a third of that can be put down to one-off items, and another third related to lower provisioning than we had forecast, results were generally not as weak as we projected. Spreads were better than forecast across the sector, fees benefited from strong syndication, and it was an impressive quarter for cost control. Comprehensive income also benefited from fair value gains on the available for sale portfolio of AED119 million.

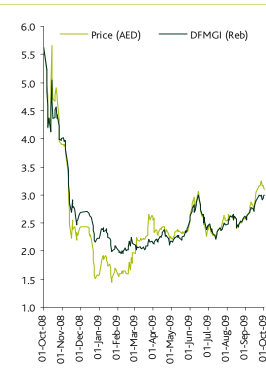
• **Raising Near-Term Forecasts**: We are increasing forecasts for net attributable income by 20% for 2009e and 11% for 2010e. In 2009e, this relates partially to better revenues related to net Islamic returns and investment returns, as well as lower costs. In 2010e, the major change to our forecasts has been a reduction in costs, but also less severe provisioning than we had originally forecast, with federal support for Dubai being a key component of that. Coverage ratios will likely remain below the average due to better security on loans, with a large proportion related to property.

• **New Directions:** DIB is in the process of reducing its loan book exposure to the real estate sector, for the moment putting 37% of the loan book into run off. The main problems have been both the over-concentration of credit risk, but also difficulties with financing long duration assets. Instead, DIB aims to focus more on the retail sector, although there are concerns it may find this a more competitive market. A more immediate risk to results is the likelihood for a 4Q2009e/1Q2010e resolution of the Tamweel issue, which may involve substantial write-downs.

• **Valuation and Recommendation**: We have tweaked our estimated LTFV number upwards from AED3.77 to AED3.90 on the back of improved forecasts. Nevertheless, we continue to see DIB as vulnerable to the Dubai risk, direct and indirect property sector risk, and still with the potential for downwards adjustment of asset prices. Whilst these are now at a manageable level, we believe the stock is rated as a premium stock for the UAE, and we don't believe that it has yet done enough to justify this. We maintain our recommendation of ST Neutral / LT Accumulate.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *3,015* | *3,198* | *3,406* | *3,709* |
| *Cost / Income Ratio* | *45%* | *41%* | *39%* | *42%* |
| *Provisions / Avg. Loans (bps)* | *43* | *126* | *171* | *117* |
| *Net Attributable Income* | *1,590* | *1,339* | *1,253* | *1,624* |
| *ROAE* | *17.0%* | *15.4%* | *14.1%* | *18.2%* |
| *ROAA* | *1.87%* | *1.49%* | *1.40%* | *1.75%* |
| | | | | |
| *EPS (AED)* | *0.45* | *0.37* | *0.35* | *0.45* |
| *P/E (x)* | *6.9* | *8.4* | *9.0* | *6.9* |
| *Dividend Yield* | *7.7%* | *8.4%* | *8.9%* | *10.6%* |
| *P/BV (x)* | *1.4* | *1.3* | *1.3* | *1.2* |
| *Capital Adequacy* | *12.0%* | *12.4%* | *12.6%* | *12.5%* |
| *Loan Growth* | *8%* | *-4%* | *1%* | *5%* |
| *Loans / Deposits* | *79.3%* | *71.6%* | *72.1%* | *73.1%* |
| *Provisions / NPLs* | *42%* | *57%* | *79%* | *88%* |

*Figures in AED million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(AED mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *2,146* | *2,198* | *2,213* | *2,209* | *2,339* |
| *Total Banking Income* | *3,015* | *3,112* | *3,198* | *3,420* | *3,406* |
| *Pre-Provision Income* | *1,647* | *1,765* | *1,898* | *1,977* | *2,072* |
| *Net Attributable Income* | *1,590* | *1,119* | *1,339* | *1,124* | *1,253* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *AED0.238 on 02 Apr 09* |
| *Mkt. Cap / Shares (mn)* | *AED11,215 / 3,618* |
| *Av. Mthly Liqd (mn)* | *AED733.5* |
| *52-Week High / Low* | *AED5.66 / 1.48* |
| *Bloomberg / Reuters* | *DIB UH / DISB.DU* |
| *Est. Free Float* | *43.72%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **881** | **2,146** | **1,104** | **2,213** | **2,339** | **2,428** |
| Dividend Income | - | - | - | - | - | - |
| Fees & Commissions | 532 | 872 | 330 | 639 | 676 | 744 |
| Trading & Investments | 307 | (294) | 41 | 144 | 222 | 261 |
| Brokerage & Fund Management | - | - | - | - | - | - |
| Property Income | 107 | 192 | 21 | 38 | 34 | 128 |
| Other Operating Income | 84 | 99 | 103 | 163 | 135 | 149 |
| **Total Non-Interest Income** | **1,029** | **869** | **496** | **985** | **1,067** | **1,281** |
| **Total Banking Income** | **1,910** | **3,015** | **1,600** | **3,198** | **3,406** | **3,709** |
| Total Operating Expenses | (664) | (1,368) | (651) | (1,299) | (1,334) | (1,565) |
| **Income before Provisions** | **1,246** | **1,647** | **948** | **1,898** | **2,072** | **2,144** |
| Provisions for Loans Losses | (65) | (217) | (237) | (660) | (900) | (643) |
| Associate Income & Adjustments | 119 | 293 | 81 | 121 | 100 | 148 |
| **Profit before Tax** | **1,299** | **1,723** | **793** | **1,359** | **1,272** | **1,649** |
| Tax, Minorities & Appropriations | 3 | (132) | (9) | (21) | (19) | (25) |
| **Net Attributable Income** | **1,303** | **1,590** | **784** | **1,339** | **1,253** | **1,624** |
| **Headline Income** | **1,303** | **1,730** | **784** | **1,359** | **1,273** | **1,649** |
| **Comprehensive Income** | **1,214** | **(305)** | **788** | **1,342** | **1,253** | **1,624** |

Source: Dubai Islamic Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 6,402 | 6,329 | 9,852 | 10,081 | 10,213 | 9,688 |
| Interbank Assets | 11,348 | 3,482 | 4,540 | 4,511 | 4,570 | 4,817 |
| Loans & Islamic Financing | 49,784 | 52,659 | 50,727 | 50,404 | 51,063 | 53,820 |
| Financial Instruments | 10,975 | 11,226 | 11,198 | 12,910 | 13,298 | 13,430 |
| Other Investments & Associates | 10,262 | 8,995 | 9,088 | 9,603 | 10,043 | 10,497 |
| Other Assets | 2,001 | 1,672 | 1,757 | 1,996 | 1,039 | 1,432 |
| Fixed Assets | 635 | 669 | 703 | 770 | 847 | 931 |
| **Total Assets** | **91,408** | **85,031** | **87,865** | **90,275** | **91,072** | **94,614** |
| Customer Deposits & Islamic Funding | 72,746 | 66,427 | 71,536 | 70,413 | 70,868 | 73,617 |
| Capital Market Liabilities | 2,755 | 2,755 | 2,450 | 6,150 | 6,150 | 6,150 |
| Interbank Liabilities | 2,235 | 3,331 | 1,155 | 1,137 | 1,144 | 1,189 |
| Other Financial Liabilities | - | - | - | - | - | - |
| Other Operating Items | 3,229 | 3,593 | 3,830 | 3,169 | 3,189 | 3,313 |
| Proposed Dividend | - | 861 | - | 939 | 998 | 1,188 |
| **Total Liabilities** | **80,965** | **76,966** | **78,971** | **81,807** | **82,350** | **85,456** |
| **Common Shareholders' Equity** | **10,443** | **8,065** | **8,891** | **8,468** | **8,722** | **9,158** |
| Minorities & Other Equity | - | - | 3 | - | - | - |
| **Total Liabilities & Equity** | **91,408** | **85,031** | **87,865** | **90,275** | **91,072** | **94,614** |

Source: Dubai Islamic Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.3% | 12.0% | 12.6% | 12.4% | 12.6% | 12.5% |
| Loans / Deposits | 68.4% | 79.3% | 70.9% | 71.6% | 72.1% | 73.1% |
| NPL Coverage Ratio | - | 41.8% | - | 56.9% | 79.2% | 88.0% |
| Net Interest Spread* | 2.33% | 2.83% | 2.75% | 2.81% | 3.03% | 2.99% |
| Cost / Income Ratio | 34.8% | 45.4% | 40.7% | 40.6% | 39.2% | 42.2% |
| Provisioning (bps) | 0.28% | 0.43% | 0.90% | 1.26% | 1.71% | 1.17% |
| RoAE* | 27.0% | 17.0% | 18.6% | 15.4% | 14.1% | 18.2% |
| RoAA* | 3.0% | 1.9% | 1.7% | 1.5% | 1.4% | 1.7% |
| EPS* | 0.72 | 0.45 | 0.43 | 0.37 | 0.35 | 0.45 |
| BVPS | 2.89 | 2.23 | 2.46 | 2.34 | 2.41 | 2.53 |
| DPS | - | 0.24 | - | 0.26 | 0.28 | 0.33 |

*Annualised for 1H data

Source: Dubai Islamic Bank, EFG-Hermes estimates

# EMIRATES NBD - GLORY DEFERRED

06 OCTOBER 2009

UAE | BANKING

| | |
|---|---|
| Short-Term Rec.: Buy | Current Price*: AED 4.40 |
| Long-Term Rec. : Buy | LT Fair Value : AED 7.17 |

• **Primarily a Corporate & Government Bank:** ENBD operates through four main divisions, with Government & Corporate accounting for 50% of all revenues in 2009 YTD. Of this, we believe a substantial proportion relates to GREs . Retail accounts for 27% of revenues, down sharply from 2008 levels. Islamic banking makes a smaller but steady contribution, amounting to 8% YTD, whilst the investments & fund management division has unsurprisingly been the source of much of the firm-wide volatility.

• **Provisioning Weighing on Recent Results:** Recent attributable income has been weak, dipping 32% Q-o-Q In addition, although operating profits were 28% ahead of expectations, this was primarily due to one-off, low-quality items, as well as continued elevated spreads. Provisioning was up over three-fold in 2Q2009 with Saudi exposures, such as Algosaibi, being partially blamed.

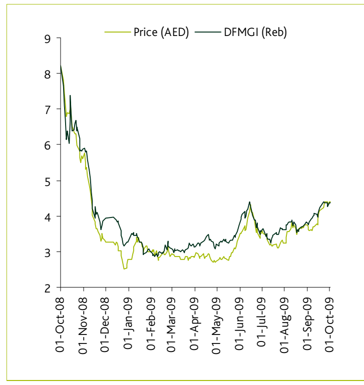
• **ST Earnings Revised Downwards, LT Earnings Improved:** We have revised down sharply our FY2009e earnings, primarily due to much higher provisioning than we had originally forecast. In addition, we expect net interest income to be higher, benefiting for longer from higher spreads, whilst non-interest income will likely be weaker across the board, apart from perhaps the bright spot of foreign exchange income. Beyond 2009e, the main revisions are for lower non-interest income, but are compensated for by lower costs, with the bank itself indicating cost-income ratios in the mid-thirties range. In addition, whilst we had initially anticipated provisioning peaking in late 2010e, we now bring that expectation forward significantly, implying a significant earnings uplift in 2011e.

• **Do Merger Benefits Counterbalance Dubai Risk?** As indicated earlier in the note, the Dubai risk is far from resolved, although the credit markets have been willing to price this in on the back of greater state support, and lower risk aversion. However, provided that there are no GRE bankruptcies, and the labour market continues to stabilise, the slope of decline should be improving. Against this, ENBD has brought its cost guidance down, closer to the market average, partially as a result of the merger. The bulk of this is scheduled to be completed in 2010, and we should at least see reduced integration-related expenses.

• **Valuation and Recommendation:** Although we are concerned about the Dubai risk, exposure to the property market through the loan book and directly, and about the difficulties related to major associate Union Properties, we believe ENBD is the cheapest investable bank in the UAE, even on the much reduced 2009e numbers, and a key beneficiary of resolution of the Nakheel uncertainties. Consequently, we continue to maintain our recommendation of ST/LT Buy. Our estimated LTFV is unchanged at AED7.17.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *8,191* | *10,077* | *9,570* | *10,371* |
| *Cost / Income Ratio* | *41%* | *36%* | *37%* | *36%* |
| *Provisions / Avg. Loans (bps)* | *73* | *153* | *101* | *80* |
| *Attributable Income* | *3,668* | *3,029* | *3,431* | *4,396* |
| *ROAE* | *19.4%* | *15.3%* | *15.9%* | *16.3%* |
| *ROAA* | *1.39%* | *1.13%* | *1.22%* | *1.44%* |
| | | | | |
| *EPS (AED)* | *0.68* | *0.56* | *0.63* | *0.81* |
| *P/E (x)* | *6.5* | *7.8* | *6.9* | *5.4* |
| *Dividend Yield* | *4.1%* | *4.0%* | *8.5%* | *9.9%* |
| *P/BV (x)* | *1.3* | *1.2* | *1.1* | *1.0* |
| *Capital Adequacy* | *11.4%* | *19.3%* | *18.8%* | *18.0%* |
| *Loan Growth* | *26%* | *6%* | *6%* | *10%* |
| *Loans / Deposits* | *128.7%* | *123.1%* | *118.2%* | *117.5%* |
| *Provisions / NPLs* | *70%* | *101%* | *102%* | *103%* |

*Figures in AED million unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(AED mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *5,834* | *6,212* | *7,060* | *6,872* | *6,732* |
| *Total Banking Income* | *8,191* | *10,044* | *10,077* | *11,378* | *9,570* |
| *Pre-Provision Income* | *4,822* | *6,267* | *6,496* | *7,055* | *6,009* |
| *Net Attributable Income* | *3,668* | *4,217* | *3,029* | *3,468* | *3,431* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *AED0.20 on 03 Apr 09* |
| *Mkt. Cap / Shares (mn)* | *AED24,453 / 5,557* |
| *Av. Mthly Liqd (mn)* | *AED50.6* |
| *52-Week High / Low* | *AED8.23 / 2.52* |
| *Bloomberg / Reuters* | *ENBD UH / ENBD.DU* |
| *Est. Free Float* | *44%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **2,742** | **5,834** | **3,643** | **7,060** | **6,732** | **7,176** |
| Fees & Commissions | 1,100 | 1,775 | 872 | 1,682 | 1,590 | 1,749 |
| Trading & Investments | (1) | (1,050) | 33 | 142 | 248 | 249 |
| Brokerage & Fund Management | - | 471 | - | - | - | - |
| Property Income | - | 80 | - | - | - | 96 |
| Other Operating Income | 847 | 1,080 | 843 | 1,193 | 1,000 | 1,100 |
| **Total Non-Interest Income** | **1,946** | **2,357** | **1,748** | **3,017** | **2,838** | **3,195** |
| **Total Banking Income** | **4,687** | **8,191** | **5,391** | **10,077** | **9,570** | **10,371** |
| Total Operating Expenses | (1,751) | (3,368) | (1,807) | (3,582) | (3,561) | (3,734) |
| **Income before Provisions** | **2,936** | **4,822** | **3,584** | **6,496** | **6,009** | **6,637** |
| Provisions for Loans Losses | (520) | (1,397) | (1,488) | (3,371) | (2,356) | (2,026) |
| Associate Income & Adjustments | 232 | 243 | 15 | 33 | 36 | 43 |
| **Profit before Tax** | **2,648** | **3,669** | **2,111** | **3,158** | **3,689** | **4,654** |
| Tax, Minorities & Appropriations | (1) | (1) | (0) | (129) | (258) | (258) |
| **Net Attributable Income** | **2,647** | **3,668** | **2,111** | **3,029** | **3,431** | **4,396** |
| **Headline Income** | **2,647** | **3,681** | **2,111** | **3,158** | **3,689** | **4,654** |
| **Comprehensive Income** | **2,803** | **2,046** | **2,392** | **3,310** | **3,431** | **4,396** |

Source: Emirates NBD, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 28,431 | 16,707 | 12,799 | 10,817 | 11,471 | 12,612 |
| Interbank Assets | 18,472 | 8,128 | 15,046 | 15,332 | 16,259 | 17,877 |
| Loans & Islamic Financing | 187,390 | 208,930 | 216,632 | 220,750 | 234,105 | 257,393 |
| Financial Instruments | 27,890 | 19,635 | 17,467 | 22,581 | 22,581 | 24,839 |
| Other Investments & Associates | 7,669 | 10,044 | 5,892 | 6,160 | 6,512 | 6,886 |
| Other Assets | 3,970 | 7,176 | 2,902 | 3,698 | 3,706 | 1,640 |
| Fixed Assets | 2,437 | 2,793 | 3,087 | 3,072 | 3,379 | 3,717 |
| Goodwill | 6,194 | 6,139 | 6,092 | 6,045 | 5,952 | 5,858 |
| **Total Assets** | **282,453** | **279,553** | **279,919** | **288,454** | **303,964** | **330,821** |
| Customer Deposits & Islamic Funding | 157,060 | 162,315 | 170,541 | 179,276 | 197,981 | 219,093 |
| Capital Market Liabilities | 31,135 | 30,070 | 26,245 | 26,145 | 27,145 | 28,145 |
| Interbank Liabilities | 47,352 | 51,686 | 45,468 | 44,819 | 37,616 | 39,437 |
| Other Financial Liabilities | 12,394 | 5,754 | 1,624 | 1,771 | 1,859 | 1,952 |
| Other Operating Items | 7,994 | 3,966 | 4,896 | 4,380 | 4,837 | 5,353 |
| Proposed Dividend | - | 1,011 | - | 968 | 2,081 | 2,412 |
| **Total Liabilities** | **255,935** | **254,802** | **248,774** | **257,359** | **271,519** | **296,392** |
| **Common Shareholders' Equity** | **26,422** | **24,655** | **27,047** | **26,997** | **28,347** | **30,331** |
| Minorities & Other Equity | 97 | 97 | 4,098 | 4,098 | 4,098 | 4,098 |
| **Total Liabilities & Equity** | **282,453** | **279,553** | **279,919** | **288,454** | **303,964** | **330,821** |

Source: Emirates NBD, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.5% | 11.4% | 19.0% | 19.3% | 18.8% | 18.0% |
| Loans / Deposits | 119.3% | 128.7% | 127.0% | 123.1% | 118.2% | 117.5% |
| NPL Coverage Ratio | - | 69.8% | - | 101.0% | 101.7% | 103.2% |
| Net Interest Spread* | 2.04% | 2.14% | 2.68% | 2.52% | 2.24% | 2.19% |
| Cost / Income Ratio | 37.4% | 41.1% | 33.5% | 35.5% | 37.2% | 36.0% |
| Provisioning (bps) | 0.58% | 0.73% | 1.37% | 1.53% | 1.01% | 0.80% |
| RoAE* | 28.8% | 19.4% | 21.9% | 15.3% | 15.9% | 16.3% |
| RoAA* | 2.0% | 1.4% | 1.6% | 1.1% | 1.2% | 1.4% |
| EPS* | 0.97 | 0.68 | 0.78 | 0.56 | 0.63 | 0.81 |
| BVPS | 3.64 | 3.33 | 3.77 | 3.77 | 4.03 | 4.40 |
| DPS | - | 0.18 | - | 0.17 | 0.37 | 0.43 |

*Annualised for 1H data

Source: Emirates NBD, EFG-Hermes estimates

# FIRST GULF BANK - NO PAIN NO GAIN

**06 OCTOBER 2009**

**UAE | BANKING**

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: AED 16.80 |
| Long-Term Rec. : Buy | LT Fair Value : AED 26.31 |

- **Primarily a Corporate Bank... and a Retail Bank:** We tend to think of FGB as a corporate bank, but the reality is that retail banking has been the main driver of operating income since the beginning of 2008. However, the main feature has been the reduction in contribution from the treasury and real estate divisions, although perhaps the latter is more of a reflection of market conditions than strategy. FGB remains a bank focussed on the UAE where 89% of its credit risk lies, which has helped it keep Saad/Algosaibi exposure in proportion.

- **Recent Results Have Matched Guidance:** With FGB generally providing good guidance on results, it is rare to see analysts get the figures too far wrong, and this was true again in 2Q2009 where FGB beat our forecasts by 1%. Within this, revenue growth was weak, rising only 2% Q-o-Q, and missing our forecasts by 3%, in spite of more positive spreads. However cost performance was very impressive, declining 12% Q-o-Q and driving strong operating profits. Higher provisioning though kept the bottom line close to the target, whilst further unrealized losses on the available-for-sale (AFS) portfolio held back comprehensive income.

- **Forecasts Little Changed for 2009, Raised for 2010:** We reduce our forecast for 2009e by 5%, but we increase those for 2010e by 8%. The main negative changes are lower estimates of recurring investment income. However, this is offset by lower provisioning in 2010e, with our expectation that some of these provisions will be taken earlier, particularly on the unsecured book, and that corporate provisions may not be as bad as we once expected. We also have moved the peak year for provisioning back to 2010e from 2011e, which implies a sharp uplift in our 2011e forecasts.

- **Concerns Still Focus on Property Portfolio**: Although FGB has high exposure to the property sector, we believe a significant portion of this may be divestable, and this may result in a rethinking of the stock. However, with continuing exposure to the Dubai property market there will likely still be a rump of problematic properties, and we believe a write-down at some point may also be possible, perhaps in 4Q2009e. In addition, with provisioning on a rising trend through 2009e, we believe this may weigh on the market in 3Q2009e results. Nevertheless, we believe that the likelihood is that FGB will try to match one piece of news against another, leaving underlying earnings relatively untouched.

- **Valuation and Recommendation.** We raise our estimated LTFV to AED26.3 from AED19.4 based on the improved outlook from 2011e, and also on a reduced discount rate. However, although we still see strong upside potential, higher provisioning in 3Q2009 may mean the best opportunities to buy the stock are after results. Consequently, we lower our ST recommendation on the stock to Accumulate from Buy, but maintain our LT Buy recommendation.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *4,521* | *5,337* | *5,973* | *7,365* |
| *Cost / Income Ratio* | *26%* | *21%* | *19%* | *21%* |
| *Provisions / Avg. Loans (bps)* | *87* | *133* | *124* | *106* |
| *Attributable Income* | *2,945* | *2,941* | *3,367* | *4,471* |
| *ROAE* | *23.4%* | *17.4%* | *17.4%* | *16.9%* |
| *ROAA* | *3.15%* | *2.52%* | *2.43%* | *2.81%* |
| *EPS (AED)* | *2.07* | *1.96* | *2.24* | *2.98* |
| *P/E (x)* | *8.1* | *8.6* | *7.5* | *5.6* |
| *Dividend Yield* | *1.9%* | *1.7%* | *2.0%* | *4.8%* |
| *P/BV (x)* | *1.6* | *1.4* | *1.2* | *1.1* |
| *Capital Adequacy* | *14.1%* | *16.8%* | *16.1%* | *15.6%* |
| *Loan Growth* | *79%* | *16%* | *17%* | *16%* |
| *Loans / Deposits* | *107.3%* | *100.8%* | *100.7%* | *101.2%* |
| *Provisions / NPLs* | *99%* | *93%* | *113%* | *125%* |

*Figures in AED million unless otherwise stated*


***Estimate Changes***

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| ***(AED mn)*** | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *2,560* | *3,685* | *3,850* | *4,320* | *4,246* |
| *Total Banking Income* | *4,521* | *5,419* | *5,337* | *6,614* | *5,973* |
| *Pre-Provision Income* | *3,326* | *3,927* | *4,199* | *4,710* | *4,843* |
| *Net Attributable Income* | *2,945* | *3,096* | *2,941* | *3,111* | *3,367* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *AED0.35 on 19 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *AED25,200 / 1,500* |
| *Av. Mthly Liqd (mn)* | *AED374.02* |
| *52-Week High / Low* | *AED17.05 / 6.84* |
| *Bloomberg / Reuters* | *FGB UH / FGB.AD* |
| *Est. Free Float* | *35%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **1,047** | **2,560** | **1,833** | **3,850** | **4,246** | **5,138** |
| Dividend Income | 7 | - | - | 1 | 3 | 3 |
| Fees & Commissions | 554 | 1,087 | 614 | 1,223 | 1,348 | 1,563 |
| Trading & Investments | 177 | 66 | 27 | 101 | 161 | 180 |
| Brokerage & Fund Management | 12 | 27 | 10 | 28 | 44 | 51 |
| Property Income | 295 | 644 | 60 | 119 | 119 | 369 |
| Other Operating Income | 48 | 137 | 1 | 15 | 52 | 60 |
| **Total Non-Interest Income** | **1,093** | **1,961** | **712** | **1,487** | **1,727** | **2,227** |
| **Total Banking Income** | **2,141** | **4,521** | **2,545** | **5,337** | **5,973** | **7,365** |
| Total Operating Expenses | (457) | (1,195) | (550) | (1,138) | (1,130) | (1,528) |
| **Income before Provisions** | **1,684** | **3,326** | **1,995** | **4,199** | **4,843** | **5,837** |
| Provisions for Loans Losses | (299) | (566) | (480) | (1,161) | (1,260) | (1,260) |
| Associate Income & Adjustments | 99 | 178 | 12 | 24 | 24 | 134 |
| **Profit before Tax** | **1,484** | **2,937** | **1,527** | **3,062** | **3,607** | **4,711** |
| Tax, Minorities & Appropriations | - | 8 | (1) | (121) | (240) | (240) |
| **Net Attributable Income** | **1,484** | **2,945** | **1,526** | **2,941** | **3,367** | **4,471** |
| **Headline Income** | **1,484** | **3,005** | **1,526** | **3,130** | **3,682** | **4,864** |
| **Comprehensive Income** | **1,430** | **2,820** | **1,431** | **2,847** | **3,367** | **4,471** |

Source: First Gulf Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 8,294 | 5,005 | 4,681 | 7,338 | 7,499 | 8,672 |
| Interbank Assets | 1,229 | 2,837 | 6,361 | 6,782 | 7,921 | 8,540 |
| Loans & Islamic Financing | 65,739 | 79,363 | 86,041 | 91,727 | 107,136 | 123,884 |
| Financial Instruments | 8,605 | 9,556 | 11,019 | 11,945 | 13,736 | 16,484 |
| Other Investments & Associates | 6,716 | 6,566 | 6,171 | 7,020 | 7,503 | 7,562 |
| Other Assets | 1,462 | 2,182 | 2,135 | 2,031 | 2,430 | 2,237 |
| Fixed Assets | 2,278 | 2,012 | 2,236 | 2,213 | 2,435 | 2,678 |
| **Total Assets** | **94,325** | **107,522** | **118,644** | **129,057** | **148,660** | **170,057** |
| Customer Deposits & Islamic Funding | 61,172 | 73,963 | 83,725 | 90,974 | 106,440 | 122,406 |
| Capital Market Liabilities | 5,785 | 5,785 | 3,030 | 5,805 | 5,805 | 5,805 |
| Interbank Liabilities | 12,951 | 7,313 | 6,727 | 5,458 | 6,120 | 7,038 |
| Other Financial Liabilities | - | - | - | - | - | - |
| Other Operating Items | 3,115 | 3,842 | 3,796 | 4,124 | 4,826 | 5,549 |
| Proposed Dividend | - | 477 | - | 422 | 512 | 1,214 |
| **Total Liabilities** | **83,022** | **91,379** | **97,278** | **106,784** | **123,703** | **142,012** |
| **Common Shareholders' Equity** | **11,302** | **15,768** | **16,991** | **17,896** | **20,581** | **23,668** |
| Minorities & Other Equity | - | 374 | 4,376 | 4,376 | 4,376 | 4,376 |
| **Total Liabilities & Equity** | **94,325** | **107,522** | **118,644** | **129,057** | **148,660** | **170,057** |

Source: First Gulf Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 9.8% | 14.1% | 18.3% | 16.8% | 16.1% | 15.6% |
| Loans / Deposits | 107.5% | 107.3% | 102.8% | 100.8% | 100.7% | 101.2% |
| NPL Coverage Ratio | - | 99.1% | 85.8% | 93.2% | 112.5% | 125.1% |
| Net Interest Spread* | 2.63% | 2.84% | 3.23% | 3.23% | 3.13% | 3.08% |
| Cost / Income Ratio | 21.3% | 26.4% | 21.6% | 21.3% | 18.9% | 20.7% |
| Provisioning (bps) | 1.08% | 0.87% | 1.14% | 1.33% | 1.24% | 1.06% |
| RoAE* | 28.1% | 23.4% | 18.7% | 17.4% | 17.4% | 16.9% |
| RoAA* | 3.5% | 3.2% | 2.7% | 2.5% | 2.4% | 2.8% |
| EPS* | 2.16 | 2.07 | 2.07 | 1.96 | 2.24 | 2.98 |
| BVPS | 8.22 | 10.51 | 11.33 | 11.93 | 13.72 | 15.78 |
| DPS | - | 0.32 | - | 0.28 | 0.34 | 0.81 |

*Annualised for 1H data

Source: First Gulf Bank, EFG-Hermes estimates

# NATIONAL BANK OF ABU DHABI - TOO SAFE A CHOICE

06 OCTOBER 2009

UAE | BANKING

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: AED 13.35 |
| Long-Term Rec. : Accumulate | LT Fair Value : AED 18.40 |

- **Largest Single Brand Franchise in the UAE:** NBAD operates through four main divisions, comprising domestic banking, international banking, financial markets, and corporate & investment banking, as well as the head office operations, and small global wealth and Islamic banking divisions. In addition, NBAD is geographically diversified with stand-alone operations in Egypt and Oman, and flag-pole operations across the GCC and international financial centres.

- **Recent Results Have Been Strong:** Recent results have been strong, with net attributable income recovering to just 10% below peak 2Q2008 levels, in spite of provisioning being nearly 4x higher. The biggest contribution came from stronger spreads, which jumped from 1.84% a year ago to 2.39% in 2Q2009, although they are now on a declining trend. Cost control has also been good. However, non-interest income in 2Q2009 was just below peak levels, and we believe this may be difficult to sustain, particularly in the light of the substantial negative number in cumulative changes in fair value, and the near-peak levels of net investment income and foreign exchange income.

- **Strong Positive Earnings Revisions:** Earnings for the first half of the year account for 73% of our previous full-year forecast, with strength spread across all divisions. Consequently, although we do not expect earnings in 2H2009e to match those in 1H2009, we are increasing our 2009e forecasts by 36% and 2010e forecasts by 53%. The main contributing factors are the much stronger spreads, driven by lower competition and more cautious pricing, and lower provisioning compared to the rest of the sector.

- **Few Concerns, but Less Low-Hanging Fruit:** NBAD's strategy seems to be untarnished with the focus continuing to be on further establishing the bank as a leading MENA bank. With generally lower multiples and less optimism built in, we are less concerned about possible acquisition value destruction. The loan book has been well diversified, with most of the growth coming from services and manufacturing over the last two years, with personal lending shrinking its contribution to the pie.

- **Valuation Still Good, but Better Opportunities Elsewhere:** NBAD has been the earliest amongst the UAE banks to recover, and deservedly so. The bank has long had a reputation for conservatism, and we see this in the lower provisions and undamaged franchise. Furthermore, the reining in of competition from the international banks is most affecting the national banks, which compete in a similar space. However, NBAD now trades at a premium to the UAE banking sector, and if risk levels continue to fall, then it will not be the primary beneficiary, in our view. Consequently, although we raise our price target to AED18.4 from AED12.2 as a result of better forecasts and a trimmed discount rate, we lower our recommendation to ST Neutral / LT Accumulate from ST Accumulate / LT Accumulate

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *5,124* | *6,288* | *6,883* | *8,109* |
| *Cost / Income Ratio* | *29%* | *28%* | *27%* | *28%* |
| *Provisions / Avg. Loans (bps)* | *67* | *95* | *103* | *52* |
| *Attributable Income* | *3,018* | *3,120* | *3,153* | *4,554* |
| *ROAE* | *22.8%* | *20.8%* | *18.3%* | *19.3%* |
| *ROAA* | *1.91%* | *1.76%* | *1.49%* | *1.88%* |
| | | | | |
| *EPS (AED)* | *1.39* | *1.45* | *1.60* | *2.30* |
| *P/E (x)* | *9.6* | *9.2* | *8.4* | *5.8* |
| *Dividend Yield* | *2.0%* | *2.6%* | *3.0%* | *6.9%* |
| *P/BV (x)* | *2.1* | *1.7* | *1.4* | *1.3* |
| *Capital Adequacy* | *13.2%* | *15.8%* | *15.4%* | *15.2%* |
| *Loan Growth* | *45%* | *14%* | *14%* | *13%* |
| *Loans / Deposits* | *111.5%* | *105.7%* | *103.1%* | *102.4%* |
| *Provisions / NPLs* | *144%* | *158%* | *188%* | *203%* |

*Figures in AED million unless otherwise stated*


***Estimate Changes***

| *(AED mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Interest Income* | *3,608* | *3,398* | *4,514* | *3,697* | *5,042* |
| *Total Banking Income* | *5,124* | *5,057* | *6,288* | *5,521* | *6,883* |
| *Pre-Provision Income* | *3,630* | *3,594* | *4,523* | *3,860* | *5,034* |
| *Net Attributable Income* | *3,018* | *2,289* | *3,120* | *2,065* | *3,153* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *AED0.27 on 19 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *AED29,027 / 2,174* |
| *Av. Mthly Liqd (mn)* | *AED98.08* |
| *52-Week High / Low* | *AED14.0 / 6.4* |
| *Bloomberg / Reuters* | *NBAD UH / NBAD.AD* |
| *Est. Free Float* | *30%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **1,600** | **3,608** | **2,162** | **4,514** | **5,042** | **6,126** |
| Dividend Income | - | 6 | - | 6 | 8 | 10 |
| Fees & Commissions | 491 | 923 | 510 | 1,017 | 1,082 | 1,150 |
| Trading & Investments | 300 | 225 | 326 | 616 | 652 | 748 |
| Brokerage & Fund Management | 104 | 208 | - | - | - | - |
| Property Income | - | - | - | - | - | - |
| Other Operating Income | 68 | 155 | 88 | 136 | 101 | 75 |
| **Total Non-Interest Income** | **963** | **1,517** | **925** | **1,775** | **1,842** | **1,983** |
| **Total Banking Income** | **2,563** | **5,124** | **3,087** | **6,288** | **6,883** | **8,109** |
| Total Operating Expenses | (686) | (1,494) | (876) | (1,765) | (1,849) | (2,260) |
| **Income before Provisions** | **1,877** | **3,630** | **2,211** | **4,523** | **5,034** | **5,849** |
| Provisions for Loans Losses | (145) | (703) | (500) | (1,197) | (1,514) | (876) |
| Associate Income & Adjustments | 177 | 163 | - | - | - | - |
| **Profit before Tax** | **1,909** | **3,090** | **1,711** | **3,326** | **3,520** | **4,973** |
| Tax, Minorities & Appropriations | (34) | (72) | (39) | (206) | (367) | (419) |
| **Net Attributable Income** | **1,875** | **3,018** | **1,673** | **3,120** | **3,153** | **4,554** |
| **Headline Income** | **1,876** | **3,019** | **1,677** | **3,125** | **3,158** | **4,560** |
| **Comprehensive Income** | **1,748** | **2,393** | **1,312** | **2,760** | **3,153** | **4,554** |

Source: National Bank of Abu Dhabi, EFG-Hermes estimates

### Balance Sheet (December Year End)

In AED million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 24,559 | 19,433 | 14,706 | 22,306 | 25,457 | 28,822 |
| Interbank Assets | 14,936 | 6,789 | 20,590 | 21,743 | 24,815 | 28,095 |
| Loans & Islamic Financing | 106,460 | 115,432 | 124,250 | 131,212 | 149,747 | 169,539 |
| Financial Instruments | 14,290 | 16,278 | 16,209 | 17,092 | 21,365 | 22,861 |
| Other Investments & Associates | - | - | - | - | - | - |
| Other Assets | 4,177 | 5,404 | 3,919 | 3,676 | 4,235 | 5,461 |
| Fixed Assets | 997 | 1,319 | 1,355 | 1,451 | 1,596 | 1,756 |
| **Total Assets** | **165,418** | **164,654** | **181,029** | **197,481** | **227,215** | **256,533** |
| Customer Deposits & Islamic Funding | 89,275 | 103,481 | 111,674 | 124,177 | 145,288 | 165,628 |
| Capital Market Liabilities | 10,192 | 11,719 | 11,330 | 14,181 | 14,890 | 15,635 |
| Interbank Liabilities | 36,751 | 25,797 | 31,360 | 28,662 | 33,534 | 37,401 |
| Other Financial Liabilities | 4,587 | 4,535 | 2,325 | 4,082 | 3,674 | 3,306 |
| Other Operating Items | 10,909 | 4,765 | 5,264 | 5,853 | 6,848 | 7,807 |
| Proposed Dividend | - | 593 | - | 697 | 779 | 1,823 |
| **Total Liabilities** | **151,714** | **150,891** | **161,952** | **177,653** | **205,013** | **231,600** |
| **Common Shareholders' Equity** | **13,704** | **13,764** | **15,078** | **15,828** | **18,202** | **20,933** |
| Minorities & Other Equity | - | - | 4,000 | 4,000 | 4,000 | 4,000 |
| **Total Liabilities & Equity** | **165,418** | **164,654** | **181,029** | **197,481** | **227,215** | **256,533** |

Source: National Bank of Abu Dhabi, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 15.5% | 13.2% | 15.4% | 15.8% | 15.4% | 15.2% |
| Loans / Deposits | 119.2% | 111.5% | 111.3% | 105.7% | 103.1% | 102.4% |
| NPL Coverage Ratio | 123.1% | 144.3% | 152.8% | 157.8% | 188.0% | 203.3% |
| Net Interest Spread* | 1.87% | 2.09% | 2.49% | 2.44% | 2.43% | 2.42% |
| Cost / Income Ratio | 26.8% | 29.2% | 28.4% | 28.1% | 26.9% | 27.9% |
| Provisioning (bps) | 0.30% | 0.67% | 0.83% | 0.95% | 1.03% | 0.52% |
| RoAE* | 29.8% | 22.8% | 23.3% | 20.8% | 18.3% | 19.3% |
| RoAA* | 2.4% | 1.9% | 2.0% | 1.8% | 1.5% | 1.9% |
| EPS* | 1.74 | 1.39 | 1.54 | 1.45 | 1.60 | 2.30 |
| BVPS | 6.30 | 6.33 | 6.93 | 8.01 | 9.21 | 10.59 |
| DPS | - | 0.27 | - | 0.35 | 0.39 | 0.92 |

*Annualised for 1H data

Source: National Bank of Abu Dhabi, EFG-Hermes estimates

المجموعة المالية - هيرميس
EFG HERMES

# AL RAJHI BANK - FRANCHISE PREMIUM IN THE PRICE

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: SAR 73.50 |
| Long-Term Rec. : Neutral | LT Fair Value : SAR 74.70 |

• **Saudi Arabia's Leading Retail Franchise:** Al Rajhi, largest Islamic bank in Saudi Arabia, holds a unique advantage over its peers in the form of substantially lower funding costs, as demand deposits account for almost 90% of the bank's deposit mix. The has allowed Al Rajhi to maintain high net special commission spreads, which have historically been twice that of conventional banks. Over the last few years, the bank has however aggressively built up its corporate and investment banking platform by hiring senior executives from international banks.

• **1H2009 Results - Earnings Grow Despite Higher Provisions:** Al Rajhi reported 5% Y-o-Y growth earnings in 1H2009, despite an almost 1.5x Y-o-Y increase in credit provisions. Improvement in spreads, primarily supported by a sharp drop in funding costs, resulted in a 10% Y-o-Y improvement in net investment income, enabling the bank to offset the impact of higher provisions. However, balance sheet growth momentum was sluggish, with net investments rising 0.6% YTD.

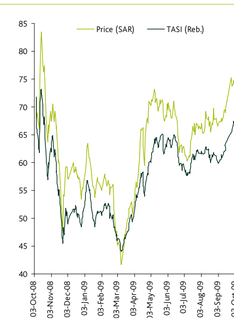
• **Loan Growth to Remain Sluggish in 2009e:** Our 2009e-2010e earnings estimates broadly remain unchanged. Even though we lower our loan growth assumption, the impact is largely offset by the improvement in our assumptions of net special commission spreads. As opposed to our earlier forecasts of a recovery in loan sheet growth in 2H2009e, we now forecast loan growth to recover in 2010e. We also lower our loan growth forecasts to 2% in 2009e from our previous estimates of 8%, as banks continue to remain risk averse in the current environment. We however increase our loan growth forecasts for 2010e-2011e to reflect increased lending activity, as risk averseness declines.

• **Utilizing the Excess Provisioning Buffer:** While banks in Saudi Arabia have not disclosed their exposure to the Saad and Algosaibi Groups, Al Rajhi's latest Basel II filing for June 2009 shows an almost SAR1.8 billion increase in NPLs compared to year-end 2008. However, the bank has utilized its excess provisioning buffer to absorb the impact of the increase in NPLs, and NPL coverage, despite an almost 2x increase in NPLs, stands at 111%.

• **Raising LTFV to SAR74.70; Valuations Remain Rich:** We raise our LTFV to SAR74.70, primarily driven by a 50bps cut in our discount rate due to improved visibility on asset quality. However, Al Rajhi's valuations continue to appear rich - trading at 2009e P/E of 17.1x and P/B of 4.1x - and we assign a ST/LT Neutral rating on the stock. Al Rajhi has historically traded at a premium to the sector's valuation, which is partly explained by the strong domestic investor interest due to the Shariah-compliant status of the bank. While we believe that it is difficult for any bank to replicate Al Rajhi's business model, we believe that this is already reflected in the valuations.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *10,575* | *11,309* | *12,107* | *13,517* |
| *Cost / Income* | *26.3%* | *25.1%* | *26.7%* | *26.3%* |
| *Provisions / Avg. Inv.(bps)* | *99.7* | *96.2* | *73.6* | *57.7* |
| *ROAE* | *25.5%* | *25.5%* | *24.4%* | *24.4%* |
| *ROAA* | *4.1%* | *3.8%* | *3.9%* | *4.0%* |
| *EPS (SAR)* | *3.93* | *4.30* | *4.69* | *5.43* |
| *P/E (x)* | *18.7* | *17.1* | *15.7* | *13.5* |
| *Dividend Yield* | *4.1%* | *3.8%* | *3.2%* | *3.7%* |
| *P/BV (x)* | *4.6* | *4.1* | *3.6* | *3.1* |
| | | | | |
| *Capital Adequacy* | *21.4%* | *20.1%* | *19.9%* | *20.1%* |
| *Loan Growth* | *37.3%* | *0.9%* | *12.4%* | *14.9%* |
| *Loans / Deposits* | *123.5%* | *115.7%* | *115.8%* | *116.8%* |
| *Provisions / NPLs* | *191.2%* | *150.8%* | *137.2%* | *130.0%* |

*Figures in SAR million unless otherwise stated*




**Estimate Changes**

| *(SAR mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Investment Income* | *8,494* | *9,179* | *9,235* | *9,938* | *9,855* |
| *Total Banking Income* | *10,575* | *11,301* | *11,309* | *12,234* | *12,107* |
| *Income before Provisions* | *7,799* | *8,270* | *8,474* | *9,016* | *8,874* |
| *Net Attributable Income* | *5,892* | *6,395* | *6,447* | *7,025* | *7,030* |

**Stock Data**

| | |
|---|---|
| *Last Dividend* | *SAR1.25 on 20 Jul 09* |
| *Mkt. Cap / Shares (mn)* | *SAR110,250 / 1,500* |
| *Av. Mthly Liqd (mn)* | *SAR3,223* |
| *52-Week High / Low* | *SAR83.5 / 41.7* |
| *Bloomberg / Reuters* | *RJHI AB / 1120.SE* |
| *Est. Free Float* | *53.46%* |

**Prices as at 03 October 2009*

## FINANCIALS STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Income from Investments | 8,583 | 4,466 | 9,421 | 4,992 | 9,971 | 10,389 | 11,660 |
| Cost of Funds | (861) | (296) | (927) | (393) | (736) | (533) | (604) |
| **Net Investment Income** | **7,722** | **4,170** | **8,494** | **4,599** | **9,235** | **9,855** | **11,056** |
| Exchange Income | 471 | 240 | 483 | 280 | 547 | 605 | 647 |
| Fees from Banking Services, Net | 981 | 709 | 1,241 | 687 | 1,250 | 1,364 | 1,513 |
| Investment Income, Net | 71 | 42 | 76 | 24 | 82 | 77 | 85 |
| Other Operating Income | 77 | 40 | 280 | 52 | 196 | 206 | 216 |
| **Total Non Special Commission Income** | **1,599** | **1,031** | **2,081** | **1,043** | **2,074** | **2,252** | **2,461** |
| **Total Banking Income** | **9,321** | **5,201** | **10,575** | **5,641** | **11,309** | **12,107** | **13,517** |
| Total Operating Expenses | (2,428) | (1,392) | (2,776) | (1,429) | (2,835) | (3,233) | (3,554) |
| Income before Provisions | 6,893 | 3,808 | 7,799 | 4,213 | 8,474 | 8,874 | 9,964 |
| Investment and Credit Provisions | (443) | (465) | (1,274) | (710) | (1,431) | (1,176) | (1,052) |
| **Reported Earnings** | **6,450** | **3,344** | **6,525** | **3,503** | **7,043** | **7,698** | **8,912** |
| Zakat and Taxes | (659) | | (633) | | (596) | (668) | (772) |
| **Net Income** | **5,791** | **3,344** | **5,892** | **3,503** | **6,447** | **7,030** | **8,140** |

Source: Al Rajhi Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 13,141 | 18,100 | 11,302 | 11,772 | 12,932 | 15,193 | 15,986 |
| Due from Banks | 791 | 515 | 2,892 | 1,382 | 4,645 | 3,458 | 1,969 |
| Investments, Net | 104,875 | 125,261 | 144,004 | 144,474 | 145,334 | 163,410 | 187,824 |
| Fixed Assets, Net | 2,591 | 2,780 | 2,868 | 3,008 | 3,418 | 3,485 | 3,558 |
| Other Assets | 3,488 | 3,383 | 3,864 | 3,980 | 4,198 | 4,618 | 5,080 |
| **Total Assets** | **124,886** | **150,039** | **164,930** | **164,616** | **170,527** | **190,164** | **214,417** |
| Customer Deposits | 89,725 | 108,496 | 116,611 | 122,953 | 125,632 | 141,090 | 160,843 |
| Due to Banks | 2,593 | 4,256 | 7,902 | 5,470 | 5,025 | 4,938 | 3,217 |
| Term Loan (Debt) | 1,875 | 1,875 | 1,875 | - | - | - | - |
| Other Liabilities | 8,311 | 11,562 | 14,693 | 8,841 | 13,169 | 13,252 | 14,632 |
| Total Liabilities | 102,504 | 126,189 | 141,081 | 137,265 | 143,826 | 159,280 | 178,691 |
| Shareholders' Equity | 22,382 | 23,851 | 23,849 | 27,351 | 26,701 | 30,884 | 35,726 |
| **Total Liabilities & Shareholders' Equity** | **124,886** | **150,039** | **164,930** | **164,616** | **170,527** | **190,164** | **214,417** |

Source: Al Rajhi Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 24.4% | 18.8% | 21.4% | 18.5% | 20.1% | 19.9% | 20.1% |
| Loans / Deposits | 116.9% | 115.5% | 123.5% | 117.5% | 115.7% | 115.8% | 116.8% |
| NPL Coverage Ratio | 109.1% | N/A | 191.2% | N/A | 150.8% | 137.2% | 130.0% |
| Net Investment Spreads | 6.4% | 6.96% | 6.0% | 6.16% | 6.0% | 5.9% | 5.8% |
| Cost / Income Ratio | 26% | 26.8% | 26% | 25.3% | 25% | 27% | 26% |
| Provisioning (bps) | 44.2 | 17.0 | 99.7 | 21.7 | 96.2 | 73.6 | 57.7 |
| ROAE | 27.9% | 28.6% | 25.5% | 28.0% | 25.5% | 24.4% | 24.4% |
| ROAA | 5.0% | 5.0% | 4.1% | 4.5% | 3.8% | 3.9% | 4.0% |
| EPS | 3.86 | 2.23 | 3.93 | 2.34 | 4.30 | 4.69 | 5.43 |
| BVPS | 14.92 | 15.90 | 15.90 | 18.23 | 17.80 | 20.59 | 23.82 |
| DPS | 1.80 | 1.25 | 3.00 | 1.25 | 2.80 | 2.30 | 2.70 |

Source: Al Rajhi Bank, EFG-Hermes estimates

# BANK ALBILAD – STRONG GROWTH, EXPENSIVE VALUATIONS



| | |
|---|---|
| Short-Term Rec.: Reduce | Current Price*: SAR 21.60 |
| Long-Term Rec. : Reduce | LT Fair Value : SAR 17.50 |

• **Small, but Growing Strongly:** With commercial operations having commenced in 2006, Bank Albilad has been growing aggressively. The bank has quickly expanded its network to over 60 branches, almost twice the size of Aljazira and SAIB, two of the more established peers. This has translated into better funding costs, but at the same time higher costs. Albilad's cost-to-income ratio is at over 70%, indicating that revenue generation is still well below potential. We believe that the high cost ratio continues be the biggest challenge for Albilad in the near term, and is likely to keep its ROE depressed.

• **1H2009 - Earnings Halves, but Loan Growth Momentum Sustained:** Bank Albilad's 1H2009 earnings declined by 56% Y-o-Y, on an almost 5x Y-o-Y increase in provisions, amidst a persistently high cost base. Balance sheet growth momentum continued to surprise positively, with net loans rising by 45% Y-o-Y. However, deposits growth was much slower at 11% Y-o-Y, as the bank worked on improving the low-cost deposit mix, and shed some of the high cost deposits.

• **Well Capitalized, but Lower NPL Coverage:** With Tier I CAR at 22.3%, Albilad remains the well-capitalised. However, Albilad's lower than peer NPL coverage of 91% is a concern, as the bank does not enjoy the cushion of excess provisioning, and deterioration in asset quality is likely to directly impact earnings. The quality of the bank's loan portfolio is also likely to be stress tested, as it experiences a slowing economic environment for the first time.

• **Lowering 2009e, but Raising 2010e-2011e Estimates:** We lower our 2009e earning estimates for Bank Albilad by 27% due to the increase in our provision estimates. Provisions in 1H2009 have been significantly higher than our estimate, and we believe that the bank is building up its NPL coverage, which has been one of the lowest in the sector. We however raise our loan growth estimates, as the bank continues to grow aggressively. The increase in 2010e-2011e earning estimates is primarily driven by higher loan growth estimates.

• **Raising LTFV; lowering LT Rating to Reduce:** With the stock trading at a 22% premium to our revised LTFV of SAR17.50, we lower our LT recommendation to Reduce from Sell. We continued to believe that the banks high cost ratio poses the biggest challenge to improving profitability, and is likely keep ROEs depressed in the near term. Valuations however continue to be at a premium to the sector on expectations of stronger balance sheet growth.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *875* | *901* | *1,031* | *1,179* |
| *Cost / Income* | *76.0%* | *78.9%* | *75.0%* | *70.9%* |
| *Provisions / Avg. Inv.(bps)* | *27.1* | *100.1* | *71.1* | *35.0* |
| *ROAE* | *3.9%* | *2.6%* | *4.7%* | *7.8%* |
| *ROAA* | *0.8%* | *0.5%* | *0.9%* | *1.3%* |
| *EPS (SAR)* | *0.41* | *0.28* | *0.52* | *0.92* |
| *P/E (x)* | *52.83* | *77.09* | *41.20* | *23.38* |
| *Dividend Yield* | *0.0%* | *0.0%* | *0.0%* | *0.9%* |
| *P/BV (x)* | *2.02* | *1.98* | *1.89* | *1.77* |
| | | | | |
| *Capital Adequacy* | *23.3%* | *23.4%* | *20.5%* | *18.5%* |
| *Loan Growth* | *34%* | *42%* | *25%* | *19%* |
| *Loans / Deposits* | *75.4%* | *88.1%* | *92.0%* | *89.8%* |
| *Provisions / NPLs* | *90.9%* | *100.0%* | *100.0%* | *100.0%* |

*Figures in SAR million, unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Investment Income* | *578* | *590* | *558* | *646* | *645* |
| *Total Banking Income* | *875* | *926* | *901* | *1,017* | *1,031* |
| *Income before Provisions* | *210* | *203* | *190* | *239* | *258* |
| *Net Attributable Income* | *123* | *115* | *84* | *149* | *157* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *N/A* |
| *Mkt. Cap/Shares (mn)* | *SAR6,480 / 300* |
| *Av. Mthly Liqd (mn)* | *SAR288.1* |
| *52-Week High / Low* | *SAR36.30 / 17.85* |
| *Bloomberg / Reuters* | *ALBI AB / 1140.SE* |
| *Est. Free Float* | *57.20%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Income from Investments | 715 | 340 | 669 | 298 | 607 | 701 | 818 |
| Cost of Funds | (180) | (46) | (91) | (19) | (50) | (56) | (180) |
| **Net Investment Income** | **534** | **294** | **578** | **279** | **558** | **645** | **743** |
| Exchange Income | 67 | 37 | 78 | 36 | 86 | 95 | 104 |
| Fees from Banking Services, Net | 177 | 124 | 216 | 140 | 249 | 283 | 322 |
| Investment Income, Net | - | - | - | (2) | - | - | - |
| Other Operating Income | - | - | 2 | 4 | 8 | 9 | 10 |
| **Total Other Operating Income** | **244** | **160** | **296** | **177** | **343** | **386** | **436** |
| **Total Banking Income** | **715** | **340** | **669** | **298** | **607** | **701** | **818** |
| Total Operating Expenses | (641) | (338) | (665) | (361) | (711) | (774) | (641) |
| Income before Provisions | 138 | 116 | 210 | 96 | 190 | 258 | 343 |
| Investment and Credit Provisions | (65) | (9) | (85) | (48) | (102) | (95) | (65) |
| **Reported Earnings** | **72** | **108** | **125** | **48** | **88** | **162** | **286** |
| Zakat and Taxes | (2) | - | (2) | - | (4) | (5) | (9) |
| **Net Income** | **71** | **108** | **123** | **48** | **84** | **157** | **277** |

Source: Bank Albilad, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash and bank | 2,058 | 2,149 | 1,125 | 1,400 | 584 | 910 | 1,268 |
| Due from Banks | 6,074 | 3,487 | 3,894 | 2,426 | 2,355 | 1,637 | 1,951 |
| Investments, Net | 1,349 | 1,678 | 1,883 | 1,474 | 1,413 | 1,637 | 1,951 |
| Loans, Net | 6,190 | 7,090 | 8,275 | 10,282 | 11,729 | 14,614 | 17,418 |
| Fixed Assets, Net | 594 | 570 | 537 | 471 | 571 | 583 | 547 |
| Other Assets | 370 | 358 | 338 | 358 | 371 | 408 | 449 |
| **Total Assets** | **16,636** | **15,332** | **16,052** | **16,410** | **17,023** | **19,788** | **23,583** |
| Customer Deposits | 12,689 | 11,390 | 10,971 | 12,713 | 13,313 | 15,877 | 19,393 |
| Due to Banks | - | - | 639 | - | - | - | - |
| Term Loan (Debt) | - | - | 825 | 1 | - | - | - |
| Other Liabilities | 842 | 735 | 404 | 408 | 444 | 489 | 537 |
| Total Liabilities | 13,532 | 12,125 | 12,839 | 13,121 | 13,757 | 16,366 | 19,930 |
| **Shareholders' Equity** | **3,104** | **3,206** | **3,213** | **3,244** | **3,266** | **3,423** | **3,653** |
| **Total Liabilities & Shareholders' Equity** | **16,636** | **15,332** | **16,052** | **16,365** | **17,023** | **19,789** | **23,583** |

Source: Bank Albilad, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 32.5% | 28.3% | 23.3% | 23.7% | 23.4% | 20.5% | 18.5% |
| Loans / Deposits | 48.8% | 62.2% | 75.4% | 80.9% | 88.1% | 92.0% | 89.8% |
| NPL Coverage Ratio | 69.9% | N/A | 90.9% | N/A | 100.0% | 100.0% | 100.0% |
| Net Investment Spreads | 4.3% | 4.3% | 4.1% | 3.8% | 3.7% | 3.8% | 3.7% |
| Cost / Income Ratio | 82.3% | 74.4% | 76.0% | 79.0% | 78.9% | 75.0% | 70.9% |
| Provisioning (bps) | 81.0 | 4.3 | 27.1 | 28.8 | 100.1 | 71.1 | 35.0 |
| ROAE | 2.3% | 6.6% | 3.9% | 2.8% | 2.6% | 4.7% | 7.8% |
| ROAA | 0.5% | 1.4% | 0.8% | 0.5% | 0.5% | 0.9% | 1.3% |
| EPS | 0.24 | 0.36 | 0.41 | 0.16 | 0.28 | 0.52 | 0.92 |
| BVPS | 10.35 | 10.69 | 10.71 | 10.81 | 10.89 | 11.41 | 12.18 |
| DPS | - | - | - | - | - | - | 0.20 |

Source: Bank Albilad, EFG-Hermes estimates

# BANK ALJAZIRA - LEVERED TO THE STOCK MARKET

**06 OCTOBER 2009**

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: SAR 19.85 |
| Long-Term Rec. : Neutral | LT Fair Value : SAR 21.80 |

• **High Revenue Leverage to Volatile Banking Income:** One of the smaller banks in the country, Bank Aljazira's revenues remains highly geared to the trading volumes at the stock exchange. The bank has a commanding presence in the broking segment, with a market share of 17%, significantly ahead of its competition. While the contribution of broking commissions to total revenue has declined considerably since 2006, it still accounts for 29% of revenues. This makes Aljazira's revenue profile significantly volatile, in our view.

• **1H2009 - Broking Commissions Drives Earnings Lower:** Bank Aljazira's 1H2009 declined by 12% Y-o-Y. Fee income, which largely comprises of broking commissions for Bank Aljazria, dropped by 31% Y-o-Y. Though returns on the investment book have improved compared to last year, credit provisions doubled from 1H2008 levels. Net loans have remained broadly unchanged since the beginning of 2009; however customer deposits have risen by 6% YTD.

• **The long-Term Challenge is Improving Core Banking Operations:** We believe that the longer-term challenge for Aljazira remains the building out of its deposit franchise to support the improvement in core banking income and lowering the revenue volatility from broking commissions. Aljazira has been able to strongly grow its loan book in 2008, with consumer loans almost doubling. However, to support high loan growth, the bank relied on raising high-cost term deposits, which accounted for 74% of the bank's total deposits at the end of 2008. This led to an almost 44bps Y-o-Y erosion in spreads in 2008. The bank is looking at expanding it branch network to develop a relatively low-cost deposit base to improve its net special commission spreads.

• **Raising 2009e-2011e Estimates:** We raise our 2009e earning estimates for Bank Aljazira by an average of 12%. While we to forecast a 15% Y-o-Y decline in broking income in 2009e, it is less severe than our previous expectations (25% Y-o-Y decline). The opening up of the market to foreign investors is likely to increase trading activity. While Aljazira is unlikely to directly benefit in the form of foreign business, we are of the view that increased foreign participation could also boost domestic investor sentiment, and hence domestic trading volumes. We also incorporate a slight improvement in spreads in 2009e, as Aljazira has shed some of its high-costs deposits in the current year, which will likely positively impact funding costs.

• **Raising LTFV; Maintaining Rating:** We raise our LTFV for Bank Aljazira to SAR21.80 on the back of an improvement in our earning estimates. We however maintain our discount rate to incorporate the risk of inherent volatility in the revenue stream of the bank due to a high reliance on broking commissions. We maintain our ST / LT Neutral rating on Aljazira.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *1,137* | *1,277* | *1,449* | *1,631* |
| *Cost / Income* | *70%* | *57%* | *53%* | *51%* |
| *Provisions / Avg. Loans (bps)* | *96.0* | *55.9* | *54.0* | *33.8* |
| *ROAE* | *4.4%* | *9.0%* | *10.5%* | *12.0%* |
| *ROAA* | *0.8%* | *1.5%* | *1.7%* | *1.9%* |
| *EPS (SAR)* | *0.69* | *1.47* | *1.84* | *2.31* |
| *P/E (x)* | *28.8* | *13.5* | *10.8* | *8.6* |
| *Dividend Yield* | *2.5%* | *2.5%* | *2.5%* | *2.5%* |
| *P/BV (x)* | *1.3* | *1.2* | *1.1* | *1.0* |
| | | | | |
| *Capital Adequacy* | *19.9%* | *19.0%* | *18.0%* | *17.4%* |
| *Loan Growth* | *53.2%* | *9.5%* | *18.5%* | *17.7%* |
| *Loans / Deposits* | *72%* | *70%* | *73%* | *76%* |
| *Provisions / NPLs* | *164%* | *146%* | *135%* | *130%* |

*Figures in SAR million unless otherwise stated*


***Estimate Changes***

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| ***(SAR mn)*** | | ***Old*** | ***New*** | ***Old*** | ***New*** |
| *Net Special Commission Income* | *631* | *711* | *706* | *815* | *827* |
| *Total Banking Income* | *1,137* | *1,294* | *1,277* | *1,468* | *1,449* |
| *Income before Provisions* | *345* | *498* | *551* | *622* | *677* |
| *Net Attributable Income* | *207* | *397* | *442* | *494* | *553* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *SAR0.50 on 20 Apr 09* |
| *Mkt. Cap / Shares (mn)* | *SAR5,955 / 300* |
| *Av. Mthly Liqd (mn)* | *SAR302.5* |
| *52-Week High / Low* | *SAR26.5 / 13.8* |
| *Bloomberg / Reuters* | *BJAZ AB / 1020.SE* |
| *Est. Free Float* | *60.50%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 909 | 524 | 1,114 | 535 | 1,052 | 1,142 | 1,283 |
| Special Commission Expense | (314) | (189) | (483) | (176) | (346) | (314) | (319) |
| **Net Special Commission Income** | **595** | **335** | **631** | **359** | **706** | **827** | **963** |
| Exchange Income | 17 | 9 | 22 | 8 | 21 | 27 | 33 |
| Fees from Banking Services, Net | 698 | 315 | 538 | 218 | 501 | 532 | 571 |
| Investments Income, Net | 130 | 12 | -57 | 40 | 46 | 59 | 60 |
| Other Operating Income | 6 | 3 | 3 | 1 | 3 | 3 | 4 |
| **Total Non Special Commission Income** | **852** | **338** | **505** | **267** | **571** | **622** | **668** |
| **Total Banking Income** | **1,447** | **673** | **1,137** | **626** | **1,277** | **1,449** | **1,631** |
| Total Operating Expenses | (671) | (395) | (791) | (358) | (726) | (772) | (836) |
| Income before Provisions | 776 | 278 | 345 | 269 | 551 | 677 | 795 |
| Investment and Credit Provisions | 26 | (25) | (123) | (44) | (91) | (101) | (74) |
| **Reported Earnings** | **802** | **253** | **222** | **224** | **460** | **576** | **721** |
| Zakat & Taxes | (21) | 0 | (15) | 0 | (18) | (23) | (29) |
| **Net Income from Operations** | **782** | **253** | **207** | **224** | **442** | **553** | **692** |
| Share in Earning of Associates | (3) | - | (1) | 1 | - | - | - |
| **Net Income** | **785** | **253** | **207** | **223** | **442** | **553** | **692** |

Source: Bank Aljazira, EFG-Hermes estimates

### Balance Sheet (December Year End)
In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 1,491 | 1,906 | 2,258 | 1,430 | 3,670 | 2,519 | 2,956 |
| Due from Banks | 3,663 | 2,759 | 3,904 | 5,807 | 3,672 | 3,319 | 3,099 |
| Loans & Advances, Net | 9,879 | 14,001 | 15,133 | 15,824 | 16,574 | 19,641 | 23,109 |
| Investment Securities, Net | 4,964 | 4,432 | 4,909 | 4,143 | 5,508 | 6,638 | 7,575 |
| Fixed Assets, Net | 459 | 467 | 494 | 490 | 500 | 506 | 539 |
| Other Assets | 1,108 | 715 | 822 | 1,246 | 889 | 964 | 1,048 |
| **Total Assets** | 21,564 | 24,280 | 27,520 | 28,939 | 30,812 | 33,587 | 38,326 |
| Customer Deposits | 15,647 | 17,287 | 20,900 | 22,148 | 23,790 | 26,776 | 30,525 |
| Due to Banks | 717 | 1,644 | 1,367 | 1,453 | 1,408 | 714 | 1,071 |
| Term Loan (Debt) | - | - | - | - | - | - | - |
| Other Liabilities | 546 | 443 | 515 | 495 | 566 | 623 | 685 |
| Total Liabilities | 16,910 | 19,374 | 22,782 | 24,096 | 25,764 | 28,113 | 32,281 |
| Shareholders' Equity | 4,654 | 4,907 | 4,738 | 4,844 | 5,048 | 5,474 | 6,045 |
| **Total Liabilities & Shareholders' Equity** | 21,564 | 24,280 | 27,520 | 28,939 | 30,812 | 33,587 | 38,326 |

Source: Bank Aljazira, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 33.5% | 17.4% | 19.92% | 18.7% | 19.0% | 18.0% | 17.4% |
| Loans / Deposits | 63.1% | 81.0% | 72.4% | 71.4% | 69.7% | 73.4% | 75.7% |
| NPL Coverage Ratio | 161.1% | N/A | 163.9% | N/A | 145.9% | 135.0% | 129.8% |
| Net Interest Spreads | 4.4% | 3.2% | 4.0% | 2.8% | 3.2% | 3.1% | 3.1% |
| Cost / Income Ratio | 46.3% | 58.6% | 69.6% | 57.1% | 56.8% | 53.3% | 51.3% |
| Provisioning (bps) | -30.79 | 1.80 | 95.97 | 3.31 | 55.92 | 54.00 | 33.84 |
| ROAE | 18.2% | 13.0% | 4.4% | 8.6% | 9.0% | 10.5% | 12.0% |
| ROAA | 4.2% | 2.8% | 0.8% | 1.5% | 1.5% | 1.7% | 1.9% |
| EPS | 2.62 | 0.84 | 0.69 | 0.74 | 1.47 | 1.84 | 2.31 |
| BVPS | 15.51 | 16.36 | 15.79 | 16.15 | 16.83 | 18.25 | 20.15 |
| DPS | 0.38 | 0.00 | 0.50 | 0.00 | 0.50 | 0.50 | 0.50 |

Source: Bank Aljazira, EFG-Hermes estimates

# SAUDI BRITISH BANK - PREMIUM QUALITY

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: SAR 52.00 |
| Long-Term Rec. : Accumulate | LT Fair Value : SAR 59.80 |

• **Well Entrenched:** The largest joint venture bank in Saudi Arabia in terms of assets, Saudi British Bank is well entrenched in all segments of the banking industry. With strong support from HSBC (40% shareholder), SABB has a strong presence in the investment and commercial banking space, and is a top 3 player in both consumer and corporate segments. With support from HSBC Amanah (the Islamic banking arm of HSBC), SABB is also a dominant player in the Islamic banking segment.

• **1H2009 Results - Earnings Impact by Higher Provisioning:** SABB reported a 7.5% Y-o-Y drop in 1H2009 earnings. However, the results were much stronger when viewed in the context of an almost doubling of credit provisions in 1H2009 vs. 1H2008. Revenues grew by 5.8%, supported by 5.3% Y-o-Y growth in non special commission income and 6.1% Y-o-Y improvement in net special commission income on improved spreads. Loan growth was flat on a Y-o-Y basis and has contracted by almost 2% YTD. The bank also shed some of its high-cost deposits (total deposits declining by 5% Q-o-Q) on slowing loan growth, supporting improved spreads.

• **NPL Levels Should Fall on Possible Restructuring:** As per the Basel II filing for the period ending June 2009, SABB's NPLs rose by almost 9x in December 2008 to SAR1.8 billion, while its NPL coverage dropped to 49%. In our view, SABB took an aggressive, but prudent approach. With news suggesting that the Saad Group has reached an agreement with banks to settle its debts, we believe NPLs should fall, and coverage levels should recover back to about 100%. We however believe that SABB is likely to maintain relatively higher provisioning levels over the next two quarters to raise its NPL coverage.

• **Adjusting 2009e Earning Estimates:** We cut our 2009e earning estimates for SABB by an average of 2% to account for higher provisioning charges and slower loan growth. However, we raise our 2010e-2011e earning estimates by an average of 5% to incorporate our expectation of a stronger recovery in earnings after a relatively slow 2009e. We are of the view that provisioning charges are likely to be higher during 2009e-2010e, as the bank builds up its provisioning coverage. We also incorporate slower balance sheet growth estimates for 2009e, as credit growth is likely to recover in early 2010e as opposed to our earlier expectation of 2H2009e.

• **Raising LTFV to SAR59.80; Raising ST Rating to Accumulate:** With visibility on loan quality improving significantly, we raise our ST rating to Accumulate. We also lower our discount rate by 50bps to account for the lower risk, which along with the revision in our earning estimates raises our LTFV to SAR59.80. Trading at 2009e P/E of 13.6x and P/B of 2.8x, SABB's valuations are not inexpensive. However, SABB's premium to the sector is supported by high visibility and management quality.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *4,912* | *5,412* | *5,885* | *6,714* |
| *Cost / Income* | *33.4%* | *31.2%* | *30.7%* | *29.1%* |
| *Provisions / Avg. Loans (bps)* | *51.8* | *82.1* | *61.2* | *45.5* |
| *ROAE* | *24.9%* | *22.4%* | *22.0%* | *22.9%* |
| *ROAA* | *2.3%* | *2.2%* | *2.5%* | *2.7%* |
| *EPS (SAR)* | *3.51* | *3.81* | *4.42* | *5.36* |
| *P/E (x)* | *14.8* | *13.6* | *11.8* | *9.7* |
| *Dividend Yield* | *1.7%* | *2.1%* | *3.5%* | *4.0%* |
| *P/BV (x)* | *3.4* | *2.8* | *2.4* | *2.1* |
| | | | | |
| *Capital Adequacy* | *11.2%* | *13.1%* | *13.1%* | *12.9%* |
| *Loan Growth* | *29.4%* | *-1.2%* | *13.1%* | *18.8%* |
| *Loans / Deposits* | *86.6%* | *86.8%* | *85.4%* | *87.1%* |
| *Provisions / NPLs* | *325%* | *80%* | *99%* | *100%* |

*Figures in SAR million, unless otherwise stated*


*Estimate Changes*

| *(SAR mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Special Commission Income* | *3,207* | *3,658* | *3,734* | *3,967* | *4,042* |
| *Total Banking Income* | *4,912* | *5,347* | *5,412* | *5,832* | *5,885* |
| *Income before Provisions* | *3,270* | *3,598* | *3,724* | *3,959* | *4,078* |
| *Net Attributable Income* | *2,636* | *2,922* | *2,858* | *3,270* | *3,315* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR0.83 on 21 Jul 09* |
| *Mkt. Cap / Shares (mn)* | *SAR 39,000 / 750* |
| *Av. Mthly Liqd (mn)* | *SAR148.5* |
| *52-Week High / Low* | *SAR91.2 / 36.4* |
| *Bloomberg / Reuters* | *SABB AB / 1060.SE* |
| *Est. Free Float* | *33.60%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 5,220 | 2,703 | 5,865 | 2,527 | 5,199 | 5,405 | 6,026 |
| Special Commission Expense | (2,161) | (1,030) | (2,658) | (752) | (1,465) | (1,363) | (1,304) |
| **Net Special Commission Income** | **3,059** | **1,673** | **3,207** | **1,775** | **3,734** | **4,042** | **4,722** |
| Exchange Income | 107 | 70 | 138 | 66 | 147 | 154 | 162 |
| Fees from Banking Services, Net | 862 | 662 | 1,257 | 604 | 1,258 | 1,368 | 1,488 |
| Investments Income, Net | 341 | 115 | 306 | 205 | 233 | 280 | 298 |
| Other Operating Income | 5 | 1 | 3 | 20 | 40 | 42 | 44 |
| **Total Non Special Commission Income** | **1,315** | **849** | **1,704** | **894** | **1,677** | **1,843** | **1,992** |
| **Total Banking Income** | **4,374** | **2,522** | **4,912** | **2,669** | **5,412** | **5,885** | **6,714** |
| Total Operating Expenses | (1,429) | (794) | (1,642) | (816) | (1,688) | (1,807) | (1,951) |
| Income before Provisions | 2,945 | 1,728 | 3,270 | 1,742 | 3,724 | 4,078 | 4,763 |
| Investment and Credit Provisions | (396) | (246) | (458) | (431) | (663) | (526) | (456) |
| **Reported Earnings** | **2,549** | **1,482** | **2,812** | **1,422** | **3,061** | **3,552** | **4,308** |
| Zakat & Taxes | (271) | | (284) | | (259) | (300) | (364) |
| **Net Income from Operations** | **2,278** | **1,482** | **2,528** | **1,422** | **2,803** | **3,252** | **3,944** |
| Share in Earning of Associates | 58 | 70 | 108 | 13 | 55 | 63 | 73 |
| **Net Income** | **2,336** | **1,552** | **2,636** | **1,436** | **2,858** | **3,315** | **4,017** |

Source: Saudi British Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 16,644 | 9,898 | 11,328 | 8,797 | 8,686 | 10,315 | 10,421 |
| Due from Banks | 1,724 | 5,562 | 6,200 | 5,518 | 5,593 | 7,619 | 8,702 |
| Loans & Advances, Net | 62,001 | 77,541 | 80,237 | 78,718 | 79,252 | 89,611 | 106,498 |
| Investment Securities, Net | 14,859 | 30,305 | 29,604 | 24,542 | 25,729 | 27,937 | 27,556 |
| Fixed Assets, Net | 552 | 551 | 561 | 557 | 568 | 575 | 583 |
| Other Assets | 2,434 | 2,294 | 3,729 | 3,825 | 4,102 | 4,537 | 5,021 |
| **Total Assets** | **98,213** | **126,151** | **131,661** | **121,957** | **123,931** | **140,594** | **158,780** |
| Customer Deposits | 71,848 | 89,090 | 92,678 | 91,447 | 91,279 | 104,971 | 122,241 |
| Due to Banks | 8,045 | 17,159 | 16,069 | 6,377 | 6,390 | 6,298 | 6,112 |
| Term Loan (Debt) | 4,226 | 4,355 | 5,844 | 5,763 | 5,725 | 5,725 | 3,470 |
| Other Liabilities | 4,560 | 4,619 | 5,436 | 5,269 | 6,619 | 7,433 | 8,081 |
| Total Liabilities | 88,679 | 115,224 | 120,027 | 108,856 | 110,013 | 124,428 | 139,904 |
| Shareholders' Equity | 9,534 | 10,927 | 11,634 | 13,101 | 13,918 | 16,166 | 18,876 |
| **Total Liabilities & Shareholders' Equity** | **98,213** | **126,151** | **131,661** | **121,957** | **123,931** | **140,594** | **158,780** |

Source: Saudi British Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.8% | 13.0% | 11.2% | 11.7% | 13.1% | 13.1% | 12.9% |
| Loans / Deposits | 86.3% | 87.0% | 86.6% | 86.1% | 86.8% | 85.4% | 87.1% |
| NPL Coverage Ratio | 289.7% | N/A | 325.0% | N/A | 80.2% | 99.4% | 99.6% |
| Net Interest Spreads | 4.20% | 4.0% | 3.32% | 3.2% | 3.21% | 3.30% | 3.39% |
| Cost / Income Ratio | 32.7% | 31.5% | 33.4% | 31.9% | 31.2% | 30.7% | 29.1% |
| Provisioning (bps) | 75.1 | 13.75 | 51.8 | 15.94 | 82.1 | 61.2 | 45.5 |
| ROAE | 25.9% | 31.2% | 24.9% | 26.6% | 22.4% | 22.0% | 22.9% |
| ROAA | 2.7% | 3.3% | 2.3% | 2.5% | 2.2% | 2.5% | 2.7% |
| EPS | 3.11 | 2.07 | 3.51 | 1.77 | 3.81 | 4.42 | 5.36 |
| BVPS | 12.71 | 14.57 | 15.51 | 17.47 | 18.56 | 21.55 | 25.17 |
| DPS | 2.00 | 0.88 | 0.88 | 0.83 | 1.10 | 1.80 | 2.10 |

Source: Saudi British Bank, EFG-Hermes estimates

المجموعة المالية - هيرميس

EFG HERMES

# BANQUE SAUDI FRANSI - CORPROATE FRANCHISE DRIVING RESLIENCE

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| Short-Term Rec.: Accumulate | Current Price*: SAR 44.50 |
|---|---|
| Long-Term Rec. : Accumulate | LT Fair Value : SAR 53.30 |

• **Strong Corporate Presence, Strengthening Retail Franchise:** Currently, Banque Saudi Fransi (BSF) is largely a corporate banking franchise, with both assets and deposits largely accruing from the corporate sector. While BSF's spreads have been relatively thin compared to its peers, the spreads have proved more resilient, and have remained largely stable over the last two years. The bank is now looking to beef up its retail banking franchise with the support from Credit Agricole.

• **1H2009 Results - Provisions Rise:** BSF reported a 5% Y-o-Y drop in earnings, largely as a result of a 2x increase in provisioning costs. Revenues were largely flat, with a slight improvement in net interest spreads offsetting the impacting of falling fee and investment income. Net loans continued to remain stagnant, while the bank shed off some of the high-cost deposits in 1H2009, which has led to the improvement in spreads.

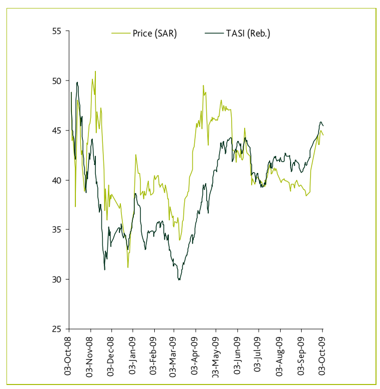
• **Lowering 2009e Estimates:** We revise our 2009e earning estimates for BSF by 4% on slower-than-expected growth. As opposed to our previous expectation of a recovery in credit growth in 2H2009e, we now expect the credit growth momentum to pick in 2010e. Recent trends suggest that banks continue to remain risk averse, with total credit of the banking sector showing a 0.8% contraction in 1H2009. We however are of the view that the risk appetite of banks is likely to improve by the end of the year, and with relatively high balance sheet liquidity and capital adequacy, credit growth is likely to recover in 2010e.

• **Provisioning Likely to Remain at Elevated Levels:** The jump in BSF's credit provisions in 1H2009 is a trend we expect to continue into 2H2009e. We believe that BSF is building up its general provisions to improve its coverage, as the slowing economic environment is creating asset quality concerns, in general. BSF's NPL coverage dropped to 107% in June 2009 from 167% a year ago. We expect credit provisioning to remain at elevated levels in 2009e-2010e compared to historical levels.

• **Raising LTFV, ST Rating to Accumulate:** We raise our LTFV on BSF to SAR53.30, primarily driven by a 50bps cut in our discount rate on improved visibility. We also raise our ST rating on BSF to Accumulate from Neutral, as we believe that a lower risk perception is likely to boost valuations in the near term. We also are of the view that upcoming results are likely to surprise positively, as we expect provisioning is unlikely to be significantly higher than in 2Q2009.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *4,391* | *4,335* | *4,702* | *5,352* |
| *Cost / Income* | *25%* | *27%* | *27%* | *25%* |
| *Provisions / Avg. Loans (bps)* | *13.2* | *43.3* | *29.4* | *17.3* |
| *ROAE* | *20.3%* | *18.2%* | *18.3%* | *19.5%* |
| *ROAA* | *2.2%* | *2.0%* | *2.2%* | *2.3%* |
| *EPS (SAR)* | *3.36* | *3.88* | *4.41* | *5.30* |
| *P/E (x)* | *13.2* | *11.5* | *10.1* | *8.4* |
| *Dividend Yield* | *2.5%* | *2.7%* | *3.1%* | *3.8%* |
| *P/BV (x)* | *2.4* | *2.2* | *1.9* | *1.7* |
| | | | | |
| *Capital Adequacy* | *12.2%* | *11.6%* | *12.4%* | *12.5%* |
| *Loan Growth* | *35.1%* | *1.1%* | *14.8%* | *17.0%* |
| *Loans / Deposits* | *87%* | *89%* | *88%* | *88%* |
| *Provisions / NPLs* | *111%* | *107%* | *106%* | *105%* |

*Figures in SAR million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Special Commission Income* | *2,821* | *3,037* | *3,048* | *3,277* | *3,260* |
| *Total Banking Income* | *4,391* | *4,430* | *4,335* | *4,787* | *4,702* |
| *Income before Provisions* | *3,295* | *3,247* | *3,164* | *3,516* | *3,449* |
| *Net Attributable Income* | *2,433* | *2,679* | *2,569* | *2,978* | *2,917* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR1.0 on 7 Apr 09* |
| *Mkt. Cap / Shares (mn)* | *SAR32,183 / 723.2* |
| *Av. Mthly Liqd (mn)* | *SAR156.9* |
| *52-Week High / Low* | *SAR51.0 / 32.1* |
| *Bloomberg / Reuters* | *BSFR AB / 1050.SE* |
| *Est. Free Float* | *41.00%* |

*Prices as at 03 October 2009

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 4,941 | 2,433 | 5,298 | 2,207 | 4,440 | 4,603 | 5,136 |
| Special Commission Expense | (2,645) | (1,111) | (2,478) | (682) | (1,392) | (1,343) | (1,397) |
| **Net Special Commission Income** | **2,296** | **1,322** | **2,821** | **1,525** | **3,048** | **3,260** | **3,739** |
| Exchange Income | 188 | 105 | 241 | 92 | 180 | 198 | 218 |
| Fees from Banking Services, Net | 898 | 460 | 834 | 447 | 882 | 973 | 1,097 |
| Investments Income, Net | 314 | 175 | 446 | 105 | 219 | 266 | 293 |
| Other Operating Income | 6 | 41 | 50 | 7 | 5 | 5 | 5 |
| **Total Non Special Commission Income** | **1,405** | **781** | **1,571** | **651** | **1,287** | **1,443** | **1,613** |
| **Total Banking Income** | **3,702** | **2,103** | **4,391** | **2,175** | **4,335** | **4,702** | **5,352** |
| Total Operating Expenses | (948) | (511) | (1,096) | (578) | (1,171) | (1,253) | (1,340) |
| Income before Provisions | 2,754 | 1,593 | 3,295 | 1,598 | 3,164 | 3,449 | 4,012 |
| Investment and Credit Provisions | (42) | (87) | (504) | (166) | (356) | (262) | (178) |
| **Reported Earnings** | 2,712 | 1,506 | 2,791 | 1,432 | 2,807 | 3,188 | 3,833 |
| Zakat & Taxes | (218) | | (345) | | (249) | (283) | (340) |
| **Net Income from Operations** | **2,494** | **1,506** | **2,446** | **1,432** | **2,558** | **2,905** | **3,493** |
| Share in Earning of Associates | 0 | 5 | 12 | (2) | 11 | 12 | 13 |
| **Net Income** | **2,712** | **1,511** | **2,433** | **1,430** | **2,569** | **2,917** | **3,506** |

Source: Banque Saudi Fransi, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 10,152 | 7,878 | 5,773 | 8,058 | 7,291 | 8,564 | 8,325 |
| Due from Banks | 3,224 | 6,720 | 4,246 | 7,351 | 6,729 | 2,508 | 2,895 |
| Loans & Advances, Net | 59,850 | 76,046 | 80,866 | 81,379 | 81,781 | 93,852 | 109,825 |
| Investment Securities, Net | 22,501 | 20,530 | 27,887 | 19,785 | 22,605 | 27,769 | 30,578 |
| Fixed Assets, Net | 577 | 599 | 591 | 620 | 742 | 774 | 809 |
| Other Assets | 3,504 | 3,377 | 6,502 | 5,629 | 7,152 | 7,867 | 8,654 |
| **Total Assets** | 99,808 | 115,148 | 125,865 | 122,822 | 126,300 | 141,334 | 161,085 |
| Customer Deposits | 74,007 | 85,378 | 92,791 | 90,315 | 92,261 | 107,229 | 124,814 |
| Due to Banks | 8,123 | 13,628 | 8,402 | 7,644 | 7,381 | 7,506 | 7,489 |
| Term Loan (Debt) | 2,438 | 2,438 | 4,927 | 4,933 | 4,781 | 2,344 | 1,658 |
| Other Liabilities | 4,314 | 1,281 | 6,452 | 5,079 | 6,915 | 7,397 | 7,986 |
| Total Liabilities | 88,882 | 102,724 | 112,572 | 107,971 | 111,338 | 124,476 | 141,947 |
| **Shareholders' Equity** | **10,927** | **12,425** | **13,292** | **14,851** | **14,962** | **16,858** | **19,138** |
| **Total Liabilities & Shareholders' Equity** | 99,808 | 115,148 | 125,865 | 122,822 | 126,300 | 141,334 | 161,085 |

Source: Banque Saudi Fransi, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.5% | 10.5% | 11.6% | 12.3% | 12.4% | 12.5% | 12.2% |
| Loans / Deposits | 80.9% | 89.1% | 87.1% | 90.1% | 88.6% | 87.5% | 88.0% |
| NPL Coverage Ratio | 189.6% | N/A | 111.0% | N/A | 107.5% | 106.1% | 105.4% |
| Net Interest Spreads | 2.91% | 2.8% | 2.9% | 2.7% | 2.73% | 2.79% | 2.82% |
| Cost / Income Ratio | 25.6% | 24.3% | 25.0% | 26.6% | 27.0% | 26.6% | 25.0% |
| Provisioning (bps) | 7.5 | 3.49 | 1324.0% | 6.16 | 43.3 | 29.4 | 17.3 |
| ROAE | 24.8% | 25.9% | 20.3% | 21.6% | 18.2% | 18.3% | 19.5% |
| ROAA | 2.8% | 2.8% | 2.2% | 2.4% | 2.0% | 2.2% | 2.3% |
| EPS | 3.75 | 2.08 | 3.36 | 1.98 | 3.88 | 4.41 | 5.30 |
| BVPS | 15.11 | 17.18 | 18.38 | 20.53 | 20.69 | 23.31 | 26.46 |
| DPS | 1.50 | - | 1.10 | - | 1.20 | 1.40 | 1.70 |

Source: Banque Saudi Fransi, EFG-Hermes estimates

# ARAB NATIONAL BANK – STRONG RETAIL FRANCHISE

30 SEPTEMBER 2009

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: SAR 48.20 |
| Long-Term Rec.: Accumulate | LT Fair Value: SAR 55.80 |

• **Playing on its Strengths:** Arab National Bank (40% owned by Arab Bank of Jordan) is, in our opinion, one of the best managed retail banking franchises in Saudi Arabia. The bank is among the top 3 players in the consumer segment, while a strong deposit franchise has enabled ANB to maintain competitive funding costs. Though a relatively conservative bank, ANB has a relatively strong retail presence and has been focused on catering to mid- and top-tier corporates. The bank has taken strategic initiatives by partnering with leading global players to capitalise on the opportunities emerging in the mortgages, construction and insurance segments, which, in our opinion, are likely to be value accretive.

• **1H2009 - Earnings Flat as Provisions Jump:** ANB reported relatively flat earnings in1H2009 despite a 3x increase in provision costs. The impact of higher provisions was offset by higher net special commission spreads, and 14% Y-o-Y increase in non special commission income as investment income recovered. Loans and deposits have declined since the end of 2008, as the bank continued to improve the risk profile of its loan portfolio, and concentrated on improving its mix of low-cost deposits.

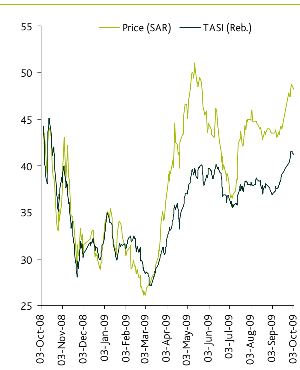
• **Strong Capacity to Absorb Asset Quality Shocks:** We believe that ANB has a high capacity to absorb asset quality shocks in the form of excess provisioning. The bank has one of the lowest NPL ratios amongst Saudi banks at 0.3% of gross loans, while its NPL coverage stood at 528% at the end of June 2009. The excess general provisions account for 1.24% of gross loans, which could be used to absorb a sudden increase in NPLs.

• **Raising 2009e-2011e Estimates:** We raise our 2009e-2011e earning estimates by an average of 5% on prospects of better spreads, a stronger-than-expected recovery in credit in 2010e, and the expectations of declining credit provisions in 2010e-2011e. ANB's net special commission spreads have recovered strongly over the last six months, rising by almost 50bps due to better management of funding costs. While we do not expect a significant improvement in spreads from current levels, we believe that ANB would be able to maintain them by utilizing its deposit franchise. Additionally, we believe that the excess provisions provide a strong buffer to ANB to absorb an increase in NPL without significantly increasing its provisioning costs.

• **Raising LTFV; Rating Changed to ST / LT Accumulate:** The revision in earnings and the 50bps cut in our discount rate raised our LTFV to SAR55.8, which suggest 16% upside potential from current levels. We raise our ST rating to Accumulate from Neutral, but we lower our LT rating to Accumulate from Buy, after a strong rally in the stock price. Upcoming results for 3Q2009e along with any development on restructuring / settlement of the Algosaibi Group's debt are key catalyst for the stock's price performance, in our opinion.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *4,135* | *4,840* | *5,179* | *5,849* |
| *Cost / Income* | *38%* | *33%* | *34%* | *32%* |
| *Provisions / Avg. Loans (bps)* | *8.9* | *46.9* | *30.5* | *27.9* |
| *ROAE* | *19.2%* | *19.3%* | *18.5%* | *18.4%* |
| *ROAA* | *2.0%* | *2.1%* | *2.2%* | *2.3%* |
| *EPS (SAR)* | *3.36* | *3.85* | *4.29* | *4.98* |
| *P/E (x)* | *14.4* | *12.5* | *11.2* | *9.7* |
| *Dividend Yield* | *2.1%* | *2.5%* | *2.7%* | *3.1%* |
| *P/BV (x)* | *2.6* | *2.2* | *1.9* | *1.6* |
| | | | | |
| *Capital Adequacy* | *14.1%* | *15.0%* | *15.3%* | *15.3%* |
| *Loan Growth* | *22.2%* | *-1.1%* | *15.9%* | *15.9%* |
| *Loans / Deposits* | *80.5%* | *84.6%* | *86.2%* | *86.7%* |
| *Provisions / NPLs* | *349%* | *261%* | *222%* | *190%* |

*Figures in SAR million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Special Commission Income* | *3,354* | *3,614* | *3,669* | *3,816* | *3,900* |
| *Total Banking Income* | *4,135* | *4,784* | *4,840* | *5,175* | *5,179* |
| *Income before Provisions* | *2,553* | *3,095* | *3,219* | *3,361* | *3,438* |
| *Net Attributable Income* | *2,181* | *2,400* | *2,506* | *2,653* | *2,789* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR1.0 on 23 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *SAR31,330 / 650* |
| *Av. Mthly Liqd (mn)* | *SAR225.5* |
| *52-Week High / Low* | *SAR51.0 / 26.1* |
| *Bloomberg / Reuters* | *ARNB AB / 1080.SE* |
| *Est. Free Float* | *33.70%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 5,417 | 2,714 | 5,639 | 2,359 | 4,719 | 4,885 | 5,487 |
| Special Commission Expense | (2,513) | (984) | (2,285) | (553) | (1,049) | (986) | (1,049) |
| **Net Special Commission Income** | **2,904** | **1,730** | **3,354** | **1,806** | **3,669** | **3,900** | **4,438** |
| Exchange Income | 201 | 120 | 266 | 120 | 239 | 267 | 299 |
| Fees from Banking Services, Net | 776 | 400 | 839 | 320 | 722 | 775 | 856 |
| Investments Income, Net | 43 | (114) | (471) | 22 | 69 | 157 | 168 |
| Other Operating Income | 32 | 88 | 148 | 100 | 140 | 80 | 88 |
| **Total Non Special Commission Income** | **1,052** | **495** | **782** | **562** | **1,170** | **1,279** | **1,412** |
| **Total Banking Income** | **3,956** | **2,225** | **4,135** | **2,369** | **4,840** | **5,179** | **5,849** |
| Total Operating Expenses | (1,428) | (762) | (1,582) | (798) | (1,621) | (1,741) | (1,881) |
| Income before Provisions | 2,528 | 1,462 | 2,553 | 1,570 | 3,219 | 3,438 | 3,968 |
| Investment and Credit Provisions | (67) | (38) | (60) | (129) | (349) | (243) | (258) |
| **Reported Earnings** | **2,461** | **1,424** | **2,493** | **1,442** | **2,870** | **3,195** | **3,711** |
| Zakat & Taxes | (288) | | (319) | | (364) | (406) | (471) |
| **Net Income from Operations** | **2,173** | **1,424** | **2,174** | **1,442** | **2,506** | **2,789** | **3,240** |
| Share in Earning of Associates | 0 | 0 | (7) | 0 | 0 | 0 | 0 |
| **Net Income** | **2,173** | **1,424** | **2,181** | **1,442** | **2,506** | **2,789** | **3,240** |

Source: Arab National Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 8,228 | 11,863 | 12,051 | 7,773 | 7,365 | 8,621 | 10,042 |
| Due from Banks | 1,294 | 3,319 | 2,747 | 4,452 | 5,180 | 4,845 | 5,541 |
| Loans & Advances, Net | 61,122 | 69,883 | 74,662 | 71,170 | 73,860 | 85,587 | 99,233 |
| Investment Securities, Net | 21,025 | 22,292 | 28,228 | 27,564 | 28,624 | 29,071 | 31,858 |
| Fixed Assets, Net | 774 | 869 | 935 | 1,107 | 923 | 947 | 974 |
| Other Assets | 2,025 | 2,104 | 2,685 | 2,641 | 2,910 | 3,089 | 3,281 |
| **Total Assets** | **94,468** | **110,330** | **121,307** | **114,707** | 118,863 | 132,160 | 150,928 |
| Customer Deposits | 73,692 | 84,915 | 92,743 | 85,232 | 87,353 | 99,328 | 114,520 |
| Due to Banks | 4,447 | 8,893 | 10,509 | 12,010 | 11,356 | 9,933 | 10,307 |
| Term Loan (Debt) | 3,188 | 1,875 | 1,875 | 1,688 | 1,688 | 1,688 | 1,688 |
| Other Liabilities | 2,616 | 2,899 | 4,158 | 2,949 | 4,541 | 4,929 | 5,391 |
| Total Liabilities | 83,943 | 98,581 | 109,286 | 101,879 | 104,937 | 115,877 | 131,906 |
| **Shareholders' Equity** | **10,525** | **11,748** | **12,021** | **13,204** | 13,925 | 16,284 | 19,022 |
| **Total Liabilities & Shareholders' Equity** | **94,468** | **110,330** | **121,307** | **115,083** | 118,863 | 132,160 | 150,928 |

Source: Arab National Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 14.6% | 14.2% | 14.1% | 15.1% | 15.0% | 15.3% | 15.3% |
| Loans / Deposits | 82.9% | 82.3% | 80.5% | 83.5% | 84.6% | 86.2% | 86.7% |
| NPL Coverage Ratio | 354.0% | N/A | 349.0% | N/A | 261.5% | 222.2% | 190.4% |
| Net Interest Spreads | 3.72% | 4.0% | 3.57% | 3.5% | 3.49% | 3.53% | 3.54% |
| Cost / Income Ratio | 36.1% | 34.3% | 38.3% | 33.7% | 33.5% | 33.6% | 32.2% |
| Provisioning (bps) | 12.11 | 2.37 | 8.88 | 7.42 | 46.94 | 30.52 | 27.88 |
| ROAE | 23.5% | 27.2% | 19.2% | 22.7% | 19.3% | 18.5% | 18.4% |
| ROAA | 2.5% | 2.9% | 2.0% | 2.5% | 2.1% | 2.2% | 2.3% |
| EPS | 3.34 | 2.19 | 3.33 | 2.22 | 3.85 | 4.29 | 4.98 |
| BVPS | 16.19 | 18.07 | 18.49 | 20.31 | 21.42 | 25.05 | 29.27 |
| DPS | 0.00 | 0.00 | 1.00 | 0.00 | 1.20 | 1.30 | 1.50 |

Source: Arab National Bank, EFG-Hermes estimates

# SAMBA FINANCIAL GROUP - HIGHLY LIQUID, IMPROVED RISK PROFILE

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| Short-Term Rec.: Buy | Current Price*: SAR 57.50 |
|---|---|
| Long-Term Rec. : Buy | LT Fair Value : SAR 72.10 |

- **Well Positioned for a Recovery:** Samba Financial Group, Saudi Arabia's largest listed bank by assets, is currently the most liquid bank in the country. Its loan-to-deposit ratio stood at 63% as of June 2009 vs. the sector average of 86%, while capital adequacy is also decently high at 15.20%. Samba is also one of the most efficient banks when it comes to its retail operations with deposit/branch substantially high compared to its peers. With a strong liquidity buffer in place, we believe that Samba is the best positioned bank amongst Saudi banks to benefit from a recovery in credit demand.

- **1H2009 results - Flat Earnings, Improving Liquidity:** Samba's earnings for were relatively flat - up 4% Y-o-Y. Net special commission spreads have recovered strongly since the end of 2008, while non special commission income has been relatively flat. Liquidity position has remained strong with loans to deposits at 63.7% at the end of 1H2009. While customer deposits have been relatively flat, loan book has contracted by almost 10% since the end of 2008.

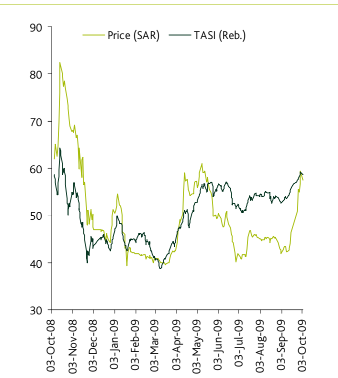
- **Improved Visibility on Risks:** We believe that Samba's risk profile has changed considerably, which, in our view, has not been priced in. Samba's stock price had been trading at depressed valuations owing to the investor perception of a relatively higher exposure to the two Saudi business groups currently negotiating their restructuring with banks. The Saad Group has reportedly agreed to settle its debt with the bank. On the other hand, the bank is likely to have a high collateralization level against its exposure to the Algosaibi Group, as under Saudi banking laws, banks are required to maintain 100% collateral against any related party lending.

- **Raising 2010e-2011e Earning Estimates:** Our 2009e earning estimates for Samba remain broadly unchanged. We however raise our 2010e-2011e earning estimates for Samba by 5% to incorporate our expectation of a stronger recovery in loan growth. We also highlight that Samba has a strong excess provision buffer, which accounts for 1.3% of gross loans, and can be used to cushion the impact of higher provisioning.

- **Raising LTFV to SAR72.10; Top Pick in the Sector:** We raise our LTFV for Samba to SAR72.10 on account of the increase in our earning estimates and a cut in discount rate by 50bps. We believe that the general risk profile of banks has improved significantly over the last three months. We also revise our ST rating on Samba to Buy. With increased visibility on provisions, higher balance sheet liquidity, and an improved risk profile, Samba is our pick in the Saudi banking sector. Despite the recent run-up in the stock price, Samba continues to trade at an almost 20% discount to its peers - 2009e P/E of 10.9x and P/B of 2.3x and ROE of 22.7%.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *7,012* | *7,580* | *8,028* | *8,897* |
| *Cost / Income* | *30%* | *28%* | *28%* | *27%* |
| *Provisions / Avg. Loans (bps)* | *29* | *60* | *45* | *27* |
| *ROAE* | *23.5%* | *22.7%* | *21.7%* | *21.9%* |
| *ROAA* | *2.6%* | *2.6%* | *2.8%* | *2.9%* |
| *EPS (SAR)* | *4.77* | *5.27* | *5.77* | *6.69* |
| *P/E (x)* | *12.0* | *10.9* | *10.0* | *8.6* |
| *Dividend Yield* | *2.9%* | *3.7%* | *4.0%* | *4.7%* |
| *P/BV (x)* | *2.7* | *2.3* | *2.0* | *1.8* |
| | | | | |
| *Capital Adequacy* | *14.1%* | *15.1%* | *14.9%* | *14.8%* |
| *Loan Growth* | *21.8%* | *-10.0%* | *16.3%* | *16.9%* |
| *Loans/ Deposits* | *73%* | *64%* | *70%* | *72%* |
| *Provisions / NPLs* | *167%* | *151%* | *143%* | *139%* |

*Figures in SAR million, unless otherwise stated*




*Estimate Changes*

| *(SAR mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Special Commission Income* | *7,580* | *5,229* | *5,355* | *5,720* | *5,661* |
| *Total Banking Income* | *7,012* | *7,672* | *7,580* | *8,153* | *8,028* |
| *Income before Provisions* | *4,901* | *5,476* | *5,477* | *5,830* | *5,817* |
| *Net Attributable Income* | *4,293* | *4,655* | *4,739* | *5,035* | *5,193* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR0.90 on 12 Jul. 09* |
| *Mkt. Cap / Shares (mn)* | *SAR51,750 / 900* |
| *Av. Mthly Liqd (mn)* | *SAR840.7* |
| *52-Week High / Low* | *SAR82.50 / 39.30* |
| *Bloomberg / Reuters* | *SAMBA AB / 1090.SE* |
| *Est. Free Float* | *42.80%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 8,386 | 4,143 | 8,426 | 3,437 | 6,979 | 7,180 | 7,928 |
| Special Commission Expense | (3,442) | (1,633) | (3,365) | (823) | (1,624) | (1,519) | (1,546) |
| **Net Special Commission Income** | **4,944** | **2,510** | **5,061** | **2,613** | **5,355** | **5,661** | **6,383** |
| Exchange Income | 431 | 226 | 409 | 180 | 383 | 451 | 497 |
| Fees from Banking Services, Net | 1,618 | 891 | 1,624 | 647 | 1,363 | 1,447 | 1,561 |
| Investments Income, Net | 167 | 15 | (122) | 351 | 469 | 458 | 446 |
| Other Operating Income | 35 | 25 | 40 | 16 | 10 | 10 | 10 |
| **Total Non Special Commission Income** | **2,252** | **1,158** | **1,951** | **1,194** | **2,225** | **2,366** | **2,514** |
| **Total Banking Income** | **7,196** | **3,668** | **7,012** | **3,807** | **7,580** | **8,028** | **8,897** |
| Total Operating Expenses | (1,966) | (963) | (2,111) | (997) | (2,102) | (2,210) | (2,359) |
| Income before Provisions | 5,230 | 2,705 | 4,901 | 2,810 | 5,477 | 5,817 | 6,538 |
| Investment and Credit Provisions | (423) | (283) | (458) | (300) | (579) | (450) | (317) |
| **Reported Earnings** | **4,807** | **2,422** | **4,443** | **2,510** | **4,898** | **5,368** | **6,221** |
| Zakat & Taxes | (154) | - | (150) | - | (159) | (174) | (202) |
| **Net Income** | **4,653** | **2,422** | **4,293** | **2,510** | **4,739** | **5,193** | **6,019** |

Source: Samba, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 11,098 | 10,139 | 13,800 | 21,089 | 17,554 | 10,896 | 11,420 |
| Due from Banks | 2,312 | 3,886 | 878 | 2,320 | 3,066 | 5,171 | 5,838 |
| Loans & Advances, Net | 80,553 | 96,363 | 98,147 | 87,949 | 88,321 | 102,760 | 120,116 |
| Investment Securities, Net | 53,574 | 66,375 | 54,213 | 57,484 | 58,250 | 60,325 | 64,213 |
| Fixed Assets, Net | 833 | 852 | 870 | 887 | 878 | 892 | 907 |
| Other Assets | 6,044 | 6,025 | 10,983 | 7,320 | 12,624 | 14,517 | 16,695 |
| **Total Assets** | **154,414** | **183,641** | **178,891** | **177,051** | **180,692** | **194,561** | **219,188** |
| Customer Deposits | 115,811 | 121,717 | 134,228 | 138,173 | 137,410 | 146,734 | 167,277 |
| Due to Banks | 11,425 | 32,880 | 12,090 | 9,385 | 9,619 | 10,271 | 11,709 |
| Term Loan (Debt) | 2,039 | 2,057 | 1,873 | 1,873 | 1,873 | 1,873 | 0 |
| Other Liabilities | 7,822 | 8,658 | 11,370 | 7,724 | 9,458 | 10,060 | 10,766 |
| Total Liabilities | 137,098 | 165,312 | 159,561 | 157,156 | 158,359 | 168,938 | 189,752 |
| **Shareholders' Equity** | **17,316** | **18,330** | **19,330** | **19,895** | **22,333** | **25,623** | **29,436** |
| **Total Liabilities & Shareholders' Equity** | **154,414** | **183,641** | **178,891** | **177,051** | **180,692** | **194,561** | **219,188** |

Source: Samba, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 15.1% | 13.10% | 14.1% | 14.40% | 15.1% | 14.9% | 14.8% |
| Loans / Deposits | 69.6% | 79.2% | 73.1% | 63.7% | 64.3% | 70.0% | 71.8% |
| NPL Coverage Ratio | 154.5% | 167.0% | 167.0% | N/A | 151.0% | 143.0% | 138.7% |
| Net Interest Spreads | 4.0% | 3.33% | 3.63% | 3.45% | 3.69% | 3.64% | 3.60% |
| Cost / Income Ratio | 27.3% | 26.3% | 30.1% | 25.9% | 27.7% | 27.5% | 26.5% |
| Provisioning (bps) | 40.6 | 7.14 | 28.9 | 22.46 | 59.9 | 45.2 | 27.4 |
| ROAE | 29.7% | 27.1% | 23.5% | 26.2% | 22.7% | 21.7% | 21.9% |
| ROAA | 3.4% | 2.9% | 2.6% | 2.9% | 2.6% | 2.8% | 2.9% |
| EPS | 5.17 | 2.69 | 4.77 | 2.79 | 5.27 | 5.77 | 6.69 |
| BVPS | 19.24 | 20.37 | 21.48 | 22.11 | 24.81 | 28.47 | 32.71 |
| DPS | 1.80 | 0.90 | 1.65 | 0.90 | 2.10 | 2.30 | 2.70 |

Source: Samba, EFG-Hermes estimates

# SAUDI HOLLANDI BANK - BUILDING UP COVERAGE



| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: SAR 34.20 |
| Long-Term Rec. : Accumulate | LT Fair Value : SAR 39.00 |

- **Corporate Focused, but Growth Restrained:** Largely a corporate franchise, SHB is the smallest joint venture bank in the country. With a 40% shareholding held by the RBS-led consortium that acquired ABN-AMRO last year, SHB's ability to grow has been constrained since the acquisition. The bank improved its capital adequacy by raising Tier II capital through a subordinated debt issue in end of 2008, SHB has been fairly conservative since the beginning of 2009. We are of the view that the bank is likely to maintain a slower loan growth momentum to maintain a healthy level of capital adequacy.

- **1H2009 Earnings Dip on Provisioning Charge:** SHB's earnings dropped by 38% Y-o-Y, primarily on higher provisions, which rose to SAR322 million in 1H2009 vs. SAR33 million in 1H2008. Pre-provision profits rose by 9%, with spread driven improvement in net special commission income offsetting decline in fee income. Loan growth has been negligible since the start of 2009, but deposit growth has been much stronger, rising by almost 20% YTD. While liquidity levels have improved significantly, it is largely being deployed in interbank assets.

- **Improving NPL Coverage:** We expect credit provisioning costs to remain at elevated levels, as SHB seeks to increase coverage of its non-performing loans. SHB's NPL coverage of 107% at the end of 2008 was amongst the lowest in the sector. The higher provisioning charge taken in 2Q2009 was largely on account of general portfolio provisions, and the bank's NPL coverage has been boosted to 132% as a result.

- **Lowering 2009e-2010e Estimates:** We lower our earning estimates for SHB by 40% in 2009e and by 20% in 2010e, primarily on account of higher provisioning. We also lower our loan growth forecasts, as we are of the view that the bank is likely to maintain a cautious stance, while the bank's aim to maintain high capital adequacy is likely to constrain loan growth.

- **Lowering LTFV; Maintaining Rating:** We lower our LTFV for SHB to SAR39.0, with the downwards revision in earnings largely offsetting the impact of a 50bps cut in our discount rate. We believe that earnings are likely to remain depressed in the near term, as the bank maintains relatively elevated level of provisioning to beef up its NPL coverage. We therefore maintain our ST Neutral rating on SHB. However, with the stock offering 14% upside potential to our revised LTFV, we raise our LT rating to Accumulate. We are of the view that a decline in the level of provision, and recovery in earnings is likely to be a key catalyst for the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *2,111* | *2,144* | *2,330* | *2,564* |
| *Cost / Income* | *38.4%* | *37.0%* | *36.3%* | *35.7%* |
| *Provisions / Avg. Loans (bps)* | *22.9* | *151.3* | *79.6* | *47.3* |
| *ROAE* | *22.0%* | *11.5%* | *15.6%* | *16.9%* |
| *ROAA* | *2.0%* | *1.0%* | *1.4%* | *1.6%* |
| *EPS (SAR)* | *3.33* | *2.01* | *3.10* | *3.86* |
| *P/E (x)* | *10.3* | *17.0* | *11.0* | *8.9* |
| *Dividend Yield* | *2.1%* | *1.2%* | *1.8%* | *2.9%* |
| *P/BV (x)* | *2.1* | *1.9* | *1.6* | *1.4* |
| | | | | |
| *Capital Adequacy* | *12.7%* | *12.3%* | *12.8%* | *12.4%* |
| *Loan Growth* | *38.0%* | *5.2%* | *8.6%* | *16.2%* |
| *Loans / Deposits* | *88.4%* | *75.5%* | *77.0%* | *78.4%* |
| *Provisions / NPLs* | *107.8%* | *134.5%* | *139.5%* | *134.0%* |

*Figures in SAR million, unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Special Commission Income* | *1,445* | *1,568* | *1,574* | *1,725* | *1,761* |
| *Total Banking Income* | *2,111* | *2,295* | *2,144* | *2,505* | *2,330* |
| *Income before Provisions* | *1,301* | *1,415* | *1,350* | *1,556* | *1,484* |
| *Net Attributable Income* | *1,102* | *1,188* | *666* | *1,260* | *1,025* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR0.75 on 25 Mar 08* |
| *Mkt. Cap / Shares (mn)* | *SAR11,312 / 330.8* |
| *Av. Mthly Liqd (mn)* | *SAR48.6* |
| *52-Week High / Low* | *SAR48.0 / 26.7* |
| *Bloomberg / Reuters* | *AAAL AB / 1040.SE* |
| *Est. Free Float* | *29.70%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 2,906 | 1,394 | 2,977 | 1,270 | 2,559 | 2,920 | 3,155 |
| Special Commission Expense | (1,705) | (677) | (1,532) | (467) | (985) | (1,160) | (1,210) |
| **Net Special Commission Income** | **1,200** | **717** | **1,445** | **803** | **1,574** | **1,761** | **1,945** |
| Exchange Income | 85 | 41 | 88 | 38 | 75 | 83 | 91 |
| Fees from Banking Services, Net | 390 | 238 | 456 | 189 | 370 | 395 | 430 |
| Investments Income, Net | 101 | 70 | 121 | 84 | 124 | 91 | 96 |
| Other Operating Income | - | - | - | - | 1 | 1 | 1 |
| **Total Non Special Commission Income** | **576** | **350** | **666** | **312** | **570** | **570** | **618** |
| **Total Banking Income** | **1,777** | **1,067** | **2,111** | **1,115** | **2,144** | **2,330** | **2,564** |
| Total Operating Expenses | (842) | (425) | (810) | (401) | (793) | (847) | (916) |
| Income before Provisions | 935 | 642 | 1,301 | 714 | 1,350 | 1,484 | 1,647 |
| Investment and Credit Provisions | (496) | (33) | (78) | (322) | (612) | (347) | (232) |
| **Reported Earnings** | **439** | **609** | **1,224** | **391** | **739** | **1,137** | **1,415** |
| Zakat & Taxes | (57) | | (122) | | (72) | (111) | (139) |
| **Net Income** | **382** | **609** | **1,102** | **391** | **666** | **1,025** | **1,276** |

Source: Saudi Hollandi Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 3,509 | 6,186 | 2,791 | 11,391 | 4,564 | 6,134 | 6,240 |
| Due from Banks | 5,272 | 3,690 | 365 | 273 | 5,580 | 5,511 | 7,082 |
| Loans & Advances, Net | 27,555 | 33,914 | 38,017 | 39,633 | 40,007 | 43,434 | 50,463 |
| Investment Securities, Net | 12,954 | 13,475 | 18,368 | 16,079 | 18,383 | 17,910 | 18,887 |
| Fixed Assets, Net | 320 | 439 | 466 | 501 | 511 | 540 | 571 |
| Other Assets | 801 | 794 | 1,429 | 1,144 | 1,572 | 1,729 | 1,902 |
| **Total Assets** | **50,411** | **58,498** | **61,436** | **69,022** | **70,619** | **75,257** | **85,146** |
| Customer Deposits | 34,605 | 41,897 | 43,012 | 51,643 | 53,001 | 56,436 | 64,337 |
| Due to Banks | 9,158 | 9,361 | 9,286 | 8,360 | 8,480 | 8,465 | 9,007 |
| Term Loan (Debt) | 700 | 700 | 1,475 | 1,475 | 775 | 775 | 775 |
| Other Liabilities | 1,402 | 1,458 | 2,181 | 1,652 | 2,276 | 2,562 | 2,911 |
| Total Liabilities | 45,865 | 53,416 | 55,954 | 63,130 | 64,532 | 68,238 | 77,031 |
| **Shareholders' Equity** | **4,547** | **5,082** | **5,482** | **5,893** | **6,087** | **7,019** | **8,115** |
| **Total Liabilities & Shareholders' Equity** | **50,411** | **58,498** | **61,436** | **69,022** | **70,619** | **75,257** | **85,146** |

Source: Saudi Hollandi Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 15.0% | 9.9% | 12.7% | 13.20% | 12.3% | 12.8% | 12.4% |
| Loans / Deposits | 79.6% | 80.9% | 88.4% | 76.7% | 75.5% | 77.0% | 78.4% |
| NPL Coverage Ratio | 110.0% | N/A | 107.8% | N/A | 134.5% | 139.5% | 134.0% |
| Net Interest Spreads | 2.51% | 3.1% | 2.61% | 3.1% | 2.47% | 2.57% | 2.59% |
| Cost / Income Ratio | 47.4% | 39.8% | 38.4% | 37.8% | 37.0% | 36.3% | 35.7% |
| Provisioning (bps) | 177.02 | 10.21 | 22.86 | 5.54 | 151.26 | 79.63 | 47.34 |
| ROAE | 8.7% | 24.1% | 22.0% | 20.2% | 11.5% | 15.6% | 16.9% |
| ROAA | 0.8% | 2.3% | 2.0% | 1.9% | 1.0% | 1.4% | 1.6% |
| EPS | 1.16 | 1.84 | 3.33 | 1.02 | 2.01 | 3.10 | 3.86 |
| BVPS | 13.75 | 15.36 | 16.57 | 17.82 | 18.40 | 21.22 | 24.54 |
| DPS | 0.64 | - | 0.71 | - | 0.40 | 0.60 | 1.00 |

Source: Saudi Hollandi Bank, EFG-Hermes estimates

# RIYAD BANK - BUCKING THE TREND

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: SAR 29.90 |
| Long-Term Rec. : Accumulate | LT Fair Value : SAR 34.00 |

- **Continuing to Grow in a Tough Economic Environment:** Despite a slowdown in the overall economic growth and higher perceived risks constraining loan growth in Saudi Arabia, Riyad Bank is defying sector-wide trends. Loan growth has continued to surprise on the upside. With other banks constrained by capital adequacy and liquidity, Riyad is capitalising on the incremental capital raised last year through a rights issue. The bank has also utilised its branch network efficiently by raising deposits aggressively to support asset growth. We believe that Riyad's branch network, the third largest in the country, remains underutilised, and represents upside potential for the bank.

- **1H2009 Results - Investment Provisions Surprise:** Riyad's 1H2009 earnings declined by 15% Y-o-Y, driven by higher investment provisions. In 1Q2009, the bank made aggressive provisions on its investment portfolio, which were partially reversed in 2Q2009. Net special commission income has remained strong, rising by 15% Y-o-Y, while non special commission income grew by 5% Y-o-Y. Credit provisions also increased by almost 3x, mostly representing general provisions. Loan growth continued to surprise on the upside, rising by 8.4% YTD vs. a 0.8% contraction in banking sector loans during the same period.

- **Risk of Rising NPLs:** We see the risk of rising NPLs as the primary risk for banks in general, and for Riyad as well. However, the bank has indicated that is has a lower exposure to the two groups, and hence we do expect credit provisions. We also highlight that Riyad's NPL coverage stood at 132% at the end of June 2009, which can used to absorb some of the shocks to asset quality. With capitalisation levels being one of the strongest in the sector, Riyad, in our view, can absorb a rise in NPLs without a significant impact on capital adequacy.

- **Adjusting Forecasts:** We lower our 2009e forecasts by 6% to adjust for the slower-than-expected credit growth in 2009e. However, we raise our earning estimates for 2010e-2011e by an average of 5% to incorporate expectations of an early recovery in credit growth. We expect credit growth to recover to 15% in 2010e against our earlier expectation of 12%.

- **Raising LTFV, ST Rating to Accumulate:** The visibility on risks and earnings has improved, in our view, and we lower our discount rate by 50bps. We increase our LTFV to SAR34.0, which suggests 14% upside potential from current levels. We also raise our ST rating to Accumulate, as we believe earnings are likely to remain strong in the short term, supported by stable spreads, and lower-than-expected provisions.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *5,248* | *6,079* | *6,879* | *8,026* |
| *Cost / Income* | *40%* | *37%* | *35%* | *32%* |
| *Provisions / Avg. Loans (bps)* | *42.6* | *62.8* | *42.7* | *27.5* |
| *ROAE* | *13.9%* | *11.7%* | *14.6%* | *17.3%* |
| *ROAA* | *1.8%* | *1.7%* | *2.0%* | *2.3%* |
| *EPS (SAR)* | *2.03* | *1.95* | *2.56* | *3.26* |
| *P/E (x)* | *14.73* | *15.4* | *11.7* | *9.2* |
| *Dividend Yield* | *5.5%* | *4.6%* | *5.1%* | *6.5%* |
| *P/BV (x)* | *1.58* | *1.76* | *1.65* | *1.53* |
| | | | | |
| *Capital Adequacy* | *16.1%* | *15.6%* | *14.2%* | *13.0%* |
| *Loan Growth* | *43.2%* | *14.7%* | *16.2%* | *15.7%* |
| *Loans/ Deposits* | *91.8%* | *85.4%* | *85.0%* | *86.3%* |
| *Provisions / NPLs* | *131.9%* | *121.1%* | *116.7%* | *114.4%* |

*Figures in SAR million unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Special Commission Income* | *3,947* | *4,451* | *4,565* | *4,819* | *5,160* |
| *Total Banking Income* | *5,248* | *6,235* | *6,079* | *6,868* | *6,879* |
| *Income before Provisions* | *3,162* | *3,995* | *3,860* | *4,450* | *4,490* |
| *Net Attributable Income* | *2,558* | *3,093* | *2,919* | *3,656* | *3,840* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR0.60 on 20 Jul. 09* |
| *Mkt. Cap / Shares (mn)* | *SAR44,850 / 1500* |
| *Av. Mthly Liqd (mn)* | *SAR464.4* |
| *52-Week High / Low* | *SAR29.9 / 18.6* |
| *Bloomberg / Reuters* | *RIBL AB / 1010.SE* |
| *Est. Free Float* | *25.71%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Special Commission Income | 6,210 | 3,186 | 6,737 | 3,188 | 6,810 | 7,442 | 8,345 |
| Special Commission Expense | (2,943) | (1,220) | (2,790) | (928) | (2,244) | (2,282) | (2,283) |
| **Net Special Commission Income** | **3,266** | **1,966** | **3,947** | **2,260** | **4,565** | **5,160** | **6,062** |
| Exchange Income | 272 | 139 | 264 | 90 | 192 | 226 | 265 |
| Fees from Banking Services, Net | 1,011 | 613 | 1,187 | 640 | 1,240 | 1,356 | 1,507 |
| Investments Income, Net | 581 | (78) | (230) | (42) | 42 | 95 | 148 |
| Other Operating Income | 51 | 19 | 80 | 36 | 40 | 42 | 44 |
| **Total Non Special Commission Income** | **1,915** | **693** | **1,302** | **724** | **1,514** | **1,719** | **1,965** |
| **Total Banking Income** | **5,181** | **2,658** | **5,248** | **2,984** | **6,079** | **6,879** | **8,026** |
| Total Operating Expenses | (1,824) | (962) | (2,086) | (1,112) | (2,219) | (2,389) | (2,585) |
| Income before Provisions | 3,357 | 1,696 | 3,162 | 1,872 | 3,860 | 4,490 | 5,442 |
| Investment and Credit Provisions | (346) | (99) | (523) | (513) | (835) | (510) | (381) |
| **Reported Earnings** | **3,011** | **1,597** | **2,639** | **1,359** | **3,025** | **3,980** | **5,060** |
| Zakat & Taxes | (75) | 0 | (81) | 0 | (106) | (139) | (177) |
| **Net Income** | **2,936** | **1,597** | **2,558** | **1,359** | **2,919** | **3,840** | **4,883** |

Source: Riyad Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)
In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 16,579 | 14,235 | 11,078 | 14,498 | 16,579 | 17,477 | 15,367 |
| Due from Banks | 4,168 | 4,290 | 6,257 | 11,056 | 9,680 | 12,950 | 10,409 |
| Loans & Advances, Net | 67,340 | 82,299 | 96,430 | 104,582 | 110,612 | 128,519 | 148,751 |
| Investment Securities, Net | 27,742 | 38,801 | 40,329 | 37,596 | 38,721 | 40,701 | 45,799 |
| Fixed Assets, Net | 1,472 | 1,493 | 1,630 | 1,736 | 1,704 | 1,786 | 1,876 |
| Other Assets | 4,049 | 3,016 | 3,928 | 3,298 | 3,426 | 3,727 | 4,057 |
| **Total Assets** | **121,351** | **144,134** | **159,653** | **172,767** | **180,723** | **205,161** | **226,258** |
| Customer Deposits | 84,331 | 88,471 | 105,056 | 122,070 | 129,558 | 151,249 | 172,424 |
| Due to Banks | 17,798 | 21,764 | 21,213 | 17,658 | 17,490 | 18,150 | 17,242 |
| Term Loan (Debt) | 1,872 | 1,872 | 1,874 | 1,873 | 1,875 | 1,875 | 0 |
| Other Liabilities | 5,237 | 6,436 | 6,950 | 4,394 | 6,259 | 6,704 | 7,350 |
| Total Liabilities | 109,239 | 118,543 | 135,093 | 145,996 | 155,182 | 177,978 | 197,016 |
| Shareholders' Equity | 12,112 | 25,592 | 24,559 | 26,771 | 25,541 | 27,183 | 29,242 |
| **Total Liabilities & Shareholders' Equity** | **121,351** | **144,134** | **159,653** | **172,767** | **180,723** | **205,161** | **226,258** |

Source: Riyad Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 16.0% | 11.70% | 16.1% | 17.50% | 15.6% | 14.2% | 13.0% |
| Loans / Deposits | 79.9% | 93.0% | 91.8% | 85.7% | 85.4% | 85.0% | 86.3% |
| NPL Coverage Ratio | 139.2% | N/A | 131.9% | N/A | 121.1% | 116.7% | 114.4% |
| Net Interest Spreads | 3.61% | 3.84% | 3.22% | 2.86% | 2.93% | 2.98% | 3.08% |
| Cost / Income Ratio | 35.2% | 36.2% | 39.8% | 37.3% | 36.5% | 34.7% | 32.2% |
| Provisioning (bps) | 57.82 | 8.44 | 42.63 | 21.62 | 62.80 | 42.66 | 27.51 |
| ROAE | 25.5% | 22.2% | 13.9% | 7.1% | 11.7% | 14.6% | 17.3% |
| ROAA | 2.7% | 2.2% | 1.8% | 1.1% | 1.7% | 2.0% | 2.3% |
| EPS | 2.93 | 1.06 | 2.03 | 0.91 | 1.95 | 2.56 | 3.26 |
| BVPS | 11.79 | 17.06 | 18.89 | 17.85 | 17.03 | 18.12 | 19.49 |
| DPS | 1.95 | 0.70 | 1.65 | 0.60 | 1.40 | 1.50 | 2.00 |

Source: Riyad Bank, EFG-Hermes estimates

# SAUDI INVESTMENT BANK - DISCOUNT TO THE MARKET

06 OCTOBER 2009

SAUDI ARABIA | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: SAR 18.55 |
| Long-Term Rec. : Accumulate | LT Fair Value : SAR 21.50 |

• **High Fee Income Exposure to Capital Markets:** Although its contribution to total revenue has declined considerably to 22.8% in 2008 from a high of 52.3% in 2006, capital markets-related revenues (brokerage commissions and trading gains) are still significant. Broking commissions alone accounted for almost 23% of non-special commission income and 11% of total revenues. We therefore remain concerned about the revenue volatility of SAIB in the current environment and are of the view that gains accruing from a decline in funding costs could be offset by lower capital markets-related revenues.

• **1H2009 Results - Improved Spreads:** SAIB's spreads have strongly recovered from their lows of 4Q2008, with the bank managing its funding costs. Earnings in 1H2009 were largely stable. Revenues declined 31% Y-o-Y, however this was due to classification of Amex Saudi Arabia and the asset management arm of the bank as associates in beginning of 2009. Net loans remained broadly unchanged, while SAIB capitalised on a slowing growth environment to shed some of its high-cost deposits.

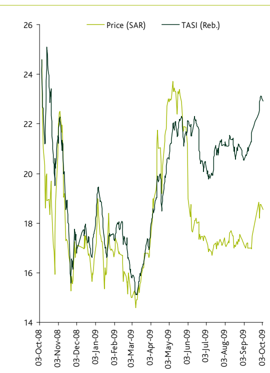
• **Liquid Balance Sheet, but Efficient Deployment is the Key Challenge:** Historically, SAIB's loan-to-deposit ratio (four-year average of 72%) has remained significantly below the central bank's guidance limit. This was due to the bank's historical reliance on non-fund-based income to drive revenue growth. Although the bank has been focusing on growing its fund-based income source, its reliance has been on corporates for loans and deposits, resulting in thin spreads. SAIB's net special commission spreads of c2.0% are the lowest among the Saudi banks. We therefore believe that an efficient utilisation of the balance sheet remains a key challenge.

• **Lowering 2009e, Raising 2010e-2011e Estimates:** We lower our 2009e our earning estimates to incorporate the trends reflected in 2Q2009 results. Although we expect spreads to remain largely stable in 2H2009, income accruing from associates is likely to remain subdued, while provisioning levels are likely to remain elevated. We however raise our 2010e-2011e earning estimates by an average of 8% on expectation of stronger credit growth, and improved spreads.

• **Raising LTFV; Rating Changed to ST / LT Accumulate:** The revision in our earning estimates raises our LTFV for SAIB to SAR21.50. We however maintain our discount rate for SAIB, as we believe that smaller banks have higher loan concentration, and hence higher asset quality risks. Our revised LTFV suggests 16% upside potential from current levels. We raise our ST rating to Accumulate from Neutral, as SAIB has underperformed the sector in the recent rally, and valuations have become attractive - SAIB trades at 2009e P/E of 10.4x and P/B of 1.1x.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *1,938* | *1,430* | *1,547* | *1,698* |
| *Cost / Income* | *21%* | *31%* | *32%* | *32%* |
| *Provisions / Avg. Loans (bps)* | *11* | *77* | *52* | *28* |
| *ROAE* | *7.3%* | *11.6%* | *12.3%* | *13.1%* |
| *ROAA* | *1.0%* | *1.5%* | *1.7%* | *1.8%* |
| *EPS (SAR)* | *1.18* | *1.79* | *2.10* | *2.49* |
| *P/E (x)* | *15.7* | *10.4* | *8.8* | *7.5* |
| *Dividend Yield* | *0.0%* | *2.2%* | *2.2%* | *2.7%* |
| *P/BV (x)* | *1.3* | *1.1* | *1.0* | *0.9* |
| *Capital Adequacy* | *13.9%* | *15.7%* | *16.1%* | *16.0%* |
| *Loan Growth* | *28%* | *7%* | *10%* | *15%* |
| *Loans / Deposits* | *73%* | *82%* | *81%* | *82%* |
| *Provisions / NPLs* | *252%* | *183%* | *162%* | *154%* |

*Figures in SAR million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(SAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Special Commission Income* | *1,026* | *1,084* | *1,047* | *1,161* | *1,097* |
| *Total Banking Income* | *1,938* | *1,480* | *1,430* | *1,621* | *1,547* |
| *Income before Provisions* | *1,528* | *1,032* | *983* | *1,133* | *1,059* |
| *Net Attributable Income* | *491* | *851* | *804* | *875* | *946* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *SAR0.29 on 7 Mar 06* |
| *Mkt. Cap / Shares (mn)* | *SAR12,058 / 650* |
| *Av. Mthly Liqd (mn)* | *SAR124.5* |
| *52-Week High / Low* | *SAR24.6 / 14.6* |
| *Bloomberg / Reuters* | *SIBC AB / 1030.SE* |
| *Est. Free Float* | *38.00%* |

**Prices as at 03 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| **Net Special Commission Income** | **1,056** | **605** | **1,026** | **504** | **1,047** | **1,097** | **1,210** |
| Exchange Income | 44 | 12 | 43 | 16 | 48 | 52 | 58 |
| Fees from Banking Services, Net | 398 | 289 | 481 | 117 | 278 | 292 | 312 |
| Investments Income, Net | (96) | 80 | 277 | 42 | 57 | 106 | 118 |
| Other Operating Income | - | - | 110 | - | - | - | - |
| **Total Non Special Commission Income** | **347** | **381** | **912** | **175** | **383** | **450** | **488** |
| **Total Banking Income** | **1,403** | **986** | **1,938** | **679** | **1,430** | **1,547** | **1,698** |
| Total Operating Expenses | (484) | (227) | (411) | (272) | (447) | (489) | (541) |
| Income before Provisions | 919 | 759 | 1,528 | 407 | 983 | 1,059 | 1,158 |
| Investment and Credit Provisions | (97) | (322) | (998) | (60) | (241) | (179) | (108) |
| Earnings before Zakat & Taxes | 822 | 437 | 530 | 347 | 741 | 880 | 1,050 |
| Zakat & Taxes | (35) | 0 | (22) | 0 | (39) | (46) | (54) |
| **Net Income from Operations** | **787** | **437** | **508** | **347** | **702** | **834** | **996** |
| Share in Earning of Associates | - | - | - | 85 | 120 | 132 | 145 |
| **Net Income before Minorities** | **787** | **437** | **508** | **432** | **822** | **966** | **1,141** |
| Minorities | - | - | (17) | - | (18) | (20) | (22) |
| **Net Income** | **787** | **512** | **491** | **432** | **804** | **946** | **1,119** |

Source: Saudi Investment Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In SAR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 1,212 | 1,861 | 1,427 | 1,452 | 1,667 | 1,983 | 2,279 |
| Due from Banks | 4,311 | 5,190 | 7,453 | 6,127 | 5,909 | 4,875 | 4,237 |
| Loans & Advances, Net | 23,129 | 28,140 | 29,556 | 30,153 | 31,517 | 34,592 | 39,888 |
| Investment Securities, Net | 16,373 | 15,159 | 13,451 | 11,236 | 11,552 | 14,262 | 15,850 |
| Fixed Assets, Net | 425 | 469 | 548 | 660 | 612 | 686 | 772 |
| Other Assets | 1,091 | 1,116 | 1,163 | 1,103 | 1,279 | 1,407 | 1,548 |
| **Total Assets** | **46,542** | **51,934** | **53,596** | **50,731** | **52,537** | **57,806** | **64,573** |
| Customer Deposits | 32,768 | 36,863 | 40,702 | 36,364 | 38,278 | 42,891 | 48,896 |
| Due to Banks | 4,512 | 5,635 | 5,209 | 5,783 | 5,359 | 5,147 | 4,890 |
| Term Loan (Debt) | 1,425 | 1,425 | - | 500 | 500 | 500 | 500 |
| Other Liabilities | 1,067 | 878 | 1,076 | 934 | 1,109 | 1,175 | 1,246 |
| Total Liabilities | 39,772 | 44,801 | 46,988 | 43,581 | 45,246 | 49,714 | 55,532 |
| Shareholders' Equity | 6,770 | 7,133 | 6,609 | 7,150 | 7,291 | 8,093 | 9,042 |
| **Total Liabilities & Shareholders' Equity** | **46,542** | **51,934** | **53,596** | **50,731** | **52,537** | **57,806** | **64,573** |

Source: Saudi Investment Bank, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 21.0% | 14.2% | 13.9% | 14.1% | 15.7% | 16.1% | 16.0% |
| Loans / Deposits | 70.6% | 76.3% | 72.6% | 82.9% | 82.3% | 80.7% | 81.6% |
| NPL Coverage Ratio | 243.2% | N/A | 251.9% | N/A | 183.0% | 162.2% | 154.1% |
| Net Interest Spreads | 2.15% | 1.9% | 1.9% | 1.8% | 1.93% | 1.96% | 1.96% |
| Cost / Income Ratio | 34.5% | 15.4% | 21.2% | 40.0% | 31.3% | 31.6% | 31.8% |
| Provisioning (bps) | 42.67 | 7.08 | 11.08 | 1.83 | 76.86 | 52.40 | 28.10 |
| ROAE | 12.3% | 8.7% | 7.3% | 14.2% | 11.6% | 12.3% | 13.1% |
| ROAA | 1.8% | 1.3% | 1.0% | 1.9% | 1.5% | 1.7% | 1.8% |
| EPS | 1.75 | 0.97 | 1.09 | 0.96 | 1.79 | 2.10 | 2.49 |
| BVPS | 15.04 | 15.85 | 14.69 | 15.89 | 16.20 | 17.98 | 20.09 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.40 | 0.40 | 0.50 |

Source: Saudi Investment Bank, EFG-Hermes estimates

# COMMERCIAL INTERNATIONAL BANK - CONTINUES TO OUTPERFORM

06 OCTOBER 2009

EGYPT | BANKS

| Short-Term Rec.: Accumulate | Current Price*: EGP 56.05 |
|---|---|
| Long-Term Rec. : Accumulate | LT Fair Value : EGP 62.70 |

• **A Strong Corporate Franchise; Retail Banking Business an Upside Risk:** CIB is one of Egypt's leading corporate banks, enjoying a strong market position among large corporations and multi-nationals operating in Egypt. Its asset market share is relatively small, at 5.5%, but this reflects the large size of Egypt's three major state-owned banks. Corporate lending has been the major driver of earnings and balance sheet growth so far. The bank is now seeking to increase its retail banking business, which currently accounts for 9% of its loan book. We believe this move will happen gradually, reflecting CIB's conservative approach to managing credit risk.

• **2Q2009 Results - Provisioning Continues to Surprise Positively:** CIB reported solid growth in 2Q2009's core-banking income, up 17% Y-o-Y and 2% Q-o-Q. However, higher costs and taxation led to net profit growth of only 4% Y-o-Y (normalised for one-off gains in 2Q2008) and a decline of 7% Q-o-Q. Earnings were nevertheless 11% ahead of expectations, with provisions and non-interest income outperforming our forecasts. Credit quality indicators remained stable vs. 1Q2009. Loan growth has been weak at 3% in June 2009 vs. December 2008.

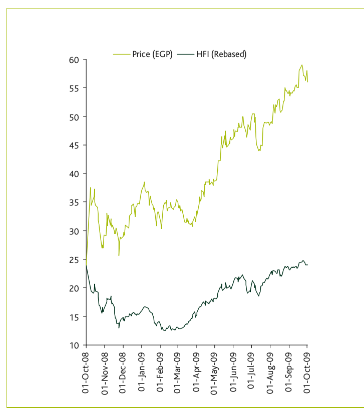
• **Raising Earnings Forecasts:** We have slightly increased our 2009e net attributable profit estimate but are more optimistic in our medium and longer-term forecasts, which we have upgraded by around 10%. Over our forecast period we have increased our loan growth assumptions (to a CAGR 2009e-2013e of 15% from our previous 11%) and lowered our previously conservative loan loss provisioning charges. We are nevertheless assuming a worsening in credit quality, with the NPL ratio estimated to peak in 2010e at 3.8% from the current 2.8% (as of June 2009).

• **Expect Declining ROE in the Medium-Term, Although Still High at c20%:** We expect ROE to remain high in 2009e at 25% and to decline in the medium-term to 22% by 2013e. Our assumption is based on increasing competition and deteriorating cost efficiency. Nevertheless, our forecasts offer upside risk surprise should CIB's retail banking operations grow significantly. Improving lending penetration on higher income per capita levels is another area of positive upside risk in the medium and longer-term.

• **Reiterating ST/LT Accumulate Rating:** We have increased our LTFV estimate to EGP62.70 after upgrading our earnings estimates and lowering our cost of equity assumption by 100bps to 15.5%. At the current share price of EGP56.05, the shares offer 11% upside potential, leading us to leave our ST/LT Accumulate rating unchanged. The stock now trades at a 2010e P/E of 9.7x and 2010e P/B of 2.1x (ex-Goodwill), on the high side of MENA bank multiples (ex-Morocco). We nevertheless believe that above average multiples are justified by the bank's high ROE, and lower risk of credit quality deterioration vis-a-vis other MENA banks (UAE, Kuwait).

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *3,117* | *3,411* | *3,952* | *4,401* |
| *Cost to Income* | *39%* | *43%* | *41%* | *40%* |
| *Provisions to Average Gross Loans (bps)* | *139* | *42* | *60* | *60* |
| *Net Attributable Income* | *1,213* | *1,446* | *1,696* | *1,912* |
| *RoAE* | *29%* | *25%* | *24%* | *23%* |
| *ROAA* | *2.6%* | *2.3%* | *2.5%* | *2.6%* |
| | | | | |
| *EPS (EGP)* | *4.15* | *4.94* | *5.80* | *6.54* |
| *P/E (x)* | *13.5* | *11.3* | *9.7* | *8.6* |
| *Dividend Yield* | *1.8%* | *1.8%* | *1.8%* | *2.3%* |
| *P/B (ex-Goodwill) (x)* | *3.2* | *2.6* | *2.1* | *1.8* |
| *Capital Adequacy Ratio (CAR)* | *14%* | *15%* | *15%* | *16%* |
| *Loan Growth* | *29%* | *9%* | *12%* | *18%* |
| *Loans / Deposits* | *54%* | *52%* | *51%* | *54%* |
| *Provisions / NPLs* | *200%* | *172%* | *143%* | *149%* |

*Figures in EGP million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(EGP mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *1,799* | *2,033* | *1,865* | *2,329* | *2,329* |
| *Net Banking Income* | *3,117* | *3,294* | *3,411* | *3,709* | *3,952* |
| *Income before Provisions* | *2,045* | *2,087* | *2,118* | *2,390* | *2,541* |
| *Net Attributable Income* | *1,213* | *1,437* | *1,446* | *1,619* | *1,696* |

*Stock Data*

| | |
|---|---|
| *Last Ex-Div Date* | *EGP1.0 on 17 Mar. 09* |
| *Mkt Value / Shares (mn)* | *EGP16,394 / 292.5* |
| *Av. Mthly Liqd. (mn)* | *EGP658* |
| *52- Week High / Low* | *EGP58.99 / 23.87* |
| *Bloomberg / Reuters* | *CMIB EY / COMI.CA* |
| *Est. Free-float* | *81%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In EGP million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **753** | **1,799** | **956** | **1,865** | **2,329** | **2,580** |
| Fee Income | 414 | 748 | 344 | 688 | 812 | 974 |
| FX Income | 187 | 326 | 167 | 316 | 293 | 293 |
| Trading & Investment Income | 220 | 231 | 313 | 527 | 504 | 542 |
| Property and Other Income | 38 | - | (8) | - | - | - |
| **Non-Interest Income** | **860** | **1,319** | **816** | **1,546** | **1,624** | **1,821** |
| **Total Banking Income** | **1,613** | **3,117** | **1,772** | **3,411** | **3,952** | **4,401** |
| Total Expenses | (450) | (1,072) | (625) | (1,293) | (1,411) | (1,515) |
| **Operating Profit** | **1,164** | **2,045** | **1,147** | **2,118** | **2,541** | **2,886** |
| Provisions | (70) | (245) | (62) | (135) | (212) | (245) |
| Other | 44 | (184) | - | - | - | - |
| **Pre-Tax Income** | **1,138** | **1,616** | **1,084** | **1,983** | **2,329** | **2,641** |
| Taxes | (146) | (251) | (174) | (347) | (408) | (475) |
| Minority Interests | (2) | 5 | (3) | (2) | (5) | (5) |
| **Net Income after Minorities** | **990** | **1,371** | **907** | **1,634** | **1,917** | **2,160** |
| Directors' & Employees' Profit Share | (114) | (158) | (105) | (188) | (220) | (248) |
| **Net Attributable Income** | **877** | **1,213** | **803** | **1,446** | **1,696** | **1,912** |

Source: Commercial International Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)
In EGP million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 7,220 | 4,473 | 4,115 | 4,631 | 4,863 | 5,252 |
| Interbank Assets | 14,669 | 6,572 | 7,944 | 8,821 | 8,799 | 8,523 |
| Customer Loans | 24,196 | 26,330 | 27,162 | 28,795 | 32,349 | 38,298 |
| Domestic Treasury Bills | 2,777 | 12,457 | 11,173 | 13,454 | 15,472 | 17,173 |
| Other Financial Investments | 4,676 | 4,803 | 9,702 | 9,878 | 10,706 | 11,283 |
| Goodwill | - | 201 | 200 | 201 | 201 | 201 |
| Other Assets | 2,185 | 1,878 | 1,855 | 2,536 | 3,898 | 3,846 |
| Fixed Assets | 618 | 748 | 805 | 793 | 841 | 891 |
| **Total Assets** | **56,343** | **57,462** | **62,956** | **69,108** | **77,129** | **85,467** |
| Deposits from Banks & Other Fin Inst | 4,153 | 229 | 3,574 | 2,205 | 1,886 | 1,420 |
| Customer Deposits | 45,618 | 48,790 | 50,798 | 55,133 | 62,851 | 71,022 |
| Sub Debt, Medium-Term Loans & Other Debt | 126 | 109 | 108 | 125 | 135 | 130 |
| Other Liabilities | 1,461 | 2,468 | 2,114 | 4,609 | 3,779 | 2,764 |
| Proposed Dividend | - | 450 | - | 480 | 513 | 629 |
| **Shareholders' Equity** | **4,981** | **5,367** | **6,308** | **6,506** | **7,909** | **9,441** |
| Minority Interests | 4 | 49 | 54 | 51 | 55 | 61 |
| **Total Liabilities & Shareholders' Equity** | **56,343** | **57,462** | **62,956** | **69,108** | **77,129** | **85,467** |

Source: Commercial International Bank, EFG-Hermes estimates

### Ratios (December Year End)

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio (CAR) | 12.8% | 11.7% | 14.1% | 14.6% | 15.2% | 16.0% |
| Loans / Deposits | 53.0% | 54.0% | 53.5% | 52.2% | 51.5% | 53.9% |
| NPL Coverage Ratio | N/A | 199.7% | 203.0% | 171.8% | 142.9% | 149.4% |
| Net Interest Spread* | 2.56% | 3.18% | 3.12% | 2.75% | 3.06% | 3.10% |
| Cost / Income Ratio | 34.9% | 39.5% | 41.2% | 43.4% | 41.3% | 40.1% |
| Provisioning (bps)* | 57.6 | 138.6 | 43.0 | 42.0 | 60.0 | 60.0 |
| RoAE* | 37.2% | 29% | 26.3% | 25% | 24% | 23% |
| RoAA* | 3.1% | 2.6% | 2.6% | 2.3% | 2.5% | 2.6% |
| EPS* | 5.99 | 4.15 | 5.49 | 4.94 | 5.80 | 6.54 |
| BVPS | 17.03 | 17.66 | 20.88 | 21.56 | 26.36 | 31.59 |
| DPS | - | 1.00 | - | 1.00 | 1.00 | 1.30 |

*Annualised for 1H data
Source: Commercial International Bank, EFG-Hermes estimates

# NSGB - A PROFITABLE FRANCHISE TRADING AT A DISCOUNT

06 OCTOBER 2009

EGYPT | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Buy | Current Price*: | EGP 28.50 |
| Long-Term Rec. : | Buy | LT Fair Value : | EGP 38.19 |

• **Low Risk Profile, but Track Record of Dynamic Growth:** National Societe Generale Bank (NSGB) has a strong corporate business and a leading position in syndications and structured finance deals. The bank launched its retail banking business in the late 1990s, and has primarily targeted customer acquisition through payroll accounts. It is currently focusing on higher-margin retail clients and developing its SMEs/professionals business. Over the past decade, NSGB has been one of the fastest growing banks in Egypt by assets, retail customers and branches. In 2006 it bought MIBank, a mid-sized Egyptian bank, to accelerate its expansion in Egypt.

• **2Q2009 Results - Lower Provisions Recoveries, as Expected:** NSGB's 2Q2009 earnings fell 27% Y-o-Y and 18% Q-o-Q, as 2Q2009 did not witness the same high level of provision write-backs, relating to MIBank, that had been seen in both 2Q2008 and 1Q2009. Provisions were nevertheless lower than expected, and 2Q2009 earnings outperformed our forecasts by 4%. The NPL ratio increased to 7.1% in June 2009 from 6.7% in March 2009. According to management, this increase relates to specific clients rather than being a deteriorating trend across the loan portfolio. NSGB's loan growth has been strong over the past three years, with exposure primarily to the large corporate sector. Retail loans, backed by salary accounts, represent 15% of the loan book. The bank has almost no exposure to the more cyclical sectors such as tourism and real estate.

• **Loan Growth Should Resume in 2010e:** The loan book contracted 1% in 1H2009 vs. December 2008. This reflects delayed investment plans in the corporate sector and tighter credit lending requirements in the retail business. We expect a slightly better performance in 2H2009 and estimate a loan growth of 7% Y-o-Y in FY2009e. In 2010e we expect loan growth to rebound to 12%. We have upgraded our medium-term loan growth forecasts to 15% from our previous 11% estimate.

• **ROE Understated by Goodwill Amortisation Charges:** NSGB amortises the goodwill generated on the MIBank acquisition over a period of five years, up until 2010e. Amortisation charges mask the true profitability of the bank. We estimate NSGB's ROE ex-goodwill at a very strong 29% in 2009e (from 37% in 2008), the highest in our Egypt coverage.

• **Reiterating ST/LT Buy**: NSGB trades at a 2010e P/E of 6.6x and P/B of 1.7x (both on an ex-goodwill basis), a discount to the Egypt bank average and despite above sector-average profitability. We have increased our LTFV estimate to EGP38.19 after lowering our discount rate by 100bps to 15.5%. Our new LTFV now implies 34% upside potential. We reiterate our ST/LT Buy recommendation on the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *2,204* | *2,401* | *2,685* | *3,025* |
| *Cost to Income* | *36%* | *37%* | *37%* | *38%* |
| *Provisions to Avg. Gross Loans (bps)* | *(104.5)* | *19.0* | *30.0* | *28.7* |
| *Attributable Income* | *1,065* | *905* | *1,040* | *1,519* |
| *RoAE (ex-Goodwill)* | *37%* | *29%* | *28%* | *25%* |
| *ROAA (ex-Goodwill)* | *3.1%* | *2.7%* | *2.7%* | *2.6%* |
| *EPS (ex-Goodwill) (EGP)* | *4.39* | *3.91* | *4.31* | *4.56* |
| *P/E (x)* | *6.5* | *7.3* | *6.6* | *6.3* |
| *Dividend Yield* | *4.4%* | *3.5%* | *3.5%* | *4.0%* |
| *P/B (ex-Goodwill) (x)* | *2.7* | *2.1* | *1.7* | *1.4* |
| *Capital Adequacy Ratio (CAR)* | *14%* | *14%* | *15%* | *16%* |
| *Loan Growth* | *27%* | *7%* | *12%* | *16%* |
| *Loans / Deposits* | *68%* | *66%* | *68%* | *72%* |
| *Provisions / NPLs* | *110%* | *103%* | *96%* | *92%* |

*Figures in EGP million unless otherwise stated*


*Estimate Changes*

| *(EGP mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Interest Income* | *1,428* | *1,698* | *1,651* | *1,847* | *1,836* |
| *Net Banking Income* | *2,204* | *2,429* | *2,401* | *2,651* | *2,685* |
| *Income before Provisions* | *1,481* | *1,605* | *1,577* | *1,752* | *1,761* |
| *Attributable Income* | *1,065* | *918* | *905* | *1,032* | *1,040* |

*Stock Data*

| | |
|---|---|
| *Last Div. Date* | *EGP1.0 on 7 Apr 09* |
| *Mket Value / Shares (mn)* | *EGP9,467 / 332.2* |
| *Av. Monthly Liqd.* | *EGP44.0* |
| *52- Week High / Low* | *EGP31.2 / 11.8* |
| *Bloomberg / Reuters* | *NSGB EY / NSGB.CA* |
| *Est Free Float* | *23%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In EGP million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **674** | **1,428** | **836** | **1,651** | **1,836** | **2,080** |
| Fee Income | 284 | 545 | 285 | 567 | 641 | 737 |
| FX Income | (10) | 141 | 82 | 125 | 145 | 135 |
| Trading & Investment Income | 50 | 83 | 38 | 47 | 48 | 63 |
| Other Income | 4 | 7 | 3 | 11 | 15 | 10 |
| **Non-Interest Income** | **328** | **777** | **408** | **750** | **849** | **945** |
| **Total Banking Income** | **1,002** | **2,204** | **1,244** | **2,401** | **2,685** | **3,025** |
| Total Expenses | (346) | (723) | (396) | (824) | (923) | (1,034) |
| **Operating Profit** | **656** | **1,481** | **848** | **1,577** | **1,761** | **1,991** |
| Provisions | 122 | 179 | 18 | (88) | (105) | (99) |
| Goodwill Amortisation and Others | (177) | (362) | (180) | (362) | (362) | - |
| **Pre-Tax Income** | **602** | **1,298** | **686** | **1,127** | **1,295** | **1,891** |
| Taxes | (53) | (160) | (118) | (158) | (181) | (265) |
| **Net Income** | **548** | **1,138** | **568** | **969** | **1,114** | **1,627** |
| Directors' & Employees' Profit Share | (36) | (72) | (32) | (64) | (74) | (108) |
| **Net Attributable Income** | **512** | **1,065** | **536** | **905** | **1,040** | **1,519** |

Source: NSGB, EFG-Hermes estimates

### Balance Sheet (December Year End)

In EGP million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 3,168 | 3,103 | 3,711 | 3,444 | 3,754 | 4,054 |
| Interbank Assets | 9,812 | 9,027 | 7,155 | 8,189 | 10,265 | 10,605 |
| Customer Loans | 22,205 | 25,011 | 24,796 | 26,860 | 30,154 | 34,476 |
| Domestic Treasury Bills | 2,491 | 2,976 | 3,919 | 4,226 | 4,565 | 4,930 |
| Other Financial Investments | 551 | 3,801 | 5,586 | 5,550 | 5,803 | 6,266 |
| Goodwill | 905 | 724 | 543 | 362 | - | - |
| Other Assets | 4,391 | 675 | 804 | 688 | 701 | 711 |
| Fixed Assets | 709 | 730 | 758 | 781 | 812 | 844 |
| **Total Assets** | **44,233** | **46,047** | **47,271** | **50,101** | **56,054** | **61,887** |
| Deposits from Banks & Other Fin. Inst | 846 | 1,460 | 405 | 1,228 | 1,339 | 1,928 |
| Customer Deposits | 36,434 | 36,889 | 39,009 | 40,947 | 44,632 | 48,203 |
| Sub Debt, MT Loans & Other Debt | 807 | 772 | 843 | 658 | 544 | 430 |
| Other Liabilities | 2,065 | 2,238 | 2,086 | 2,065 | 3,646 | 4,238 |
| Proposed Dividend | - | 405 | - | 398 | 407 | 491 |
| Shareholders' Equity | 4,082 | 4,283 | 4,927 | 4,805 | 5,486 | 6,597 |
| Minority Interests | - | - | - | - | - | - |
| **Total Liabilities & Shareholders' Equity** | **44,233** | **46,047** | **47,271** | **50,101** | **56,054** | **61,887** |

Source: NSGB, EFG-Hermes estimates

### Ratios (December Year End)

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio (CAR) | 13.4% | 13.8% | 15.0% | 14.2% | 15.4% | 15.9% |
| Loans / Deposits | 60.9% | 67.8% | 63.6% | 65.6% | 67.6% | 71.5% |
| NPL Coverage Ratio | 106.0% | 110.0% | 107.7% | 102.6% | 96.2% | 91.8% |
| Net Interest Spread* | 2.83% | 2.91% | 2.89% | 3.00% | 3.04% | 3.02% |
| Cost / Income Ratio | 38.1% | 36.0% | 34.4% | 37.0% | 37.1% | 37.8% |
| Provisioning (bps)* | (49) | (105) | (15) | 19 | 30 | 29 |
| RoAE (Ex-Goodwill)* | 35.5% | 36.8% | 29.8% | 28.7% | 27.9% | 25.1% |
| RoAA (Ex-Goodwill)* | 3.02% | 3.13% | 2.98% | 2.71% | 2.71% | 2.58% |
| EPS (Ex- Goodwill) | 4.16 | 4.39 | 4.30 | 3.91 | 4.31 | 4.56 |
| BVPS (Ex- Goodwill) | 9.53 | 10.68 | 13.16 | 13.33 | 16.46 | 19.80 |
| DPS | - | 1.25 | - | 1.00 | 1.00 | 1.15 |

*Annualised for 1H data

Source: NSGB, EFG-Hermes estimates

# CREDIT AGRICOLE EGYPT - RESTRUCTURING STORY

06 OCTOBER 2009

EGYPT | BANKS

| Short-Term Rec.: | Accumulate | Current Price*: | EGP 12.71 |
|---|---|---|---|
| Long-Term Rec. : | Buy | LT Fair Value : | EGP 16.65 |

- **Significant Untapped Potential to Increase Lending:** CAE remains the only restructuring story within our "large-cap" Egyptian banks. Since France's Credit Agricole and its partner Mansour & Maghraby Group bought Egyptian American Bank (subsequently re-branded Credit Agricole Egypt) three years ago, asset growth has been strong and well above its peers. We believe there is nevertheless still significant potential for strong loan growth in the medium-term. CAE's loan to deposit ratio is well below the sector average at just 40%, and the bank has a strong excess capital cushion, almost entirely core capital, to support medium-term loan growth. Furthermore, legacy NPLs are sufficiently covered.

- **2Q2009 Results - Strong Loan Growth, Stable Asset Quality, Spreads Decline:** CAE's earnings fell 23% Y-o-Y and 26% Q-o-Q, as 2Q2008 and 1Q2009 results were boosted by provision write-backs and a low tax rate. Loan growth was above sector average at 7% Q-o-Q in June 2009 (up 11% Y-o-Y). However, Q-o-Q spreads compression was higher than its peers, partly due to CAE's higher proportion of FX interbank loans in its asset mix, given 2Q2009's USD LIBOR declines. Provisioning charges were primarily driven by loan growth and were limited to generic provisions. Credit quality remained unchanged in 2Q2009, according to management.

- **Expect 29% Y-o-Y Decline in Earnings, Reflecting an Increase in Tax Rate:** We forecast FY2009e net attributable profit to decline by 29%, mainly reflecting 2008's large provision write-backs and a very low tax rate when the bank was still using brought-forward losses. Our forecasts assume 10% loan growth in 2009e, an increase in spreads vs. 2008 (which was negatively impacted by one-off expensive deposits), sluggish fee income growth, and operating costs above inflation. We estimate ROE to decline, but to remain high at 19.8%.

- **Revenue Returns, Cost Efficiency Should Converge to Peers in the Medium-Term:** CAE has two key underperforming areas vs. its peers, (i) revenue returns, particularly fee income and other non-interest income, and (ii) cost efficiency. While we do not expect the cost to income ratio to improve in the short-term, because of branch openings, we expect the level to converge in the medium to longer-term as CAE's operations in Egypt mature. Increasing lending exposure in the asset mix should also improve revenue returns.

- **Valuation and Recommendation:** We have raised our LTFV to EGP16.65 (from EGP15.5) after lowering our discount rate by 100bps to 15.5%. CAE's share price has recently underperformed other Egyptian banks and now trades at attractive multiples of 8.1x 2010e P/E and 1.9x 2010e P/B, with 2010e's ROE estimated at 24%. With our new LTFV implying 31% upside potential, we raise our rating to ST Accumulate / LT Buy from ST Neutral/LT Accumulate.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *1,000* | *1,070* | *1,299* | *1,450* |
| *Cost to Income* | *52%* | *55%* | *52%* | *52%* |
| *Provisions to Avg. Gross Loans* | *0.15%* | *0.58%* | *0.70%* | *0.50%* |
| *Attributable Income* | *430* | *343* | *450* | *514* |
| *RoAE* | *26.3%* | *19.8%* | *24.2%* | *25.2%* |
| *ROAA* | *2.0%* | *1.5%* | *1.7%* | *1.8%* |
| | | | | |
| *EPS (EGP)* | *1.67* | *1.19* | *1.57* | *1.79* |
| *P/E (x)* | *7.6* | *10.6* | *8.1* | *7.1* |
| *Dividend Yield* | *8.7%* | *7.1%* | *7.9%* | *8.7%* |
| *P/B (x)* | *2.2* | *2.1* | *1.9* | *1.7* |
| *Capital Adequacy Ratio (CAR)* | *19.0%* | *17.8%* | *17.0%* | *16.0%* |
| *Loan Growth* | *50%* | *10%* | *14%* | *17%* |
| *Loans / Deposits* | *37%* | *38%* | *40%* | *44%* |
| *Provisions / NPLs* | *120%* | *133%* | *125%* | *129%* |

*Figures in EGP million unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(EGP mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *600* | *662* | *668* | *788* | *839* |
| *Net Banking Income* | *1,000* | *1060* | *1,070* | *1243* | *1,299* |
| *Income before Provisions* | *469* | *508* | *514* | *626* | *676* |
| *Attributable Income* | *430* | *339* | *343* | *432* | *450* |

*Stock Data*

| | |
|---|---|
| *Last Ex-Div. Date* | *EGP1.1 on 21 Apr. 09* |
| *Mkt Value / Shares (mn)* | *EGP3,647 / 287.0* |
| *Av. Monthly Liqd.* | *EGP23.7* |
| *52- Week High / Low* | *EGP14.5 / 6.5* |
| *Bloomberg / Reuters* | *CIEB EY / CIEB.CA* |
| *Est Free Float* | *20%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In EGP million, unless otherwise stated

| | 1H2008a | 2008e | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **263** | **600** | **331** | **668** | **839** | **944** |
| Fee Income | 104 | 206 | 104 | 213 | 244 | 284 |
| Trading & Investment Income | 107 | 186 | 81 | 180 | 205 | 217 |
| Other Income | 1 | 7 | 5 | 9 | 10 | 5 |
| **Non-Interest Income** | **212** | **399** | **190** | **402** | **460** | **506** |
| **Total Banking Income** | **475** | **1,000** | **521** | **1,070** | **1,299** | **1,450** |
| Total Expenses | (290) | (530) | (275) | (556) | (623) | (698) |
| **Operating Profit** | **185** | **469** | **246** | **514** | **676** | **752** |
| Provisions | 21 | 18 | (20) | (46) | (62) | (51) |
| Other | - | 1 | - | - | - | - |
| **Pre-Tax Income** | **206** | **489** | **226** | **468** | **614** | **701** |
| Taxes | 2 | (13) | (45) | (89) | (117) | (133) |
| **Net Income** | **208** | **475** | **181** | **379** | **497** | **568** |
| Directors & Employees' Profit Share | (23) | (45) | (18) | (36) | (47) | (54) |
| **Net Attributable Income** | **185** | **430** | **163** | **343** | **450** | **514** |

Source: Credit Agricole Egypt, EFG-Hermes estimates

### Balance Sheet (December Year End)

In EGP million, unless otherwise stated

| | 1H2008a | 2008e | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 2,454 | 1,739 | 1,389 | 1,847 | 1,995 | 2,155 |
| Interbank Assets | 9,840 | 8,737 | 7,674 | 9,036 | 9,542 | 9,837 |
| Domestic Treasury Bills | 2,076 | 3,214 | 3,187 | 3,793 | 4,362 | 4,667 |
| Customer Loans | 6,777 | 6,977 | 7,551 | 7,669 | 8,732 | 10,256 |
| Other Financial Investments | 603 | 864 | 1,348 | 1,803 | 1,997 | 2,121 |
| Goodwill | - | - | - | - | - | - |
| Other Assets | 358 | 331 | 528 | 300 | 322 | 347 |
| Fixed Assets | 146 | 175 | 294 | 189 | 203 | 215 |
| **Total Assets** | **22,253** | **22,038** | **21,970** | **24,638** | **27,153** | **29,598** |
| Deposits from Banks & Other Fin Inst | 326 | 258 | 224 | 258 | 325 | 468 |
| Customer Deposits | 19,430 | 18,766 | 18,947 | 20,080 | 21,687 | 23,421 |
| Sub Debt, MT Loans & Other Debt | - | - | - | - | - | - |
| Other Liabilities | 709 | 960 | 905 | 2,229 | 2,868 | 3,201 |
| Proposed Dividend | | 361 | | 294 | 334 | 370 |
| **Shareholders' Equity** | **1,789** | **1,692** | **1,894** | **1,777** | **1,940** | **2,138** |
| Minority Interests | - | - | - | - | - | - |
| **Total Liabilities & Shareholders Equity** | **22,253** | **22,038** | **21,970** | **24,638** | **27,153** | **29,598** |

Source: Credit Agricole Egypt, EFG-Hermes estimates

### Ratios (December Year End)

| | 1H2008a | 2008e | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio (CAR) | N/A | 19.0% | N/A | 17.8% | 17.0% | 16.0% |
| Loans / Deposits | 34.9% | 37.2% | 39.9% | 38.2% | 40.3% | 43.8% |
| NPL Coverage Ratio | N/A | 120% | N/A | 133% | 125% | 129% |
| Net Interest Spread* | 1.95% | 2.36% | 2.40% | 2.55% | 2.70% | 2.74% |
| Cost / Income Ratio | 65.8% | 52.5% | 56.3% | 55.4% | 51.6% | 51.8% |
| Provisioning (bps)* | N/A | 0.15% | N/A | 0.58% | 0.70% | 0.50% |
| RoAE* | 21.3% | 26.3% | 17.5% | 19.8% | 24.2% | 25.2% |
| RoAA* | 1.62% | 1.98% | 1.46% | 1.47% | 1.74% | 1.81% |
| EPS* | 1.29 | 1.67 | 1.13 | 1.19 | 1.57 | 1.79 |
| BVPS | 6.23 | 5.90 | 6.60 | 6.19 | 6.76 | 7.45 |
| DPS | - | 1.10 | - | 0.90 | 1.00 | 1.10 |

*Annualised for 1H data

Source: Credit Agricole Egypt, EFG-Hermes estimates

# BLOM BANK - CONSERVATIVE WITH HIGH RETURNS

06 OCTOBER 2009

LEBANON | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Accumulate | Current Price*: | USD 84.00 |
| Long-Term Rec. : | Buy | LT Fair Value : | USD 104.2 |

• **A Conservative, but Strong Franchise in Lebanon:** BLOM is a leading deposit franchise in Lebanon, with an estimated market share of c20% as of June 2009, close to that of its peer Bank Audi. BLOM is nevertheless a much smaller lender than Audi and we estimate its domestic lending market share at 12% as of June 2009. BLOM started its regional expansion in 2004 and is now present in Egypt, Syria, Qatar, Saudi Arabia and Jordan. The contribution of regional entities to consolidated earnings has increased from 5% in 2005 to 19% in 2008. Despite its conservative lending approach compared to its peers, BLOM Bank is the most profitable bank in Lebanon by ROE, which stood at 22% (adjusting for preferred dividends) in 2008.

• **2Q2008 Results - Minimal Provisioning Effort:** BLOM reported a 1% Y-o-Y (against a strong 2Q2008 comparable) and 19% Q-o-Q increase in earnings. Spreads were roughly flat Q-o-Q, as were commissions, with the strong Q-o-Q increase in net profit driven by a provision release. BLOM is one of the few banks in our MENA coverage that has released provisions in 2Q2009, highlighting that credit quality is not an issue for the bank. Deposit growth was solid at 5% Q-o-Q and 9% since December 2008, with most of the growth driven by LBP deposits, as per the recent sector trends.

• **Slight Increase in Earnings Forecasts:** We have increased our earnings forecasts by 8% in 2009e and now expect net attributable earnings to expand by 8% Y-o-Y. BLOM and the other Lebanese banks we cover are perhaps the only MENA banks with expanding earnings in 2009e, despite lower Y-o-Y spreads on a declining USD Libor. BLOM's 2009e earnings growth is largely driven its low reliance on investment income, strong cost control and low provisioning effort. We expect loan growth to resume in 2010e, to 12% from 8% in 2009e, and see a recovery in spreads assuming a slight increase in global interest rates. We forecast 13% earnings growth in 2010e.

• **Capital Sufficient to Support Asset Growth over the Next Three Years:** With the expected softening in asset growth rates over the next three years (compared to the highs seen in 2007-2008) and the controlled expansion of the activities of its regional subsidiaries, we estimate that BLOM's current capital position should allow it to support asset growth. The capital adequacy ratio (based on Basel II) stood at 12.1% in 2008, compared to the 8% minimum (estimated) required by the central bank.

• **Reiterating ST Accumulate / LT Buy:** We believe that BLOM's current valuation of 2010e P/E of 6.4x and P/B of 1.2x fails to reflect its conservative profile, high profitability and the medium-term growth opportunities of its regional subsidiaries. Lebanese banks have tended to trade at a discount to their regional peers, partly owing to political uncertainty. Despite the strong performance of the shares over the past month, we see still value in them. Our revised LTFV, after lowering the discount rate by 50bps, is USD104.2 (from USD91.6) and suggests a 24% upside potential. We reiterate our ST Accumulate / LT Buy rating on the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *515.1* | *520.5* | *584.2* | *660.2* |
| *Cost to Income* | *43%* | *42%* | *41%* | *40%* |
| *Provisions to Avg. Gross Loans (bps)* | *(9.2)* | *18.5* | *34.2* | *23.0* |
| *Net Income (Common)* | *226.4* | *245.4* | *276.9* | *315.9* |
| *RoAE* | *21.7%* | *20.6%* | *20.2%* | *19.9%* |
| *ROAA* | *1.4%* | *1.4%* | *1.4%* | *1.4%* |
| | | | | |
| *EPS (Common) (USD)* | *10.68* | *11.58* | *13.07* | *14.91* |
| *P/E (x)* | *7.9* | *7.3* | *6.4* | *5.6* |
| *Dividend Yield* | *5.4%* | *5.4%* | *5.5%* | *5.7%* |
| *P/B (Common) (x)* | *1.6* | *1.4* | *1.2* | *1.1* |
| *Capital Adequacy Ratio* | *12.1%* | *12.8%* | *13.0%* | *13.9%* |
| *Loan Growth* | *25%* | *7%* | *9%* | *14%* |
| *Loans / Deposits* | *23%* | *21%* | *21%* | *22%* |
| *Provisions / NPLs* | *80%* | *85%* | *95%* | *90%* |

*Figures in USD million, unless otherwise stated*


**Estimate Changes**

| *(USD mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Interest Income* | *410* | *413* | *409* | *474* | *480* |
| *Net Banking Income* | *515* | *519* | *521* | *576* | *584* |
| *Income before Provisions* | *319* | *314* | *332* | *344* | *373* |
| *Net Income (Common)* | *226* | *227* | *245* | *250* | *277* |

**Stock Data**

| | |
|---|---|
| *Last Ex-Div Date* | *USD3.47 on 15 Apr. 09* |
| *Mkt Value / Shares (mn)* | *USD1,806 / 21.5* |
| *Av. Mthly Lid.* | *USD8.4* |
| *52- Week High / Low* | *USD87 /60* |
| *Bloomberg / Reuters* | *BQLB LB / BLBD.BY* |
| *Est. Free Float* | *55%* |

**Prices as at 02 October 2009 (GDR)*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **188** | **410** | **202** | **409** | **480** | **545** |
| Fees & Commissions Income | 35 | 74 | 33 | 69 | 78 | 89 |
| Trading & Investment Income | 22 | 31 | 21 | 42 | 27 | 27 |
| Other Income | 25.3 | 45.0 | 22.5 | 48.4 | 46.4 | 45.1 |
| **Non-Interest Income** | **57** | **105** | **54** | **160** | **151** | **160** |
| **Total Banking Income** | **270** | **560** | **278** | **569** | **631** | **705** |
| Total Expenses | (115) | (241) | (122) | (237) | (258) | (283) |
| **Operating Profit** | **155** | **319** | **156** | **332** | **373** | **423** |
| Provisions | 1 | (19) | 7 | (7) | (13) | (10) |
| Other | 1 | 3 | - | 1 | 0 | 0 |
| **Pre-Tax Income** | **157** | **304** | **164** | **326** | **359** | **413** |
| Taxes | (26) | (52) | (26) | (55) | (61) | (70) |
| Net Income | 131 | 252 | 138 | 271 | 298 | 343 |
| Minority Interests | (4) | (9) | (5) | (9) | (12) | (17) |
| **Net Income after Minority** | **127** | **242** | **133** | **261** | **286** | **325** |
| Preferred Dividend | - | (16) | - | (16) | (10) | (10) |
| **Net Income (Common)** | **127** | **226** | **133** | **245** | **277** | **316** |

Source: Blom Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & Central Bank Deposits | 4,485 | 2,375 | 2,528 | 2,731 | 2,977 | 3,245 |
| Interbank Assets | 4,375 | 3,859 | 3,885 | 4,317 | 4,329 | 4,719 |
| Customer Loans | 3,357 | 3,470 | 3,597 | 3,712 | 4,047 | 4,613 |
| Financial Investments | 4,873 | 7,666 | 8,864 | 8,727 | 9,684 | 10,569 |
| Associates Investments | - | - | - | - | - | - |
| Goodwill | 39 | 42 | 42 | 43 | 40 | 40 |
| Other Assets | 300 | 267 | 269 | 295 | 284 | 293 |
| Fixed Assets | 203 | 219 | 236 | 240 | 264 | 287 |
| **Total Assets** | **17,633** | **17,898** | **19,420** | **20,066** | **21,624** | **23,766** |
| Deposits from Banks & Other Fin Inst | 900 | 794 | 620 | 518 | 376 | 410 |
| Customer Deposits | 14,786 | 15,016 | 16,572 | 17,268 | 18,822 | 20,516 |
| Sub debt, MT Loans & Other Debt | - | - | - | - | - | - |
| Other Liabilities | 718 | 629 | 715 | 550 | 580 | 747 |
| Proposed Dividend | - | 94 | - | 94 | 90 | 92 |
| Preferred Equity | 175 | 175 | 175 | 175 | 100 | 100 |
| Common Shareholders' Equity | 989 | 1,109 | 1,257 | 1,370 | 1,553 | 1,780 |
| Minority Interests | 64 | 80 | 80 | 90 | 102 | 120 |
| **Total Liabilities & Shareholders' Equity** | **17,633** | **17,898** | **19,420** | **20,066** | **21,624** | **23,766** |

Source: Blom Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 12.1% | N/A | 12.8% | 13.0% | 13.9% |
| Loans / Deposits | 22.7% | 23.1% | 21.7% | 21.5% | 21.5% | 22.5% |
| NPL Coverage Ratio | N/A | 80.0% | N/A | 85.0% | 95.2% | 90.4% |
| Net Interest Spread* | 1.8% | 2.0% | 1.8% | 1.8% | 2.0% | 2.1% |
| Cost / Income Ratio | 42.7% | 43.0% | 43.9% | 41.6% | 40.9% | 40.1% |
| Provisioning (bps)* | N/A | (9.2) | N/A | 10.0 | 10.0 | 19.0 |
| RoAE* | 24.1% | 21.7% | 20.3% | 20.6% | 20.2% | 19.9% |
| RoAA* | 1.3% | 1.4% | 1.3% | 1.4% | 1.4% | 1.4% |
| EPS* | 11.22 | 10.68 | 11.85 | 11.58 | 13.07 | 14.91 |
| BVPS | 45.99 | 51.57 | 58.46 | 59.33 | 68.46 | 79.31 |
| DPS | - | 3.47 | - | 3.47 | 3.56 | 3.66 |

*Annualised for 1H data

Source: Blom Bank, EFG-Hermes estimates

المجموعة المالية - هيرميس
EFG HERMES

# BANK AUDI - INCREASINGLY DIVERSIFIED

06 OCTOBER 2009

LEBANON | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | N/R** | Current Price*: | USD 72.9 (GDR) |
| Long-Term Rec. : | N/R** | LT Fair Value : | N/R** |

- **Diversification Drive Continues Despite a Slowdown in Investment:** Bank Audi now sources 19% of its total assets and 19% of earnings from its MENA subsidiaries outside of Lebanon. Its regional expansion drive only started in 2004, and has primarily involved greenfields (Syria, Qatar, Saudi Arabia, Jordan) or acquisitions of small subsidiaries that it is currently scaling up (Egypt).Bank Audi has slowed down branch expansion in most markets, but this follows 3 years of strong investment in its regional subsidiaries.

- **2Q2009 Results - Improvement in Spreads Despite Weak USD LIBOR:** Bank Audi reported a 3% Y-o-Y increase in 1H2009 earnings and a 4% Y-o-Y decline in 2Q2009, although it should be borne in mind that 2Q2008 earnings for Lebanese banks were boosted by high investment gains. While spreads are under pressure Y-o-Y, with lower USD Libor rates squeezing yields on USD-interbank assets, spreads have nevertheless improved slightly Q-o-Q reflecting a better pricing of lending. Deposit growth remained strong at 9% Q-o-Q and 11% since December 2008. The provisioning effort increased slightly in 2Q2009, to 6% of banking income from 3% in 1Q2009. Bank Audi has confirmed a small exposure to Algosaibi of just 0.06% of loan book, 50% of which was provided for in 2Q2009.

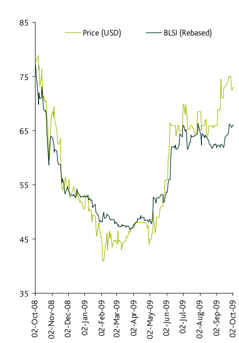
- **Expect 11% Y-o-Y Increase in 2009e Earnings:** Following new management guidance pointing to a solid performance in 3Q2009 and a continued improvement in spreads, we have increased our 2009e net profit forecast (before preferred dividends) by 10% to USD258 million, a Y-o-Y increase of 10%. Our forecasts are nevertheless slightly conservative vs. management target's, especially on spreads. Adjusting for dividends to preferred shareholders, we estimate attributable net income of USD248 million, a 15% Y-o-Y increase.

- **Increasing Lending to Assets Ratio should Enhance ROE:** Audi and Lebanese banks exhibit lower profitability vis-à-vis other MENA banks (ex Morocco and Kuwait), despite higher balance sheet gearing, due to their particular balance sheet structure. Currently, Audi's loans to total assets ratio accounts for just 35%. However, we assume that by 2013e (under a normal deposit growth rate scenario) this ratio will improve to 45%, reflecting the bank's drive to increase lending to regional corporations and the growth of its regional entities. We therefore expect ROE to improve to 18% in 2013e, from 15% in 2009e.

- **Multiples Still Attractive:** Despite the 10% increase in the share price (for the GDR) over the past month, Bank Audi continues to trade at an attractive 2010e P/E of 9.3x and P/B of 1.3x. We do not issue a fair value or recommendation on Audi as EFG-Hermes has a c29% stake in the bank.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *617* | *655* | *729* | *831* |
| *Cost to Income* | *55%* | *51%* | *50%* | *49%* |
| *Provisions to Avg. Gross Loans (bps)* | *9.5* | *45.6* | *34.3* | *22.7* |
| *Net Income (Common)* | *215* | *248* | *283* | *339* |
| *RoAE* | *14.5%* | *15.1%* | *15.5%* | *16.4%* |
| *RoAA* | *1.24%* | *1.18%* | *1.21%* | *1.33%* |
| | | | | |
| *EPS (Common) (USD)* | *6.48* | *7.48* | *7.83* | *9.05* |
| *P/E (x)* | *11.3* | *9.8* | *9.3* | *8.1* |
| *Dividend Yield* | *4.4%* | *4.4%* | *4.4%* | *4.5%* |
| *P/B (Common) (x)* | *1.6* | *1.4* | *1.3* | *1.2* |
| *Capital Adequacy Ratio* | *13.2%* | *12.1%* | *12.0%* | *11.9%* |
| *Loan Growth* | *32%* | *7%* | *8%* | *11%* |
| *Loans / Deposits* | *36%* | *33%* | *33%* | *33%* |
| *Provisions / NPLs* | *90%* | *82%* | *85%* | *90%* |

*Figures in USD million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(USD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *423* | *414* | *414* | *500* | *517* |
| *Net Banking Income* | *617* | *633* | *655* | *703* | *729* |
| *Income before Provisions* | *299* | *319* | *347* | *352* | *389* |
| *Net Income (Common)* | *215* | *228* | *248* | *253* | *283* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *USD2.16 on 17 Apr. 09* |
| *Mkt Value / Shares (mn)* | *USD2,493 / 34.2* |
| *Av. Mthly Lid.* | *USD3.4* |
| *52- Week High / Low* | *USD79 / 41* |
| *Bloomberg / Reuters* | *BKAD LB / AUSRq.L* |
| *Est. Free Float* | *65%* |

**Prices as at 02 October 2009*
***We do not issue a recommendation or fair value on Bank Audi as EFG-Hermes owns a 29% stake in the bank*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **201** | **423** | **204** | **414** | **517** | **590** |
| Fee Income | 72 | 141 | 68 | 143 | 164 | 192 |
| Trading & Investment Income | 58 | 53 | 52 | 98 | 48 | 50 |
| Other Income | 25.5 | 44.1 | 25.8 | 50 | 51 | 52 |
| **Non-Interest Income** | **130** | **194** | **120** | **290** | **263** | **294** |
| **Total Banking Income** | **356** | **661** | **350** | **705** | **780** | **884** |
| Total Expenses | (186) | (362) | (172) | (358) | (391) | (431) |
| **Operating Profit** | **171** | **299** | **178** | **347** | **389** | **453** |
| Provisions | (13) | (14) | (16) | (28) | (23) | (17) |
| Other | - | - | - | 0 | 0 | 0 |
| **Pre-Tax Income** | **158** | **285** | **162** | **319** | **366** | **436** |
| Taxes | (28) | (46) | (29) | (52) | (60) | (71) |
| Net Income | 130 | 238 | 133 | 267 | 306 | 365 |
| Minority Interests | (7) | (5) | (5) | (9) | (14) | (16) |
| **Net Income after Minority** | **124** | **233** | **128** | **258** | **293** | **349** |
| Preferred Dividend | - | (18) | - | (10) | (10) | (10) |
| **Net Income (Common)** | **124** | **215** | **128** | **248** | **283** | **339** |

Source: Bank Audi, EFG-Hermes estimates

### Balance Sheet (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 5,031 | 2,946 | 3,470 | 3,565 | 3,636 | 4,000 |
| Interbank Assets | 3,223 | 3,622 | 3,749 | 3,961 | 4,492 | 4,705 |
| Customer Loans | 5,496 | 5,959 | 6,160 | 6,376 | 6,886 | 7,643 |
| Financial Investments | 3,870 | 6,882 | 8,009 | 8,365 | 8,975 | 10,081 |
| Associates Investments | 16 | 22 | 22 | 17 | 18 | 19 |
| Goodwill | 138 | 139 | 145 | 139 | 148 | 148 |
| Other Assets | 510 | 510 | 512 | 516 | 523 | 530 |
| Fixed Assets | 324 | 331 | 364 | 336 | 342 | 348 |
| Total Assets | 18,608 | 20,410 | 22,429 | 23,274 | 25,019 | 27,474 |
| Deposits from Banks & Other Fin. Inst. | 437 | 464 | 408 | 396 | 428 | 471 |
| **Customer Deposits** | **15,374** | **17,072** | **19,033** | **19,804** | **21,388** | **23,527** |
| Sub debt, MT Loans & Other Debt | 102 | 102 | 102 | 101 | 101 | 101 |
| **Other Liabilities** | **795** | **807** | **975** | **840** | **773** | **809** |
| Proposed Dividend | - | 96 | - | 87 | 88 | 90 |
| Preferred Equity | 216 | 225 | 102 | 133 | 133 | 133 |
| Common Shareholders' Equity | 1,603 | 1,558 | 1,723 | 1,816 | 1,998 | 2,219 |
| **Minority Interests** | **82** | **87** | **86** | **96** | **109** | **123** |
| Total Liabilities & Shareholders' Equity | 18,608 | 20,410 | 22,429 | 23,274 | 25,019 | 27,474 |

Source: Bank Audi, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 13.2% | N/A | 12.1% | 12.1% | 12.2% |
| Loans / Deposits | 35.7% | 35.9% | 32.4% | 33.0% | 33.0% | 33.2% |
| NPL Coverage Ratio | N/A | 90.3% | N/A | 82.0% | 85.0% | 90.0% |
| Net Interest Spread* | 0.0% | 1.9% | 0.0% | 1.6% | 1.9% | 2.0% |
| Cost / Income Ratio | 52.1% | 54.8% | 49.2% | 50.8% | 50.2% | 48.8% |
| Provisioning (bps)* | N/A | 9.5 | N/A | 45.6 | 34.3 | 22.7 |
| RoAE* | 14.3% | 14.5% | 13.8% | 15.1% | 15.5% | 16.4% |
| RoAA* | 1.2% | 1.2% | 1.1% | 1.2% | 1.2% | 1.3% |
| EPS* | 6.91 | 6.48 | 7.40 | 7.48 | 8.53 | 10.22 |
| BVPS | 47.56 | 46.24 | 51.15 | 51.29 | 57.35 | 65.03 |
| DPS | - | 2.16 | - | 2.16 | 2.19 | 2.23 |

*Annualised for 1H data

Source: Bank Audi, EFG-Hermes estimates

# BYBLOS BANK - A LEADING CONSUMER FRANCHISE

06 OCTOBER 2009

LEBANON | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Accumulate | Current Price*: | USD 1.90 |
| Long-Term Rec. : | Buy | LT Fair Value : | USD 2.60 |

• **A Strong Consumer Franchise in Lebanon:** Byblos Bank is the third largest bank in Lebanon with a market share of 12% of system assets, loans and deposits. It has a strong franchise in consumer banking in Lebanon and the second largest branch network after Audi, highlighting scope for market share gains in the medium-term. Byblos has subsidiaries in Syria and Sudan, and representative offices in Nigeria and UAE as well as a branch in Iraq. Byblos is primarily aiming to capture regional trading flows as well as business flows from the Lebanese Diaspora in these countries. In Syria, Byblos is seeking to use its larger branch network to develop both commercial and retail banking services in the under-penetrated market.

• **2Q2009 Results - Strong Q-o-Q Increase on Lower Provisions and Taxes:** Byblos reported a 12% Y-o-Y decline in 2Q2009 earnings and a strong 58% Q-o-Q increase. The Y-o-Y decline was mostly driven by lower investment and other operating income, and against a very strong 2Q2008. The strong Q-o-Q increase in earnings was boosted by lower provisioning and a lower tax rate, with operating profit pre-provisions remaining flat Q-o-Q thanks to stability in both revenues and costs. Credit quality has remained stable Q-o-Q, according to management.

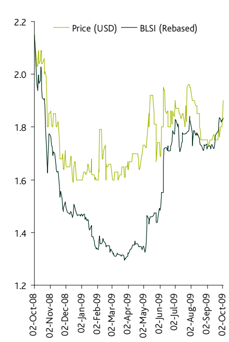
• **Expecting 7% Y-o-Y Earnings Growth in 2009e:** We estimate lending growth of 8% Y-o-Y, driven by consumer lending in Lebanon given the supportive economic backdrop and anecdotal evidence of strong private consumption on resilient remittances and strong tourism. Although we expect a rising loan loss provisioning effort, we also estimate much lower investment provisions in 2009e vs. last year. We expect loan growth to return to 10% Y-o-Y in 2010e, and earnings growth to accelerate to 11% Y-o-Y.

• **Core Capital Position Stretched:** Byblos' core capital position, excluding preferred shares and convertible bonds, is stretched with a common shareholders' equity to total assets ratio of 5.6%, vs. an average of 8% for BLOM and Audi. While the total capital adequacy ratio of 11% is well above the 8% minimum required by the central bank, Byblos has a lower excess equity cushion to allow it to be opportunistic in either regional or domestic acquisitions. Byblos has long expressed its intention of increasing its market share in Lebanon and would participate in any attractive domestic consolidation moves, although we believe that it would need to raise fresh capital to do so.

• **Valuation Multiples Undemanding:** Byblos now trades at a 2010e P/E of 7.8x and P/B of 1.0x, with the ROE estimated at 14% in 2010e. These multiples imply a large discount to MENA banks ex-UAE. At our LTFV of USD2.60 (vs. our previous 2.5 after lowering slightly the discount rate), the upside potential is 36%. We therefore reiterate our ST Accumulate / LT Buy recommendation on the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *322.8* | *348.5* | *362.5* | *399.4* |
| *Cost to Income* | *47%* | *49%* | *51%* | *52%* |
| *Provisions to Avg. Gross Loans (bps)* | *14* | *64* | *36* | *19* |
| *Net Income (Common)* | *95.6* | *102.5* | *103.0* | *118.9* |
| *RoAE* | *14.7%* | *14.1%* | *13.7%* | *14.3%* |
| *ROAA* | *1.1%* | *1.0%* | *1.0%* | *1.1%* |
| | | | | |
| *EPS (Common) (USD)* | *0.21* | *0.23* | *0.24* | *0.28* |
| *P/E (x)* | *9.0* | *8.4* | *7.8* | *6.8* |
| *Dividend Yield* | *5.2%* | *5.2%* | *5.2%* | *5.3%* |
| *P/B (Common) (x)* | *1.2* | *1.1* | *1.0* | *0.9* |
| *Capital Adequacy Ratio* | *11.9%* | *11.2%* | *10.8%* | *10.5%* |
| *Loan Growth* | *25%* | *8%* | *10%* | *12%* |
| *Loans / Deposits* | *34%* | *32%* | *31%* | *32%* |
| *Provisions / NPLs* | *95%* | *98%* | *94%* | *93%* |

*Figures in USD million, unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(USD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *236* | *243* | *243* | *290* | *269* |
| *Net Banking Income* | *323* | *339* | *348* | *395* | *399* |
| *Income before Provisions* | *176* | *172* | *181* | *188* | *201* |
| *Net Income (Common)* | *96* | *95* | *102* | *93* | *103* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *USD0.10 on 25 May 09* |
| *Mkt Value / Shares (mn)* | *USD804 / 423.12* |
| *Av. Mthly Lid.* | *USD1.3* |
| *52- Week High / Low* | *USD2.15 / 1.60* |
| *Bloomberg / Reuters* | *BYBK LB / BYB.BY* |
| *Est. Free Float* | *55%* |

**Prices as at 02 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **100** | **236** | **121** | **243** | **269** | **290** |
| Fee Income | 35 | 71 | 37 | 73 | 83 | 98 |
| Trading & Investment Income | 16 | 16 | 16 | 33 | 10 | 11 |
| Other Income | 7.6 | 11.6 | 2.4 | 10.6 | 16.6 | 18.6 |
| **Non-Interest Income** | **51** | **87** | **53** | **106** | **93** | **110** |
| **Total Banking Income** | **159** | **334** | **176** | **359** | **379** | **418** |
| Total Expenses | (81) | (158) | (89) | (178) | (194) | (217) |
| **Operating Profit** | **78** | **176** | **87** | **181** | **185** | **201** |
| Provisions | (6) | (29) | (11) | (24) | (11) | (7) |
| Other | - | - | - | - | - | - |
| **Pre-Tax Income** | **72** | **147** | **76** | **158** | **174** | **195** |
| Taxes | (12) | (25) | (13) | (27) | (30) | (33) |
| **Net Income** | **61** | **122** | **63** | **130** | **144** | **161** |
| Minority Interests | (3) | (8) | (4) | (8) | (9) | (10) |
| **Net Income after Minority** | **58** | **114** | **59** | **123** | **136** | **151** |
| Preferred Dividend | 0 | (19) | 0 | (20) | (33) | (33) |
| **Net Income (Common)** | **58** | **96** | **59** | **102** | **103** | **119** |

Source: Byblos Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In USD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | N/A | 1,343 | 1,410 | 1,526 | 1,694 | 1,863 |
| Interbank Assets | N/A | 1,676 | 2,165 | 2,003 | 1,905 | 2,096 |
| Customer Loans | N/A | 2,783 | 2,852 | 3,005 | 3,306 | 3,702 |
| Financial Investments | N/A | 5,000 | 5,424 | 5,838 | 6,277 | 6,728 |
| Associates Investments | N/A | - | - | - | - | - |
| Goodwill | N/A | - | - | - | - | - |
| Other Assets | N/A | 268 | 280 | 280 | 401 | 406 |
| Fixed Assets | N/A | 162 | 168 | 180 | 200 | 218 |
| **Total Assets** | **10,240** | **11,230** | **12,299** | **12,831** | **13,782** | **15,012** |
| Deposits from Banks & Other Fin. Inst. | N/A | 1,025 | 955 | 1,003 | 897 | 1,098 |
| Customer Deposits | N/A | 8,292 | 9,238 | 9,536 | 10,585 | 11,643 |
| Sub debt, MT Loans & Other debt | N/A | 374 | 519 | 515 | 505 | 495 |
| Other Liabilities | N/A | 465 | 611 | 523 | 453 | 333 |
| Proposed Dividend | N/A | 53 | - | 55 | 61 | 61 |
| Preferred Equity | N/A | 297 | 197 | 400 | 400 | 400 |
| **Common Shareholders' Equity** | **N/A** | **646** | **705** | **714** | **789** | **879** |
| Minority Interests | N/A | 77 | 74 | 85 | 94 | 103 |
| **Total Liabilities & Shareholders' Equity** | **10,240** | **11,230** | **12,299** | **12,831** | **13,782** | **15,012** |

Source: Byblos Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 11.9% | N/A | 12.5% | 11.8% | 11.0% |
| Loans / Deposits | N/A | 33.6% | 30.9% | 31.5% | 31.2% | 31.8% |
| NPL Coverage Ratio | N/A | 95.0% | N/A | 98.0% | 94.0% | 92.9% |
| Net Interest Spread* | N/A | 1.7% | 1.6% | 1.3% | 1.5% | 1.5% |
| Cost / Income Ratio | 50.9% | 47.3% | 50.5% | 49.5% | 51.1% | 51.9% |
| Provisioning (bps)* | N/A | 14.4 | N/A | 64.2 | 35.7 | 18.9 |
| RoAE* | N/A | 14.7% | 13.7% | 14.1% | 13.7% | 14.3% |
| RoAA* | N/A | 1.1% | 85.8% | 1.0% | 1.0% | 1.1% |
| EPS* | 0.23 | 0.21 | 0.48 | 0.23 | 0.24 | 0.28 |
| BVPS | N/A | 1.53 | 1.67 | 1.69 | 1.86 | 2.08 |
| DPS | - | 0.10 | - | 0.10 | 0.10 | 0.10 |

*Annualised for 1H data
Source: Byblos Bank, EFG-Hermes estimates

# COMMERCIAL BANK OF QATAR - BRIGHT IF TRANSLUCENT

06 OCTOBER 2009

QATAR | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: QAR 80.6 |
| Long-Term Rec. : Buy | LT Fair Value : QAR 113.5 |

• **CBQ's Franchise Still Weighted Towards Corporates**: CBQ is predominantly a corporate bank, with 64% of its revenues coming from that division in 2009 YTD. Retail banking is a smaller, but still significant division, accounting for 19% of revenues. Most of the rest comes from associates, of which the main ones are a 35% stake in National Bank of Oman, Oman's second largest bank, and a recently-acquired 40% stake in United Arab Bank, a Sharjah, UAE-based bank. Within corporate banking, the largest exposure is towards contracting and real estate, which together account for 27% of the total loan book.

• **Recent Results have Disappointed**: Although 1Q2009 earnings held up well, albeit boosted by the disposal of a tower block, these did not follow through into 2Q2009. The main issue was a pick-up in provisioning, blamed on a small number of retail loans and the restructuring of corporate property loans. In addition, costs were higher, primarily due to higher provisioning. Fee income continued to fall as a result of weaker growth in fees from corporate lending. As for other banks, spreads provided some relief from other areas of weakness, ensuring net interest income was strongly ahead.

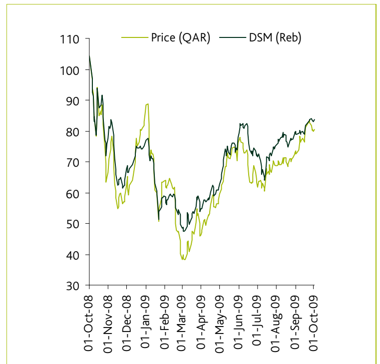
• **Minor Reduction to ST Forecasts**: In spite of weak 2Q2009 results, we trim our forecasts by just 8% for 2009e and 3% for 2010e. In 2009e, the principle changes are better net interest income, driven by better spreads, compensating for weaker investment income and, to some extent, lower fee income. However, higher costs and upwards revisions to provisioning are causing the downwards revision. We make little in the way of cost revisions for 2010e; however, we presume that lower growth opportunities are likely to mean lower-cost investments. In addition, we make less of an adjustment to provisioning longer term.

• **As Everywhere, Provisioning Continues to be Uncertain**: With lower levels of transparency at CBQ, we remain concerned at the possibility for provisioning increases. Whilst Qatar clearly has the means to address systemic provisioning issues and guarantee GRE loans, private sector lending is likely to be stressed, particularly amongst those businesses linked to a high immigration rate. We believe that we have been sufficiently cautious with CBQ, erring on the side of caution compared to guidance, but uncertainty remains. Where we have been more aggressive is in assuming currently elevated spreads are maintained, with repricing continuing to be a feature, also assuming the fees and commissions recover from the depressed state of 2Q2009.

• **Valuation and Recommendation**: CBQ trades at a significant discount to the other Qatari banks, in spite of having a narrower capital base. We believe recent weakness in results is reflected in current numbers. Given improved visibility, we have cut the discount rate by 50 basis points, boosting our estimated LTFV to QAR113.5 from QAR104.6. We maintain our recommendation of ST Accumulate / LT Buy.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *2,304* | *2,721* | *2,946* | *3,303* |
| *Cost / Income Ratio* | *33%* | *31%* | *31%* | *30%* |
| *Provisions / Avg. Loans (bps)* | *20* | *142* | *124* | *79* |
| *Attributable Income* | *1,702* | *1,720* | *1,753* | *2,183* |
| *ROAE* | *22.1%* | *16.7%* | *15.3%* | *19.0%* |
| *ROAA* | *3.19%* | *2.82%* | *2.74%* | *3.04%* |
| | | | | |
| *EPS (QAR)* | *8.84* | *7.20* | *7.33* | *9.13* |
| *P/E (x)* | *9.1* | *11.2* | *11.0* | *8.8* |
| *Dividend Yield* | *7.9%* | *7.3%* | *7.5%* | *8.0%* |
| *P/BV (x)* | *2.1* | *1.7* | *1.6* | *1.5* |
| *Capital Adequacy* | *13.4%* | *16.7%* | *15.6%* | *14.4%* |
| *Loan Growth* | *35%* | *1%* | *11%* | *15%* |
| *Loans / Deposits* | *102.8%* | *105.7%* | *104.6%* | *105.5%* |
| *Provisions / NPLs* | *49%* | *62%* | *92%* | *90%* |

*Figures in QAR million unless otherwise stated*




*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(QAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *1,292* | *1,503* | *1,710* | *1,632* | *1,770* |
| *Total Banking Income* | *2,304* | *2,668* | *2,721* | *2,942* | *2,946* |
| *Pre-Provision Income* | *1,554* | *1,884* | *1,891* | *2,029* | *2,047* |
| *Net Attributable Income* | *1,702* | *1,878* | *1,720* | *1,800* | *1,753* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *QAR7.00 on 17 Feb 09* |
| *Mkt. Cap / Shares (mn)* | *QAR18,281 / 226.8* |
| *Av. Mthly Liqd (mn)* | *QAR950.0* |
| *52-Week High / Low* | *QAR104.2 / 38.1* |
| *Bloomberg / Reuters* | *CBQK QD / COMB.QA* |
| *Est. Free Float* | *87%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **564** | **1,292** | **828** | **1,709** | **1,770** | **1,970** |
| Dividend Income | 33 | 39 | 61 | 68 | 75 | 82 |
| Fees & Commissions | 461 | 943 | 363 | 786 | 867 | 997 |
| Trading & Investments | 194 | (58) | 7 | 80 | 150 | 154 |
| Brokerage & Fund Management | - | - | - | - | - | - |
| Other Operating Income | 34 | 87 | 19 | 78 | 85 | 98 |
| **Total Non-Interest Income** | **722** | **1,012** | **451** | **1,011** | **1,177** | **1,332** |
| **Total Banking Income** | **1,286** | **2,304** | **1,279** | **2,721** | **2,946** | **3,303** |
| Total Operating Expenses | (333) | (750) | (373) | (830) | (900) | (1,007) |
| **Income before Provisions** | **953** | **1,554** | **906** | **1,891** | **2,047** | **2,296** |
| Provisions for Loans Losses | (18) | (61) | (202) | (484) | (462) | (334) |
| Associate Income & Adjustments | 104 | 210 | 240 | 314 | 168 | 220 |
| **Profit before Tax** | **1,039** | **1,702** | **943** | **1,720** | **1,753** | **2,183** |
| Tax, Minorities & Appropriations | - | - | - | - | - | - |
| **Net Attributable Income** | **1,039** | **1,702** | **943** | **1,720** | **1,753** | **2,183** |
| **Headline Income** | **1,039** | **1,702** | **943** | **1,720** | **1,753** | **2,183** |
| **Comprehensive Income** | **1,126** | **1,071** | **1,166** | **1,943** | **1,753** | **2,183** |

Source: Commercial Bank of Qatar, EFG-Hermes estimates

### Balance Sheet (December Year End)

In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 3,216 | 3,015 | 4,202 | 3,890 | 4,742 | 5,455 |
| Interbank Assets | 10,467 | 14,316 | 7,561 | 8,053 | 8,128 | 8,377 |
| Loans & Islamic Financing | 29,848 | 33,898 | 32,051 | 34,388 | 38,116 | 43,850 |
| Financial Instruments | 5,357 | 4,775 | 9,650 | 9,789 | 10,278 | 10,792 |
| Other Investments & Associates | 3,636 | 3,641 | 3,683 | 4,006 | 4,406 | 4,847 |
| Other Assets | 488 | 521 | 999 | 859 | 1,027 | 1,385 |
| Fixed Assets | 808 | 1,136 | 897 | 909 | 1,018 | 1,161 |
| Goodwill | - | - | - | - | - | - |
| **Total Assets** | **53,818** | **61,302** | **59,043** | **61,893** | **67,716** | **75,867** |
| Customer Deposits & Islamic Funding | 29,898 | 32,967 | 30,818 | 32,524 | 36,425 | 41,563 |
| Capital Market Liabilities | 7,627 | 6,096 | 5,557 | 6,096 | 6,596 | 7,096 |
| Interbank Liabilities | 7,609 | 10,923 | 10,268 | 9,840 | 10,726 | 12,227 |
| Other Financial Liabilities | - | - | - | - | - | - |
| Other Operating Items | 1,262 | 1,337 | 1,893 | 1,342 | 1,463 | 1,667 |
| Proposed Dividend | - | 1,443 | - | 1,338 | 1,376 | 1,459 |
| **Total Liabilities** | **46,396** | **52,767** | **48,535** | **51,139** | **56,585** | **64,013** |
| **Common Shareholders' Equity** | **7,422** | **8,535** | **10,508** | **10,754** | **11,131** | **11,854** |
| Minorities & Other Equity | - | - | - | - | - | - |
| **Total Liabilities & Equity** | **53,818** | **61,302** | **59,043** | **61,893** | **67,716** | **75,867** |

Source: Commercial Bank of Qatar, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 13.3% | 13.4% | 17.5% | 16.7% | 15.6% | 14.4% |
| Loans / Deposits | 99.8% | 102.8% | 104.0% | 105.7% | 104.6% | 105.5% |
| NPL Coverage Ratio | 98.4% | 48.5% | 44.0% | 61.8% | 91.7% | 90.3% |
| Net Interest Spread* | 2.33% | 2.37% | 2.59% | 2.71% | 2.69% | 2.67% |
| Cost / Income Ratio | 25.9% | 32.6% | 29.2% | 30.5% | 30.5% | 30.5% |
| Provisioning (bps) | 0.13% | 0.20% | 1.18% | 1.42% | 1.24% | 0.79% |
| RoAE* | 33.1% | 22.1% | 19.2% | 16.7% | 15.3% | 19.0% |
| RoAA* | 4.23% | 3.19% | 3.05% | 2.82% | 2.74% | 3.04% |
| EPS* | 11.26 | 8.84 | 8.32 | 7.20 | 7.33 | 9.13 |
| BVPS | 39.72 | 37.63 | 46.33 | 47.42 | 49.08 | 52.27 |
| DPS | - | 6.36 | - | 5.90 | 6.07 | 6.43 |

*Annualized for 1H data

Source: Commercial Bank of Qatar, EFG-Hermes estimates

# QATAR ISLAMIC BANK - UNTROUBLED

06 OCTOBER 2009

QATAR | BANKING

| Short-Term Rec.: Neutral | Current Price*: QAR 90.0 |
|---|---|
| Long-Term Rec. : Accumulate | LT Fair Value : QAR 108.8 |

- **QIB's Loan Book Weighted to SME, Property and Consumer**: QIB does not report divisional earnings, preferring instead to give greater breakdown of the lending book. Within that, 56% of its lending is to the corporate sector, including just under half related to the SME sector, 20% is to the retail sector, predominantly in consumer financing, and 18% consists of finance with real estate mortgages, which includes both retail and corporate mortgages. In addition, just 6% relates to government and GRE lending.

- **Recent Results Beat Forecasts**: Results for QIB frequently surprise, and in 2Q2009 they were in keeping with this, jumping 32% Q-o-Q, in spite of global weakness. QIB's 2Q2009 net attributable income was a record for the bank, in spite of investment income being down significantly from its peak. The main reasons were elevated spreads, in common with the rest of the sector, as well as partially recovering investment income, combined with falling costs and, most surprisingly, a net write-back of provisions, with the latter likely being impacted by the buy-out of the property portfolios.

- **Nevertheless, Reducing Forecasts**: Recent results notwithstanding, we believe the second half will be weaker than the first half, particularly given the likelihood that there will be some provisioning. As a result, we are reducing our forecasts by 15% for 2009e and by 35% in 2010e. The principle differences are reduced investment income as a result of having disposed of its equity portfolio, and zero property income. These are partially mitigated by better spreads and much lower cost growth than we had originally forecast. Significantly reduced loan growth forecasts also reduce earnings beyond 2011e, in spite of better cost control.

- **Why is Provisioning so Low?** One of the key uncertainties for us is the fact that QIB has been able to maintain such low provisioning in spite of the mix of its loan portfolio. Part of this is due to being able to sell its most risky property-related exposures to the government at face value. However, the greater reason, we believe is that QIB's customer base includes a much higher Qatari contingent, and that these have access to significant liquidity.

- **Valuation and Recommendation:** In spite of recovering less than the rest of the sector, QIB still trades at a significant premium, both in terms of earnings and in terms of price to book, in spite of having a greater amount of excess capital than other Qatari banks. We believe that QIB deserves to trade at a premium to the sector, with Islamic banks frequently growing more quickly and generally being more profitable, but we believe the current premium is excessive, particularly in a lower-growth environment. We leave our estimated LTFV largely unchanged at QAR108.8, up fractionally from QAR106.6, with the lower discount rate and lower capital requirements counterbalancing weaker earnings. We maintain our recommendation at ST Neutral / LT Accumulate.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *2,101* | *1,956* | *2,054* | *2,427* |
| *Cost / Income Ratio* | *21%* | *22%* | *22%* | *24%* |
| *Provisions / Avg. Loans (bps)* | *-* | *38* | *64* | *45* |
| *Attributable Income* | *1,643* | *1,457* | *1,401* | *1,653* |
| *ROAE* | *26.5%* | *20.0%* | *16.6%* | *19.8%* |
| *ROAA* | *5.74%* | *4.07%* | *3.39%* | *3.48%* |
| | | | | |
| *EPS (QAR)* | *8.36* | *6.81* | *6.47* | *7.63* |
| *P/E (x)* | *10.8* | *13.2* | *13.9* | *11.8* |
| *Dividend Yield* | *7.8%* | *6.3%* | *6.8%* | *6.8%* |
| *P/BV (x)* | *3.1* | *2.5* | *2.4* | *2.3* |
| *Capital Adequacy* | *17.0%* | *21.6%* | *19.0%* | *16.4%* |
| *Loan Growth* | *62%* | *11%* | *18%* | *20%* |
| *Loans / Deposits* | *113.7%* | *95.3%* | *94.1%* | *94.1%* |
| *Provisions / NPLs* | *80%* | *61%* | *59%* | *64%* |

*Figures in QAR million unless otherwise stated*


***Estimate Changes***

| *(QAR mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Interest Income* | *939.4* | *884.0* | *1,249* | *1,146* | *1,337* |
| *Total Banking Income* | *2,101* | *2,442* | *1,956* | *3,167* | *2,054* |
| *Pre-Provision Income* | *1,657* | *1,792* | *1,523* | *2,294* | *1,602* |
| *Net Attributable Income.* | *1,643* | *1,720* | *1,457* | *2,169* | *1,401* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *QAR7.00 on 19 Feb 09* |
| *Mkt. Cap / Shares (mn)* | *QAR19,494 / 216.6* |
| *Av. Mthly Liqd (mn)* | *QAR997.2* |
| *52-Week High / Low* | *QAR122.9 / 51.40* |
| *Bloomberg / Reuters* | *QIBK QD / QISB.QA* |
| *Est. Free Float* | *72%* |

**Prices as at 01 October 2009*

# FINANCIAL STATEMENTS

## Income Statement (December Year End)

In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **388** | **939** | **647** | **1,249** | **1,337** | **1,566** |
| Dividend Income | - | - | - | - | - | - |
| Fees & Commissions | 114 | 223 | 100 | 214 | 234 | 305 |
| Trading & Investments | 613 | 764 | 253 | 479 | 466 | 485 |
| Brokerage & Fund Management | - | - | - | - | - | - |
| Property Income | 81 | 162 | - | - | - | 62 |
| Other Operating Income | 2 | 13 | 9 | 15 | 16 | 9 |
| **Total Non-Interest Income** | **811** | **1,162** | **362** | **707** | **716** | **860** |
| **Total Banking Income** | **1,199** | **2,101** | **1,009** | **1,956** | **2,054** | **2,427** |
| Total Operating Expenses | (234) | (444) | (217) | (433) | (451) | (586) |
| **Income before Provisions** | **965** | **1,657** | **792** | **1,523** | **1,602** | **1,841** |
| Provisions for Loans Losses | (49) | 48 | - | (76) | (149) | (126) |
| Associate Income & Adjustments | - | - | - | - | - | - |
| **Profit before Tax** | **916** | **1,705** | **792** | **1,447** | **1,453** | **1,715** |
| Tax, Minorities & Appropriations | (62) | (62) | 21 | 11 | (52) | (61) |
| **Net Attributable Income** | **854** | **1,643** | **813** | **1,457** | **1,401** | **1,653** |
| **Headline Income** | **854** | **1,643** | **813** | **1,457** | **1,401** | **1,653** |
| **Comprehensive Income** | **929** | **1,551** | **827** | **1,472** | **1,401** | **1,653** |

Source: Qatar Islamic Bank, EFG-Hermes estimates

## Balance Sheet (December Year End)

In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 771 | 1,023 | 2,497 | 3,154 | 3,736 | 3,590 |
| Interbank Assets | - | - | - | - | - | - |
| Loans & Islamic Financing | 15,264 | 18,866 | 19,711 | 21,024 | 24,910 | 29,917 |
| Financial Instruments | - | - | - | - | - | - |
| Other Investments & Associates | 9,578 | 12,657 | 13,776 | 13,975 | 14,695 | 15,918 |
| Other Assets | 1,229 | 737 | 765 | 870 | 722 | 789 |
| Fixed Assets | 116 | 260 | 274 | 299 | 348 | 383 |
| **Total Assets** | **26,960** | **33,543** | **37,024** | **39,322** | **44,410** | **50,596** |
| Customer Deposits & Islamic Funding | 15,509 | 16,592 | 20,202 | 22,067 | 26,481 | 31,777 |
| Capital Market Liabilities | - | - | - | - | - | - |
| Interbank Liabilities | - | - | - | - | - | - |
| Other Financial Liabilities | 3,633 | 8,697 | 6,741 | 6,808 | 7,084 | 7,368 |
| Other operating Items | 980 | 886 | 1,017 | 1,111 | 1,333 | 1,600 |
| Proposed Dividend | - | 1,378 | - | 1,227 | 1,322 | 1,334 |
| **Total Liabilities** | **20,122** | **27,553** | **27,960** | **31,213** | **36,221** | **42,079** |
| **Common Shareholders' Equity** | **6,589** | **5,765** | **7,524** | **7,897** | **7,976** | **8,295** |
| Minorities & Other Equity | 249 | 226 | 201 | 211 | 213 | 222 |
| **Total Liabilities & Equity** | **26,960** | **33,543** | **35,685** | **39,322** | **44,410** | **50,596** |

Source: Qatar Islamic Bank, EFG-Hermes estimates

## Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 17.0% | 23.0% | 21.6% | 19.0% | 16.4% |
| Loans / Deposits | 98.4% | 113.7% | 97.6% | 95.3% | 94.1% | 94.1% |
| NPL Coverage Ratio | | 79.6% | | 60.7% | 59.3% | 63.8% |
| Net Interest Spread* | 4.26% | 5.00% | 6.03% | 5.57% | 4.98% | 4.88% |
| Cost / Income Ratio | 19.5% | 21.1% | 21.5% | 22.1% | 22.0% | 24.1% |
| Provisioning (bps) | 0.70% | N/A | N/A | 0.38% | 0.64% | 0.45% |
| RoAE* | 29.3% | 26.5% | 23.8% | 20.0% | 16.6% | 19.8% |
| RoAA* | 6.31% | 5.74% | 4.77% | 4.07% | 3.39% | 3.48% |
| EPS* | 8.79 | 8.36 | 7.68 | 6.81 | 6.47 | 7.63 |
| BVPS | 33.46 | 29.27 | 34.73 | 36.46 | 36.82 | 38.30 |
| DPS | - | 7.00 | - | 5.66 | 6.10 | 6.16 |

*Annualised for 1H data

Source: Qatar Islamic Bank, EFG-Hermes estimates

# QATAR NATIONAL BANK - NO BIG SECRET

06 OCTOBER 2009

QATAR | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: QAR 154.0 |
| Long-Term Rec. : Accumulate | LT Fair Value : QAR 169.4 |

• **QNB Business Looks Relatively Secure**: QNB rather uninterestingly splits its business into just conventional banking, Islamic banking and wealth management, with conventional banking accounting for 85% of operating profits and Islamic banking much of the rest. Government and government-related entities account for 43% of the loan book, whilst the personal sector amounts to 21%, and real estate and construction to just 13% (primarily real estate). As such, from a top-down point of view, it should have one of the least risky balance sheets in the GCC. Geographically it is a little more diversified than the rest of the Qatari banking sector, with 10% of assets allocated to the GCC and a further 10% to Europe.

• **Recent Results Positive, in spite of Provisioning**: QNB reported net profit up 12% Y-o-Y, 5% Q-o-Q and beating our expectations by 11%. This reflected strong revenues, aided by continued spread expansion, and good cost control. Whilst the market may be spooked by the jump in provisions, we do not think this was in any way a mould-breaker. Deposit growth has also been strong, although lending growth has been impacted by reallocations, disposals of lower quality credits and other one-off impacts.

• **Adjusting Forecasts Positively**: We are adjusting our 2009e forecast by 11% and that for 2010e by 10%. For both 2009 and 2010, elevated spreads will continue to impact revenues, although this has less of an impact by 2011e. Offsetting this are much reduced investment gains, and lower dividends, driven by the disposal of the DSM-listed equity portfolio. Our expectation for better cost control, aided by lower growth rates, is driving the positive adjustments to our operating profit forecast. Provisioning forecasts are largely unchanged. However, beyond 2011, we have not significantly changed our bottom line earnings forecasts, with lower revenue forecasts matching lower costs.

• **Dominant Domestically, Looking Overseas**: With 70% of its assets in Qatar, QNB is still primarily a domestic bank. Nevertheless, given the dominance of QNB in the local market, and a possible slowing of the GRE borrowing requirement beyond 2011, QNB has been building its footprint across the Arab world. Greenfield operations include those in Kuwait, Oman, Sudan, Yemen and recently IPOed Syria. In addition, QNB has built up minority stakes in Jordan, Tunisia, and the UAE. Whilst these operations have yet to make much of a dent in QNB's numbers, they do enable QNB to stretch its growth horizon beyond Qatar's boarders.

• **Valuation and Recommendation:** We adjust our estimated LTFV to QAR169.4 from QAR167.8. In addition, following the 113% increase in the share price and 23% outperformance since its lows on 1 March 2009, we reduce our ST / LT recommendation to Accumulate / Accumulate from Buy / Buy. We continue to like the stock, based on its close links to the public sector, strong Islamic banking franchise, low risk profile and long-term growth opportunities, but we believe there may be cheaper options.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *4,770* | *5,333* | *5,924* | *5,906* |
| *Cost / Income Ratio* | *24%* | *20%* | *19%* | *21%* |
| *Provns / Avg. Loans (bps)* | *29* | *40* | *34* | *30* |
| *Attributable Income* | *3,653* | *4,145* | *4,640* | *4,478* |
| *ROAE* | *22.7%* | *23.8%* | *23.2%* | *20.6%* |
| *ROAA* | *2.60%* | *2.80%* | *2.81%* | *2.40%* |
| | | | | |
| *EPS (QAR)* | *12.31* | *13.76* | *15.41* | *14.87* |
| *P/E (x)* | *12.5* | *11.2* | *10.0* | *10.4* |
| *Dividend Yield* | *3.9%* | *4.0%* | *4.4%* | *4.6%* |
| *P/BV (x)* | *3.1* | *2.6* | *2.3* | *2.0* |
| *Capital Adequacy* | *13.9%* | *16.6%* | *17.2%* | *16.8%* |
| *Loan Growth* | *51%* | *3%* | *12%* | *15%* |
| *Loans / Deposits* | *96.0%* | *95.3%* | *94.3%* | *96.2%* |
| *Provisions / NPLs* | *105%* | *78%* | *71%* | *68%* |

*Figures in QAR million unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(QAR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *2,856* | *3,463* | *3,824* | *3,756* | *4,395* |
| *Total Banking Income* | *4,770* | *5,114* | *5,333* | *5,776* | *5,924* |
| *Pre-Provisions Income* | *3,644* | *4,052* | *4,270* | *4,461* | *4,797* |
| *Net Attributable Income* | *3,653* | *3,725* | *4,145* | *4,223* | *4,640* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *QAR6.0 on 9 Feb 09* |
| *Mkt. Cap / Shares (mn)* | *QAR46,373 / 301* |
| *Av. Mthly Liqd (mn)* | *QAR402.3* |
| *52-Week High / Low* | *QAR154 / 72.2* |
| *Bloomberg / Reuters* | *QNBK QD / QNBK.QA* |
| *Est. Free Float* | *50%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest & Islamic Returns** | **1,232** | **2,856** | **1,771** | **3,824** | **4,395** | **4,193** |
| Dividend Income | 135 | 138 | 182 | 185 | 37 | 41 |
| Fees & Commissions | 505 | 976 | 478 | 900 | 990 | 1,138 |
| Trading & Investments | 457 | 769 | 170 | 411 | 489 | 519 |
| Other Operating Income | 25 | 32 | 10 | 13 | 13 | 15 |
| **Total Non-Interest Income** | **1,123** | **1,915** | **840** | **1,509** | **1,529** | **1,713** |
| **Total Banking Income** | **2,354** | **4,770** | **2,610** | **5,333** | **5,924** | **5,906** |
| Total Operating Expenses | (542) | (1,126) | (508) | (1,063) | (1,127) | (1,241) |
| **Income before Provisions** | **1,813** | **3,644** | **2,102** | **4,270** | **4,797** | **4,664** |
| Provisions for Loans Losses | (39) | (248) | (110) | (368) | (371) | (380) |
| Associate Income & Adjustments | 93 | 276 | 87 | 265 | 236 | 214 |
| **Profit before Tax** | **1,867** | **3,672** | **2,079** | **4,166** | **4,662** | **4,499** |
| Tax, Minorities & Appropriations | (10) | (20) | (12) | (21) | (22) | (21) |
| **Net Attributable Income** | **1,857** | **3,653** | **2,067** | **4,145** | **4,640** | **4,478** |
| **Headline Income** | **1,857** | **3,653** | **2,067** | **4,145** | **4,640** | **4,478** |
| **Comprehensive Income** | **3,396** | **1,032** | **2,912** | **4,990** | **4,640** | **4,478** |

Source: Qatar National Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)
In QAR million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 18,050 | 6,270 | 9,214 | 7,589 | 10,478 | 10,756 |
| Interbank Assets | 29,567 | 27,044 | 25,194 | 15,178 | 15,717 | 17,926 |
| Loans & Islamic Financing | 84,285 | 100,053 | 82,898 | 103,352 | 115,390 | 132,773 |
| Financial Instruments | 15,304 | 11,815 | 23,144 | 22,448 | 24,693 | 27,162 |
| Other Investments & Associates | 2,917 | 4,597 | 4,370 | 5,056 | 5,562 | 6,118 |
| Other Assets | 1,719 | 1,576 | 1,691 | 1,615 | 3,160 | 2,151 |
| Fixed Assets | 797 | 618 | 604 | 662 | 742 | 846 |
| **Total Assets** | **152,640** | **151,974** | **147,115** | **155,901** | **175,741** | **197,732** |
| Customer Deposits & Islamic Funding | 98,524 | 104,253 | 102,823 | 108,494 | 122,367 | 138,075 |
| Interbank Liabilities | 24,081 | 21,989 | 16,714 | 17,590 | 19,701 | 22,065 |
| Other Financial Liabilities | 6,717 | 6,719 | 6,721 | 6,719 | 7,391 | 8,426 |
| Other Operating Items | 4,336 | 2,370 | 3,131 | 3,295 | 3,691 | 4,133 |
| Proposed Dividend | - | 1,807 | - | 1,851 | 2,037 | 2,114 |
| **Total Liabilities** | **133,658** | **137,137** | **129,389** | **137,949** | **155,186** | **174,813** |
| **Common Shareholders' Equity** | **18,982** | **14,837** | **17,725** | **17,952** | **20,555** | **22,919** |
| Minorities & Other Equity | - | - | - | - | - | - |
| **Total Liabilities & Equity** | **152,640** | **151,974** | **147,115** | **155,901** | **175,741** | **197,732** |

Source: Qatar National Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 18.4% | 13.9% | 20.4% | 16.6% | 17.2% | 16.8% |
| Loans / Deposits | 85.5% | 96.0% | 80.6% | 95.3% | 94.3% | 96.2% |
| NPL Coverage Ratio | 113.3% | 104.7% | 101.3% | 78.1% | 71.2% | 67.7% |
| Net Interest Spread* | 1.63% | 1.80% | 2.32% | 2.46% | 2.20% | 2.10% |
| Cost / Income Ratio | 23.0% | 23.6% | 19.5% | 19.9% | 19.0% | 21.0% |
| Provisioning (bps) | 0.10% | 0.29% | 0.25% | 0.40% | 0.34% | 0.30% |
| RoAE* | 25.0% | 22.7% | 25.1% | 23.8% | 23.2% | 20.6% |
| RoAA* | 2.82% | 2.60% | 2.85% | 2.80% | 2.81% | 2.40% |
| EPS* | 12.60 | 12.31 | 13.73 | 13.76 | 15.41 | 14.87 |
| BVPS | 63.04 | 49.27 | 58.86 | 59.62 | 68.26 | 76.11 |
| DPS | - | 6.00 | - | 6.15 | 6.76 | 7.02 |

*Annualised for 1H data
Source: Qatar National Bank, EFG-Hermes estimates

# BANK MUSCAT - DOMINANT FRANCHISE AT A DISCOUNT

06 OCTOBER 2009

OMAN | BANKING

| | |
|---|---|
| Short-Term Rec.: Buy | Current Price*: OMR 0.925 |
| Long-Term Rec. : Buy | LT Fair Value : OMR 1.240 |

• **Oman's Dominant Bank; Geared to Recovery:** With a commanding market share of 44% of the banking sector's assets and 42% of the total banking sector's deposits in Oman, Bank Muscat is almost 3x as big as its closest competitor. With a dominant presence in all major market segments, we believe that Bank Muscat is geared to a recovery in Oman.

• **1H2009 Results - Higher Provisions Cushioned by Capital Gains:** Bank Muscat's 1H2009 earnings grew 22% Y-o-Y driven by capital gains booked on the HDFC Bank stake sale. Excluding capital gains, we estimate that Bank Muscat earnings dropped by almost 80% Y-o-Y. Provisions have jumped by almost 5x as the bank partially provisioned against its exposure to Saad and Algosaibi Groups. The bank's balance sheet growth momentum has decelerated sharply in 1H2009 on increased risk aversion, as banks generally throughout the region were protecting their balance sheet liquidity.

• **Loan Growth to Recover after A Slow 2009:** We expect a gradual pick-up in loan growth momentum in 2H2009, as investor confidence recovers on the back of increased government spending. With international banks expected to play a smaller part in the region as compared to before, we believe that domestic banks are likely to get a larger share of the corporate credit demand. We expect loan growth to recover to 12-15% in the medium term, with demand primarily emanating from corporates servicing the infrastructure-related spending of the government.

• **Risk from Associates Exists, but is Small in Magnitude:** While the bank has largely addressed the risk emanating from the investment book by shifting the composition in favour of government securities, balance sheet risk emanates from the bank's associates – Silk Bank in Pakistan and Bank Muscat International in Bahrain (BMI). BMI, 49% owned by Bank Muscat, has an exposure of OMR17 million to the Saad and Algosaibi Groups, and this poses a risk to Bank Muscat's earnings. Additionally, Bank Muscat's investment in Silk Bank is underwater, and we see a potential mark-to-market provision of OMR5-7 million. However, with these two associates accounting for less then 14% of Bank Muscat's equity, we do not view this as a significant risk.

• **Trading at a Discount; Recommend ST / LT Buy:** Bank Muscat's valuations in relation to its peers represent a sharp contrast to its size advantage. Trading at a 2010e P/E of 10.2x and P/B of 1.1x, Bank Muscat's valuation multiples are at an almost 20% discount to its peers in Oman. We are of the view that the valuation discrepancy is explained by the perception of higher risks to Bank Muscat's book value, which we believe is overplayed. We recommend a ST/LT Buy on Bank Muscat with our LTFV of OMR1.24, suggesting 34% upside potential from current levels.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *237* | *286* | *250* | *289* |
| *Cost / Income* | *37%* | *31%* | *39%* | *38%* |
| *Provisions / Avg. Loans (bps)* | *36.2* | *148.9* | *87.8* | *66.6* |
| *ROAE* | *14.0%* | *14.4%* | *11.2%* | *13.1%* |
| *ROAA* | *1.8%* | *1.8%* | *1.5%* | *1.7%* |
| *EPS (OMR)* | *0.09* | *0.10* | *0.09* | *0.12* |
| *P/E (x)* | *10.63* | *8.90* | *10.16* | *7.86* |
| *Dividend Yield* | *2.2%* | *2.2%* | *2.0%* | *2.5%* |
| *P/BV (x)* | *1.39* | *1.19* | *1.09* | *0.98* |
| | | | | |
| *Capital Adequacy* | *11.8%* | *14.0%* | *13.4%* | *13.1%* |
| *Loan Growth* | *38.7%* | *5.2%* | *15.0%* | *17.3%* |
| *Loans / Deposits* | *117.5%* | *119.4%* | *124.8%* | *127.3%* |
| *Provisions / NPLs* | *138.8%* | *90.0%* | *90.0%* | *100.0%* |

*Figures in OMR million, unless otherwise stated*


***Estimate Changes***

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(OMR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *162* | *N/A* | *172* | *N/A* | *180* |
| *Total Banking Income* | *237* | *N/A* | *286* | *N/A* | *250* |
| *Income before Provisions* | *149* | *N/A* | *196* | *N/A* | *152* |
| *Net Attributable Income* | *94* | *N/A* | *112* | *N/A* | *98* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *OMR0.02 on 22 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *OMR996 / 1077.1* |
| *Av. Mthly Liqd (mn)* | *OMR27.7* |
| *52-Week High / Low* | *OMR1.124 / 0.471* |
| *Bloomberg / Reuters* | *BKMB OM / BKMB.OM* |
| *Est. Free Float* | *60.16%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Interest Income | 218 | 123 | 263 | 139 | 289 | 303 | 339 |
| Interest Expense | (93) | (48) | (101) | (56) | (117) | (123) | (128) |
| **Net Interest Income** | **125** | **75** | **162** | **83** | **172** | **180** | **210** |
| Exchange Income | 6 | 3 | 7 | 4 | 8 | 8 | 9 |
| Fees from Banking Services, Net | 38 | 23 | 55 | 26 | 50 | 56 | 65 |
| Investments Income, Net | 2 | 8 | 10 | 54 | 54 | 3 | 3 |
| Other Operating Income | 2 | 1 | 3 | 0 | 2 | 2 | 2 |
| **Total Non Interest Income** | **48** | **34** | **75** | **85** | **114** | **70** | **79** |
| **Total Banking Income** | **173** | **109** | **237** | **168** | **286** | **250** | **289** |
| Total Operating Expenses | (65) | (41) | (87) | (47) | (90) | (99) | (109) |
| **Income Before Provisions** | 108 | 68 | 149 | 121 | 196 | 152 | 180 |
| Credit & Investment Provisions | (10) | (9) | (41) | (49) | (67) | (39) | (34) |
| Pre-Tax Profits | 98 | 60 | 108 | 72 | 129 | 113 | 146 |
| Taxation | (13) | (10) | (15) | (12) | (17) | (15) | (19) |
| **Net Income** | 84 | 50 | 94 | 60 | 112 | 98 | 127 |

Source: Bank Muscat, EFG-Hermes estimates

### Balance Sheet (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 488 | 335 | 453 | 538 | 615 | 556 | 507 |
| Due from Banks | 588 | 810 | 1,078 | 899 | 948 | 1,032 | 1,040 |
| Loans & Advances, Net | 2,687 | 3,192 | 3,728 | 3,811 | 3,923 | 4,510 | 5,288 |
| Investment Securities, Net | 218 | 527 | 472 | 242 | 301 | 393 | 437 |
| Fixed Assets, Net | 19 | 21 | 22 | 23 | 25 | 29 | 34 |
| Other Assets | 218 | 128 | 277 | 216 | 299 | 329 | 362 |
| **Total Assets** | **4,218** | **5,013** | **6,028** | **5,728** | **6,109** | **6,848** | **7,667** |
| Customer Deposits | 2,322 | 2,803 | 3,173 | 3,118 | 3,284 | 3,612 | 4,154 |
| Due to Banks | 678 | 973 | 1,413 | 1,266 | 1,149 | 1,445 | 1,662 |
| Term Loan (Debt) | 275 | 293 | 342 | 355 | 395 | 395 | 304 |
| Other Liabilities | 316 | 231 | 386 | 303 | 445 | 481 | 531 |
| Total Liabilities | 3,590 | 4,300 | 5,313 | 5,041 | 5,273 | 5,934 | 6,651 |
| Shareholders' Equity | 628 | 713 | 715 | 687 | 836 | 915 | 1,016 |
| **Total Liabilities & Shareholders' Equity** | **4,218** | **5,013** | **6,028** | **5,728** | **6,109** | **6,849** | **7,667** |

Source: Bank Muscat, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 16.1% | 12.09% | 11.8% | 15.03% | 14.0% | 13.4% | 13.1% |
| Loans / Deposits | 115.7% | 115.7% | 117.5% | 117.5% | 119.4% | 124.8% | 127.3% |
| NPL Coverage Ratio | 145.9% | N/A | 138.8% | N/A | 90.0% | 90.0% | 100.0% |
| Net Interest Spreads | 3.96% | 4% | 4% | 3% | 3.18% | 3.03% | 3.13% |
| Cost / Income Ratio | 37.5% | 40% | 37% | 25% | 31.4% | 39.4% | 37.8% |
| Provisioning (bps) | 44.23 | 59.57 | 36.16 | 254.14 | 148.87 | 87.84 | 66.63 |
| ROAE | 17.8% | 17% | 14% | 17% | 14.4% | 11.2% | 13.1% |
| ROAA | 2.3% | 2% | 2% | 2% | 1.8% | 1.5% | 1.7% |
| EPS | 0.08 | 0.05 | 0.09 | 0.06 | 0.10 | 0.09 | 0.12 |
| BVPS | 0.58 | 0.66 | 0.66 | 0.64 | 0.77 | 0.85 | 0.94 |
| DPS | 0.05 | 0.00 | 0.02 | 0.00 | 0.02 | 0.02 | 0.02 |

Source: Company reports, EFG-Hermes estimates

# NATIONAL BANK OF OMAN - FOCUSING ON THE DEPOSIT FRANCHISE

06 OCTOBER 2009

OMAN | BANKING

| | |
|---|---|
| Short-Term Rec.: Accumulate | Current Price*: OMR 0.332 |
| Long-Term Rec. : Accumulate | LT Fair Value : OMR 0.410 |

• **Deposit and Funding Mix Rebalancing to Deliver Value:** The second largest bank in Oman, National Bank of Oman, has aggressively set out to optimize its funding mix. The bank has historically lagged behind its peers in terms of a strong deposit franchise. The bank has recently completed the modernization of its branch network, and is working to expand its footprint across the country to improve its deposit mix. Initial results are promising and the bank has been able to significantly beef up its demand and saving deposits with the launch of the Al-Kanz deposit scheme at the beginning of 2009

• **1H2009 Results - Lower Investment Income, Higher Provisions:** An almost 10x increase in credit provisions and a 25% Y-o-Y drop in non-interest income led to a 40% Y-o-Y decline in net profits for NBO in 1H2009. The drop in non-interest income however was compensated for, to a certain extent, by an improvement in net interest spreads. Loans and deposits have been virtually stagnant since the end of 2Q2009. However, NBO has been able to improve its deposit mix in 1H2009 by shedding time deposits and replacing them with low-cost demand and saving deposits.

• **Asset Quality Poses Risk to Earnings:** The bank has progressively changed the profile of its investment book, the majority of which now is comprised of government securities. The biggest risk to earnings comes from asset quality deterioration, in our view. NBO announced that is has an exposure of OMR6.9 million (0.5%) to Awal Bank in Bahrain (owned by the Saad Group), which is in default. The bank has made a 25% provision against this exposure, and could potentially provision against the remaining amount if the Saad Group is unable to reach a restructuring agreement with the bank.

• **Earnings Recovery Likely to be Swift after Dipping in 2009e:** Over the last few years, the contribution of non-interest income and particularly investment income to total income of NBO has been on a rising trend. The sharp drop in equity prices and volumes traded at the stock market has dented the bank's investment income. However, NBO has been able to partially offset the impact through an improvement in net interest spreads. We expect earnings to recover in 2010e, rising by 42% Y-o-Y, supported by stronger loan growth and improved net interest spreads. Balance sheet growth momentum is likely to start recovering in 2H2009, and we expect loan growth of 12-15% in the medium term.

• **Our Preferred Pick in the Sector:** Being the second largest bank in the country, we believe that NBO is a leveraged play on government spending in Oman. We assign ST / LT Accumulate rating on NBO with our LTFV of OMR0.41 suggesting 22% upside to the current price. While provisioning on the bank's exposure to the Saudi business groups is likely to dampen earnings in the short term, we believe that earnings are likely to recover strongly in 2010e. At the current price, the NBO at 2010e P/E of 9.2x and P/B of 1.3x.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *88* | *87* | *94* | *110* |
| *Cost / Income* | *38%* | *41%* | *41%* | *38%* |
| *Provisions / Avg. Loans (bps)* | *57.6* | *133.6* | *81.8* | *84.5* |
| *ROAE* | *20.5%* | *11.6%* | *15.0%* | *15.7%* |
| *ROAA* | *2.6%* | *1.4%* | *1.8%* | *1.9%* |
| *EPS (OMR)* | *0.04* | *0.03* | *0.04* | *0.04* |
| *P/E* | *7.91* | *13.05* | *9.19* | *7.80* |
| *Dividend Yield* | *1.9%* | *1.9%* | *2.7%* | *3.2%* |
| *P/BV* | *1.58* | *1.45* | *1.30* | *1.15* |
| | | | | |
| *Capital Adequacy* | *15.7%* | *15.6%* | *14.9%* | *14.2%* |
| *Loan Growth* | *54.5%* | *4.5%* | *15.0%* | *16.3%* |
| *Loans / Deposits* | *108.8%* | *107.2%* | *110.1%* | *110.3%* |
| *Provisions / NPLs* | *100.1%* | *100.0%* | *100.0%* | *100.0%* |

*Figures in OMR million, unless otherwise stated*


***Estimate Changes***

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(OMR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *48* | *NA* | *57* | *NA* | *62* |
| *Total Banking Income* | *88* | *NA* | *87* | *NA* | *94* |
| *Income before Provisions* | *54* | *NA* | *51* | *NA* | *55* |
| *Net Attributable Income* | *45* | *NA* | *28* | *NA* | *39* |

***Stock Data***

| | |
|---|---|
| *Last Dividend* | *OMR0.018 on 24 Mar 09* |
| *Mkt. Cap / Shares (mn)* | *OMR359 / 1081* |
| *Av. Mthly Liqd (mn)* | *OMR4.5* |
| *52-Week High / Low* | *OMR0.505 / 0.243* |
| *Bloomberg / Reuters* | *NBOB OM / NBO.OM* |
| *Est. Free Float* | *21.64%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Interest Income | 75 | 42 | 90 | 53 | 104 | 110 | 125 |
| Interest Expense | (36) | (19) | (43) | (25) | (47) | (49) | (52) |
| **Net Interest Income** | **39** | **22** | **48** | **28** | **57** | **62** | **74** |
| Exchange Income | 2 | 1 | 3 | 1 | 3 | 3 | 3 |
| Fees from Banking Services, Net | 16 | 6 | 25 | 10 | 22 | 25 | 28 |
| Investments Income, Net | 5 | 11 | 12 | 3 | 4 | 2 | 2 |
| Other Operating Income | 3 | 1 | 2 | 1 | 2 | 2 | 2 |
| **Total Non Interest Income** | **26** | **19** | **41** | **14** | **30** | **32** | **36** |
| **Total Banking Income** | **65** | **41** | **88** | **42** | **87** | **94** | **110** |
| Total Operating Expenses | (29) | (15) | (34) | (17) | (36) | (38) | (42) |
| **Income before Provisions** | **36** | **25** | **54** | **25** | **51** | **55** | **68** |
| Credit & Investment Provisions | 14 | 0 | (3) | (9) | (20) | (11) | (15) |
| Pre-Tax Profits | 50 | 26 | 52 | 15 | 31 | 44 | 52 |
| Taxation | (6) | (3) | (6) | (2) | (4) | (5) | (6) |
| **Net Income** | **45** | **23** | **45** | **13** | **28** | **39** | **46** |

Source: National Bank of Oman, EFG-Hermes estimates

### Balance Sheet (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash in Hand & SAMA | 246 | 254 | 266 | 223 | 316 | 328 | 358 |
| Due from Banks | 202 | 161 | 199 | 127 | 157 | 160 | 186 |
| Loans & Advances, Net | 907 | 1,174 | 1,401 | 1,392 | 1,464 | 1,683 | 1,957 |
| Investment Securities, Net | 46 | 51 | 31 | 33 | 35 | 40 | 46 |
| Fixed Assets, Net | 7 | 7 | 10 | 12 | 10 | 12 | 14 |
| Other Assets | 70 | 76 | 78 | 34 | 83 | 91 | 99 |
| **Total Assets** | **1,477** | **1,723** | **1,984** | **1,821** | **2,066** | **2,314** | **2,660** |
| Customer Deposits | 888 | 1,122 | 1,288 | 1,265 | 1,365 | 1,529 | 1,774 |
| Due to Banks | 215 | 203 | 277 | 208 | 273 | 306 | 355 |
| Term Loan (Debt) | 60 | 66 | 82 | 61 | 73 | 82 | 89 |
| Other Liabilities | 96 | 89 | 111 | 44 | 108 | 120 | 132 |
| Total Liabilities | 1,260 | 1,480 | 1,758 | 1,578 | 1,818 | 2,037 | 2,349 |
| Shareholders' Equity | 217 | 242 | 226 | 243 | 247 | 276 | 311 |
| **Total Liabilities & Shareholders' Equity** | **1,477** | **1,723** | **1,984** | **1,821** | **2,066** | **2,314** | **2,660** |

Source: National Bank of Oman, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 14.9% | 12.94% | 15.7% | N/A | 15.6% | 14.9% | 14.2% |
| Loans / Deposits | 102.1% | 104.6% | 108.8% | 110.0% | 107.2% | 110.1% | 110.3% |
| NPL Coverage Ratio | 91.7% | N/A | 100.1% | N/A | 100.0% | 100.0% | 100.0% |
| Net Interest Spreads | 3.32% | 3.34% | 3.29% | 3.31% | 3.05% | 3.06% | 3.16% |
| Cost / Income Ratio | 44.0% | 37.8% | 38.4% | 40.7% | 40.9% | 41.1% | 38.3% |
| Provisioning (bps) | (14.41) | (4.04) | 57.59 | 132.48 | 133.57 | 81.82 | 84.51 |
| ROAE | 23.0% | 20.2% | 20.5% | 11.3% | 11.6% | 15.0% | 15.7% |
| ROAA | 3.5% | 3.0% | 2.6% | 1.4% | 1.4% | 1.8% | 1.9% |
| EPS | 0.05 | 0.02 | 0.04 | 0.01 | 0.03 | 0.04 | 0.04 |
| BVPS | 0.20 | 0.22 | 0.21 | 0.22 | 0.23 | 0.26 | 0.29 |
| DPS | 0.01 | 0.02 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |

Source: National Bank of Oman, EFG-Hermes estimates

المجموعة المالية - هيرميس
EFG HERMES

# BANK DHOFAR - EXPENSIVE VALUTIONS

06 OCTOBER 2009

OMAN | BANKING

| | |
|---|---|
| Short-Term Rec.: Reduce | Current Price*: OMR 0.610 |
| Long-Term Rec. : Reduce | LT Fair Value : OMR 0.530 |

- **Facing Competition from New Entrants:** Oman's third largest bank, Bank Dhofar has been loosing market share of deposits and corporate loans to the competition over the last two years. The bank has been able to compensate for the loss in corporate loan market share by growing its consumer book aggressively during the period. However, with the consumer loan portfolio nearing the ceiling prescribed by the central bank, we expect Bank Dhofar's consumer loan growth to moderate.

- **1H2009 Results - Steady Performance:** Bank Dhofar reported relatively steady 1H2009 earnings compared to its peers, with earnings declining 3% Y-o-Y despite an almost doubling in credit provisions. The decline in non-interest income was largely compensated for by an improvement in net interest income on the back of improved net interest spreads. Balance sheet growth momentum, though slower than last year, has been better compared to the bank's peers. Net loans have grown by 9.6% YTD, with the bank utilising increased room provided for by the rights issue in 4Q2008.

- **Lower Risk Profile:** Bank Dhofar enjoys a relatively lower risk profile compared to its peers. The investment book risk has been largely addressed through a shift towards government securities, while the bank also has the lowest exposure among Omani banks to Saudi business groups. Domestic asset quality in Oman has held up quite well so far, and we do not see any significant risk with government spending recovering.

- **Spreads have Recovered Strongly, but Upside Potential is Limited:** The improved liquidity accruing from the rights issue coupled with slowing credit growth prospects has allowed Bank Dhofar to improve its net interest spreads. However, we believe that upside potential is likely to be limited from here, as we expect increased competition for low-cost deposits, which is likely to keep any improvement in funding costs restrained. We expect earnings to remain largely stable in 2009e and grow by 14% Y-o-Y in 2010e on account of improved loan growth and lower provisions.

- **Inclusion in MSM 30 Index Drives Up Valuation:** Bank Dhofar's stock price has recently risen on the back of the stock being included in the MSM 30 Index with an 8.49% weight - rising by over 20% since the inclusion in the index. This has meant that the inclusion of the stock in the portfolio of funds tracking the index has driven up the stock price in the absence of an increase in free float. The recent run-up in the stock price has stretched the bank's valuation in our opinion - 2010e P/E of 15.2x and P/B of 2.0x - making it expensive compared to its well-established peers. We recommend a ST/LT Reduce on Bank Dhofar, with our LTFV of OMR0.53 suggesting 13% downside potential from current levels.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *56* | *65* | *70* | *77* |
| *Cost / Income* | *38%* | *34%* | *35%* | *36%* |
| *Provisions / Avg. Loans (bps)* | *27.0* | *93.8* | *78.2* | *49.3* |
| *ROAE* | *15.8%* | *13.1%* | *13.6%* | *15.1%* |
| *ROAA* | *2.1%* | *1.9%* | *1.9%* | *2.2%* |
| *EPS (OMR)* | *0.04* | *0.04* | *0.04* | *0.05* |
| *P/E (x)* | *14.11* | *17.33* | *15.22* | *12.46* |
| *Dividend Yield* | *3.3%* | *2.0%* | *2.3%* | *2.8%* |
| *P/BV (x)* | *1.77* | *2.16* | *1.98* | *1.80* |
| | | | | |
| *Capital Adequacy* | *15.0%* | *15.3%* | *15.5%* | *15.0%* |
| *Loan Growth* | *44.5%* | *15.5%* | *9.8%* | *14.3%* |
| *Loans/ Deposits* | *104.8%* | *114.2%* | *114.1%* | *113.4%* |
| *Provisions / NPLs* | *100.2%* | *100.0%* | *100.0%* | *100.0%* |

*Figures in OMR million, unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(OMR mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *40* | *N/A* | *50* | *N/A* | *54* |
| *Total Banking Income* | *56* | *N/A* | *65* | *N/A* | *70* |
| *Income before Provisions* | *35* | *N/A* | *43* | *N/A* | *45* |
| *Net Attributable Income* | *24* | *N/A* | *26* | *N/A* | *30* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *OMR0.016 on 30 Mar 09* |
| *Mkt. Cap/Shares (mn)* | *OMR 451 / 739.6* |
| *Av. Mthly Liqd (mn)* | *OMR 3.8* |
| *52-Week High / Low* | *OMR0.634 / 0.335* |
| *Bloomberg / Reuters* | *BKDB OM / BKDB.OM* |
| *Est. Free Float* | *60.00%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Interest Income | 52 | 29 | 64 | 38 | 77 | 83 | 90 |
| Interest Expense | (21) | (11) | (24) | (14) | (27) | (29) | (31) |
| **Net Interest Income** | **30** | **19** | **40** | **23** | **50** | **54** | **59** |
| Exchange Income | 1 | 1 | 2 | 1 | 2 | 2 | 2 |
| Fees from Banking Services, Net | 3 | 2 | 5 | 2 | 5 | 6 | 7 |
| Investments Income, Net | 5 | 4 | 4 | 1 | 1 | 0 | 1 |
| Other Operating Income | 5 | 3 | 6 | 5 | 7 | 8 | 8 |
| **Total Non Interest Income** | **14** | **10** | **16** | **9** | **15** | **16** | **18** |
| **Total Banking Income** | **44** | **28** | **56** | **32** | **65** | **70** | **77** |
| Total Operating Expenses | (17) | (10) | (21) | (12) | (22) | (25) | (27) |
| Income before Provisions | 27 | 18 | 35 | 20 | 43 | 45 | 50 |
| Credit & Investment Provisions | (2) | (2) | (8) | (4) | (13) | (11) | (8) |
| **Pre-Tax Profits** | **25** | **17** | **27** | **16** | **30** | **34** | **41** |
| Taxation | (3) | (2) | (3) | (2) | (4) | (4) | (5) |
| **Net Income** | **23** | **15** | **24** | **14** | **26** | **30** | **36** |

Source: Bank Dhofar, EFG-Hermes estimates

### Balance Sheet (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash & Bank | 119 | 58 | 116 | 196 | 161 | 183 | 191 |
| Due from Banks | 29 | 19 | 38 | 24 | 54 | 29 | 33 |
| Loans & Advances, Net | 705 | 894 | 1,018 | 1,118 | 1,177 | 1,292 | 1,477 |
| Investment Securities, Net | 89 | 120 | 137 | 55 | 54 | 58 | 66 |
| Fixed Assets, Net | 4 | 5 | 5 | 5 | 5 | 5 | 6 |
| Other Assets | 9 | 10 | 10 | 12 | 11 | 11 | 12 |
| **Total Assets** | **955** | **1,105** | **1,324** | **1,408** | **1,461** | **1,580** | **1,786** |
| Customer Deposits | 675 | 801 | 972 | 989 | 1,030 | 1,133 | 1,303 |
| Due to Banks | 93 | 119 | 90 | 151 | 144 | 136 | 143 |
| Term Loan (Debt) | 46 | 39 | 39 | 39 | 39 | 39 | 39 |
| Other Liabilities | 31 | 34 | 36 | 38 | 40 | 45 | 50 |
| Total Liabilities | 845 | 992 | 1,135 | 1,217 | 1,252 | 1,352 | 1,535 |
| **Shareholders' Equity** | **110** | **113** | **188** | **192** | **209** | **228** | **251** |
| **Total Liabilities & Shareholders' Equity** | **955** | **1,105** | **1,324** | **1,408** | **1,461** | **1,580** | **1,786** |

Source: Bank Dhofar, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 12.5% | 11.9% | 15.0% | 15.3% | 15.3% | 15.5% | 15.0% |
| Loans/Deposits | 104.5% | 111.6% | 104.8% | 113.0% | 114.2% | 114.1% | 113.4% |
| NPL Coverage Ratio | 91.8% | N/A | 100.2% | N/A | 100.0% | 100.0% | 100.0% |
| Net Interest Spreads | 3.88% | 4.11% | 3.63% | 3.91% | 3.64% | 3.63% | 3.59% |
| Cost/Income Ratio | 38.5% | 35.7% | 37.6% | 37.2% | 34.3% | 35.2% | 35.7% |
| Provisioning (bps) | 19.22 | 43.60 | 27.03 | 76.39 | 93.77 | 78.17 | 49.31 |
| ROAE | 22.4% | 27.5% | 15.8% | 16.7% | 13.1% | 13.6% | 15.1% |
| ROAA | 2.8% | 2.9% | 2.1% | 2.2% | 1.9% | 1.9% | 2.2% |
| EPS | 0.04 | 0.02 | 0.04 | 0.02 | 0.04 | 0.04 | 0.05 |
| BVPS | 0.21 | 0.15 | 0.34 | 0.26 | 0.28 | 0.31 | 0.34 |
| DPS | 0.03 | 0.00 | 0.02 | 0.00 | 0.01 | 0.01 | 0.02 |

Source: Bank Dhofar, EFG-Hermes estimates

# BANK SOHAR - STRONG GROWTH, PREMIUM VALUATION

06 OCTOBER 2009

OMAN | BANKING

| Short-Term Rec.: Neutral | Current Price*: OMR 0.217 |
|---|---|
| Long-Term Rec. : Neutral | LT Fair Value : OMR 0.200 |

• **Gaining Market Share:** Established in 2007, Bank Sohar has aggressively grown its balance sheet to become the fifth largest commercial bank in the country, surpassing in size some of its more established peers. Bank Sohar has a market share in excess of 7% on most balance sheet measures. We view this positively, as the bank has gained a critical mass on which it can now build profitably.

• **1H2009 Results - Positive Surprise:** Bank Sohar reported its strongest performance in 2Q2009 since inception, with the bank posting earnings of OMR2.4 million compared to a net loss of OMR0.04 million. Net interest spreads recovered strongly, rising by almost 100bps Y-o-Y on improved asset yields, and lower funding costs, while non-interest income remained steady. Balance sheet growth momentum, while sharply lower, was one of the strongest in the sector, with loans growing by 61% Y-o-Y and 17% YTD.

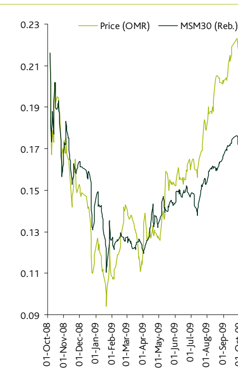
• **Shifting Gears. - Focusing on Profitable Growth:** We believe that with the bank achieving critical mass, the focus is gradually shifting towards an improvement in profitability. We expect balance sheet growth to moderate from levels seen over the last two years; however, earnings are likely to rise on the back of an improvement in net interest spreads and cost efficiencies. We believe that the primary thrust of the bank is likely to be on improving its core income, which is already visible in 1H2009 results. We expect Bank Sohar to improve its net interest spreads through a combination of asset yield and funding cost improvements.

• **Risks to Asset Quality:** The risk to Bank Sohar's earnings primarily emanates from deterioration in asset quality. We believe that strong loan growth since the commencement of commercial operations in 2007 could lead to higher NPLs on loan book seasoning in a slowing economic environment. However, according to the management, majority of the corporate loan book is comprised of loans to government owned entities, and to large established business groups, suggesting lower risk of NPLs.

• **Rich Valuation:** We assign a ST/LT Neutral rating to Bank Sohar, with our LTFV of OMR0.20 suggesting 10% downside potential from current levels. Bank Sohar has grown aggressively over the last two years in to the ranks of the top 5 banks in the country. While the bank has been profitable on a pre-provision, pre tax basis right from the beginning, net earnings have been volatile, with the bank posting positive earnings in only three out of the nine quarters since it commenced commercial operation. Bank Sohar's strongest performance has come in 2Q2009, with the bank announcing earnings of OMR2.4 million. We look for more sustainable earnings performance before considering a more positive stance on the bank. At the current price, Bank Sohar's valuations are demanding, in our opinion, at 2010e P/E of 18.7x and P/B of 1.9x, with ROE expected to improved to 11% in 2010e.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *18* | *30* | *38* | *48* |
| *Cost / Income* | *71%* | *50%* | *46%* | *42%* |
| *Provisions / Avg. Loans (bps)* | *113.9* | *100.8* | *83.7* | *58.0* |
| *ROAE* | *-3.1%* | *6.6%* | *10.6%* | *15.4%* |
| *ROAA* | *-0.4%* | *0.7%* | *1.0%* | *1.4%* |
| *EPS (OMR)* | *(0.00)* | *0.01* | *0.01* | *0.02* |
| *P/E (x)* | *N/M* | *32.78* | *18.73* | *11.31* |
| *Dividend Yield* | *0.0%* | *0.0%* | *0.0%* | *0.0%* |
| *P/BV (x)* | *2.25* | *2.10* | *1.89* | *1.62* |
| *Capital Adequacy* | *13.8%* | *12.8%* | *12.0%* | *12.3%* |
| *Loan Growth* | *112.2%* | *25.0%* | *19.6%* | *17.2%* |
| *Loans/ Deposits* | *115.8%* | *109.0%* | *105.4%* | *107.4%* |
| *Provisions / NPLs* | *1273.4%* | *211.4%* | *158.0%* | *141.6%* |

*Figures in OMR million, unless otherwise stated*




| *Estimate Changes* | | | | | |
|---|---|---|---|---|---|
| | *2008a* | *2009e* | | *2010e* | |
| ***(OMR million)*** | | ***Old*** | ***New*** | ***Old*** | ***New*** |
| *Net Interest Income* | *11* | *N/A* | *22* | *N/A* | *28* |
| *Total Banking Income* | *18* | *N/A* | *30* | *N/A* | *38* |
| *Income Before Provisions* | *5* | *N/A* | *15* | *N/A* | *21* |
| *Net Attributable Income* | *(2)* | *N/A* | *7* | *N/A* | *12* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *N/A* |
| *Mkt. Cap / Shares (mn)* | *OMR217 / 1000* |
| *Av. Mthly Liqd (mn)* | *OMR7.9* |
| *52-Week High / Low* | *OMR0.223 / 0.094* |
| *Bloomberg / Reuters* | *BKSB OM / BKSB.OM* |
| *Est. Free Float* | *69.43%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Interest Income | 9 | 14 | 33 | 25 | 50 | 61 | 73 |
| Interest Expense | (6) | (10) | (22) | (15) | (28) | (33) | (37) |
| **Net Interest Income** | **4** | **4** | **11** | **10** | **22** | **28** | **37** |
| Exchange Income | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Fees from Banking Services, Net | 5 | 3 | 7 | 3 | 8 | 10 | 11 |
| Investments Income, Net | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Operating Income | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total Non Interest Income** | **5** | **3** | **7** | **2** | **8** | **10** | **12** |
| **Total Banking Income** | **8** | **7** | **18** | **12** | **30** | **38** | **48** |
| Total Operating Expenses | (6) | (5) | (13) | (8) | (15) | (17) | (20) |
| Income Before Provisions | 3 | 2 | 5 | 5 | 15 | 21 | 28 |
| Credit & Investment Provisions | (4) | (3) | (8) | (2) | (7) | (7) | (6) |
| Pre-Tax Profits | (2) | (1) | (3) | 3 | 8 | 13 | 22 |
| Taxation | 0 | 0 | 0 | (0) | (1) | (2) | (3) |
| **Net Income before Exceptionals** | **(2)** | **(1)** | **(2)** | **2** | **7** | **12** | **19** |
| Pre-Operating Expenses | (1) | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net Income** | **(2)** | **(1)** | **(2)** | **2** | **7** | **12** | **19** |

Source: Bank Sohar, EFG-Hermes estimates

### Balance Sheet (December Year End)

In OMR million, unless otherwise stated

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Cash and Central Bank Deposits | 20 | 14 | 94 | 108 | 113 | 156 | 184 |
| Due from Banks | 37 | 47 | 69 | 15 | 74 | 77 | 50 |
| Loans & Advances, Net | 299 | 458 | 634 | 739 | 793 | 948 | 1,112 |
| Investment Securities, Net | 55 | 56 | 26 | 88 | 37 | 44 | 50 |
| Fixed Assets, Net | 5 | 13 | 14 | 14 | 18 | 22 | 26 |
| Other Assets | 4 | 9 | 6 | 8 | 7 | 7 | 8 |
| **Total Assets** | **420** | **597** | **843** | **973** | **1,042** | **1,253** | **1,429** |
| Customer Deposits | 243 | 346 | 548 | 662 | 727 | 900 | 1,035 |
| Due to Banks | 29 | 38 | 90 | 95 | 109 | 135 | 155 |
| Term Loan (Debt) | 91 | 92 | 90 | 90 | 90 | 90 | 90 |
| Other Liabilities | 9 | 22 | 18 | 26 | 12 | 14 | 15 |
| Total Liabilities | 371 | 498 | 746 | 873 | 939 | 1,139 | 1,295 |
| Shareholders' Equity | 49 | 98 | 96 | 99 | 103 | 115 | 134 |
| **Total Liabilities & Shareholders' Equity** | **420** | **597** | **843** | **973** | **1,042** | **1,253** | **1,429** |

Source: Bank Sohar, EFG-Hermes estimates

### Ratios

| | 2007a | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | 14.4% | 19.30% | 13.8% | 13.09% | 12.8% | 12.0% | 12.3% |
| Loans / Deposits | 123.1% | 132.4% | 115.8% | 111.7% | 109.0% | 105.4% | 107.4% |
| NPL Coverage Ratio | N/A | N/A | 1273.4% | N/A | 211.4% | 158.0% | 141.6% |
| Net Interest Spreads | 0.81% | 1.31% | 1.75% | 2.48% | 2.61% | 2.87% | 3.22% |
| Cost/Income Ratio | 66.0% | 77% | 71.0% | 63% | 50.3% | 45.6% | 41.6% |
| Provisioning (bps) | 145.15 | 153.83 | 113.93 | 58.58 | 100.80 | 83.72 | 58.03 |
| ROAE | -10.1% | -3.2% | -3.1% | 4.8% | 6.6% | 10.6% | 15.4% |
| ROAA | -1.2% | -0.4% | -0.4% | 0.5% | 0.7% | 1.0% | 1.4% |
| EPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 | 0.01 | 0.02 |
| BVPS | 0.05 | 0.10 | 0.10 | 0.10 | 0.10 | 0.11 | 0.13 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Bank Sohar, EFG-Hermes estimates

# ATTIJARIWAFA - LEADER IN MOROCCO, GROWING IN AFRICA

06 OCTOBER 2009

MOROCCO | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Neutral | Current Price*: | MAD 269.0 |
| Long-Term Rec. : | Accumulate | LT Fair Value : | MAD 309.8 |

- **Expanding its Reach:** ATW embarked on an aggressive expansion into the Moroccan retail segment in 2004, and today has the second largest branch network, the largest share of demand deposits and consumer loans and the second largest share in mortgages. In addition, it has a strong domestic franchise in the corporate sector. Regional expansion in the Maghreb and Sub-Saharan Africa is another important strategic focus. ATW has subsidiaries in Tunisia and Senegal, and representative offices in Mauritania, Libya and the UAE. It has recently bought two banks (Congo and Gabon) from Credit Agricole, and plans to complete the acquisition of three other African banks, also from Credit Agricole, by the end of this year.

- **1H2009 - Solid Revenue Growth, Higher Provisioning:** ATW's earnings rose by 11% Y-o-Y, 5% ahead of expectations. Loan growth was a respectable 18% Y-o-Y and 8% from .December 2008, while deposit growth was weak at 4% Y-o-Y and 2% from December 2008, in line with sector trends. Spreads declined by 70bps Y-o-Y on lower asset yields and higher funding costs. While fees were weak, investment income was up strongly from last year boosted, we believe, by one-offs. Provisioning increased to 8% of banking income in 1H2009 (4% in 1H2008), with the NPLs rising 8% from December 2008. The NPL ratio remained flat at 5.9%.

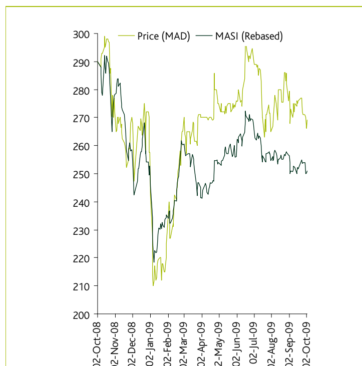
- **Expect a Weaker 2H2009:** Despite above-expectation 1H2009 , we have left our 2009e net profit forecast unchanged. We expect further pressure on spreads in 2H2009, lower investment gains and an increase in the provisioning effort. We expect provisioning to peak in 2010e. While ATW's coverage ratio is low by MENA standards, at 67%, we do not expect a dramatic increase in NPLs. ATW's retail portfolio is primarily geared towards residential mortgages, while its corporate portfolio is largely diversified. Our forecasts do not yet incorporate the consolidation of the new African banks, until further guidance from the company. We estimate that the acquisition of the five banks could enhance earnings by 5%.

- **Core Capital Position Tight, Rights Issue Likely in 2010e:** ATW has launched several subordinated debt issues in 2008 and 2009, and its CAR is just above the 10% minimum required by the central bank. While we had expected a rights issue later this year, this is likely to be postponed until 2010e after ATW’s capital position has been strengthened by real estate asset sales. The shareholders’ equity to asset ratio stood at 7.4% in June 2009, much higher than its peer BMCE but low by MENA standards.

- **Reiterate ST Neutral / LT Accumulate:** The valuation premium of Moroccan equities relative to MENA equities is at least partially explained by the existence of capital controls in Morocco. ATW trades at a 2010e P/E of 14.9x and P/B of 2.2x, with the ROE expected at 16% by 2010e. ATW is our top pick in Morocco, although the 15% upside potential implied by our LTFV and the lack of ST triggers mean that we remain LT Accumulate on the shares. We note that we have kept our discount rate for Moroccan banks of 10.3% unchanged as we were using already a relatively low cost of equity vs. other MENA banks.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *10,967* | *11,679* | *12,577* | *13,594* |
| *Cost to Income* | *44.2%* | *44.8%* | *44.5%* | *44.5%* |
| *Provisions to Average Gross Loans (bps)* | *44.9* | *67.0* | *60.0* | *55.0* |
| *Attributable Income* | *3,118* | *3,219* | *3,478* | *3,812* |
| *RoAE* | *18.3%* | *16.7%* | *16.1%* | *15.7%* |
| *RoAA* | *1.3%* | *1.2%* | *1.3%* | *1.3%* |
| | | | | |
| *EPS (MAD)* | *16.16* | *16.68* | *18.02* | *19.75* |
| *P/E (x)* | *16.7* | *16.1* | *14.9* | *13.6* |
| *Dividend Yield* | *1.9%* | *1.9%* | *1.9%* | *1.9%* |
| *P/BV (x)* | *2.7* | *2.4* | *2.2* | *1.9* |
| *Capital Adequacy Ratio* | *10.5%* | *10.6%* | *10.6%* | *10.7%* |
| *Loan Growth* | *29%* | *8%* | *9%* | *10%* |
| *Loans to Deposits* | *87%* | *87%* | *88%* | *88%* |
| *Provisions / NPLs* | *77%* | *74%* | *74%* | *74%* |

*Figures in MAD million, unless otherwise stated*




| *Estimate Changes* | | | | | |
|---|---|---|---|---|---|
| | *2008a* | *2009e* | | *2010e* | |
| *(MAD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *6,963* | *7,831* | *7,230* | *8,320* | *8,320* |
| *Net Banking Income* | *10,967* | *11,671* | *11,679* | *12,507* | *12,577* |
| *Income before Provisions* | *6,120* | *6,437* | *6,445* | *6,854* | *6,977* |
| *Attributable Income* | *3,118* | *3,215* | *3,219* | *3,409* | *3,478* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *MAD5.0 on 22 Jun. 09* |
| *Mkt Val / Shares (mn)* | *MAD59,915 / 193* |
| *Av. Mthly Lid.* | *MAD 262 mn* |
| *52-Week High / Low* | *MAD298 / 210* |
| *Bloomberg / Reuters* | *ATW MC/ ATW.CS* |
| *Est. Free-Float* | *17%* |

**Prices as at 02 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In MAD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **3,272** | **6,963** | **3,554** | **7,230** | **8,320** | **8,941** |
| Fee Income | 1,071 | 2,152 | 1,010 | 2,087 | 2,442 | 2,833 |
| Trading & Investment Income | 791 | 1,323 | 1,191 | 1,950 | 1,375 | 1,355 |
| Other Income | 205 | 529 | 197 | 412 | 440 | 465 |
| **Non-Interest Income** | **2,067** | **4,004** | **2,398** | **4,449** | **4,257** | **4,653** |
| **Total Banking Income** | **5,338** | **10,967** | **5,951** | **11,679** | **12,577** | **13,594** |
| Operating Expenses | (2,380) | (4,847) | (2,626) | (5,234) | (5,601) | (6,049) |
| **Operating Profit** | **2,958** | **6,120** | **3,325** | **6,445** | **6,977** | **7,545** |
| Provisions | (216) | (632) | (477) | (796) | (874) | (857) |
| Other | - | 11 | - | - | - | - |
| **Pre-Tax Income** | **2,749** | **5,500** | **2,857** | **5,648** | **6,103** | **6,688** |
| Taxes | (1,021) | (1,862) | (903) | (1,920) | (2,075) | (2,274) |
| **Net Income** | **1,728** | **3,637** | **1,954** | **3,728** | **4,028** | **4,414** |
| Minority Interests | (204) | (519) | (267) | (508) | (549) | (602) |
| **Net Income after Minority Interests** | **1,523** | **3,118** | **1,687** | **3,219** | **3,478** | **3,812** |

Source: Attijariwafa Bank, EFG-Hermes estimates

### Balance Sheet (December Year End)

In MAD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 16,983 | 15,730 | 15,046 | 16,211 | 17,508 | 19,259 |
| Interbank Assets | 21,825 | 25,704 | 24,722 | 25,175 | 20,206 | 22,227 |
| Customer Loans | 141,329 | 153,472 | 166,356 | 166,114 | 181,234 | 199,432 |
| Financial Investments | 41,443 | 46,840 | 46,278 | 45,671 | 48,443 | 51,756 |
| Property Investments | 723 | 791 | 959 | 815 | 823 | 831 |
| Goodwill | 4,451 | 5,055 | 5,056 | 5,000 | 4,950 | 4,900 |
| Other Assets | 10,260 | 6,117 | 5,850 | 6,179 | 6,243 | 6,306 |
| Fixed Assets | 4,691 | 5,233 | 5,187 | 5,756 | 6,159 | 6,528 |
| **Total Assets** | **241,705** | **258,942** | **269,454** | **270,921** | **285,567** | **311,240** |
| Deposits from Banks & Other Fin. Inst. | 15,551 | 25,358 | 27,651 | 19,197 | 18,653 | 20,492 |
| Customer Deposits | 172,551 | 176,593 | 179,544 | 190,720 | 205,978 | 226,576 |
| Sub debt, MT Loans & Other Debt | 8,008 | 10,886 | 13,221 | 12,433 | 12,433 | 12,333 |
| Other Liabilities | 25,821 | 25,015 | 26,445 | 24,350 | 21,220 | 21,107 |
| Proposed Dividend | - | 965 | - | 965 | 965 | 984 |
| **Shareholders' Equity** | **17,851** | **17,769** | **19,935** | **20,390** | **22,903** | **25,731** |
| Minority Interests | 1,924 | 2,357 | 2,659 | 2,865 | 3,415 | 4,017 |
| **Total Liabilities & Shareholders' Equity** | **241,705** | **258,942** | **269,454** | **270,921** | **285,567** | **311,240** |

Source: Attijariwafa Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 10.5% | N/A | 10.6% | 10.6% | 10.7% |
| Loans / Deposits | 81.9% | 86.9% | 92.7% | 87.1% | 88.0% | 88.0% |
| NPL Coverage Ratio | N/A | 77.3% | N/A | 74.2% | 73.9% | 73.8% |
| Net Interest Spread* | 3.3% | 3.1% | 2.6% | 2.7% | 2.9% | 2.9% |
| Cost / Income Ratio | 44.6% | 44.2% | 44.1% | 44.8% | 44.5% | 44.5% |
| Provisioning (bps)* | N/A | 44.9 | N/A | 67.0 | 60.0 | 55.0 |
| RoAE* | 17.5% | 18.3% | 17.5% | 16.7% | 16.1% | 15.7% |
| RoAA* | 1.3% | 1.3% | 1.3% | 1.2% | 1.3% | 1.3% |
| EPS* | 15.78 | 16.16 | 17.48 | 16.68 | 18.02 | 19.75 |
| BVPS | 92.49 | 98.97 | 103.29 | 110.65 | 123.67 | 138.43 |
| DPS | - | 5.00 | - | 5.00 | 5.00 | 5.10 |

*Annualised for 1H data

Source: Attijariwafa Bank, EFG-Hermes estimates

# BMCE BANK- THE ENTREPENEURIAL BANK

06 OCTOBER 2009

MOROCCO | BANKS

| Short-Term Rec.: | Reduce | Current Price*: | MAD 235.0 |
|---|---|---|---|
| Long-Term Rec. : | Reduce | LT Fair Value : | MAD 150.3 |

• **A Rapidly Growing Bank:** BMCE Bank, Morocco's third largest banks by assets, has over the past few years grown rapidly its branch network to capitalize on the strong growth of retail lending demand in Morocco. Furthermore, the bank has strong corporate and project finance franchises. BMCE has also developed its international business in recent years. It set up MediCapital in 2007, an investment bank headquartered in London, aiming to attract international investments into Africa. It also bought a 35% stake in Bank of Africa (BoA), a network of eleven commercial banks. The stake was raised to 42.5% in 2008, and BoA is now fully consolidated into BMCE's accounts. International operations accounted for 19% of consolidated earnings as of June 2009.

• **1H2009 Results - Spreads Decline, Provisioning Rises:** BMCE's 1H2009 net profit fell by 15% Y-o-Y following lower investment income, fast growth in expenses and rising provisioning charges. Loan growth has decelerated considerable to 4% in June 2009 vs. December 2008, while deposits declined slightly. Similarly to its peers, spreads have declined significantly Y-o-Y by 60bps, reflecting a squeeze in asset margins and higher funding costs. Credit quality has remained broadly stable in Morocco, with most of the new NPLs arising from the African operations.

• **Slight Contraction in Earnings in 2009e:** We forecast 2009e net attributable profit to decline by 4% in 2009e, reflecting higher Y-o-Y provisioning charges and compared to a low base in 2008. We expect earnings growth to pick up to 10% Y-o-Y in 2010e. We estimate loan growth of 9% Y-o-Y in 2009e and a recovery to 13% Y-o-Y in 2010e and an average of 15% until 2013e. We expect low growth in deposits in 2009 of 5% Y-o-Y to improve to 10% Y-o-Y in 2010e. The bank's strong branch expansion over the past three years should allow BMCE to increase its share of retail deposits in the medium term. We expect spreads to remain under pressure this year on higher funding costs and to stabilize in 2010e.

• **The Most Leveraged Bank in MENA:** BMCE's shareholders' equity-to-total assets ratio has fallen to 4.5% in 1H2009 from 7% in 2007, with BMCE being the most leveraged bank in our MENA coverage. The bank's capital adequacy ratio is slightly above 10% following the several issues of subordinated debt during 2008 and 2009. Despite high leverage, ROE is at the low range of MENA banks at 12.8% in 2009e.

• **ST/LT Reduce:** BMCE trades at a 2010e P/E of 42.3x and P/B of 5.4x. From a fundamental standpoint, and despite accounting for BMCE' strong medium- and long-term prospects in Morocco and Africa, BMCE is clearly overvalued, in our view. With our revised LTFV of MAD150.3 (lower than our previous MAD211 on lower earnings forecasts) implying a substantial downside potential, we assign a ST/LT Reduce rating on the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *6,018* | *6,760* | *7,625* | *8,645* |
| *Cost to Income* | *64.8%* | *63.5%* | *65.3%* | *67.4%* |
| *Provisions to Avg. Gross Loans (bps)* | *1.9* | *55.0* | *45.0* | *29.0* |
| *Attributable Income* | *830* | *801* | *881* | *1,002* |
| *RoAE* | *13.7%* | *12.8%* | *13.2%* | *13.9%* |
| *RoAA* | *0.6%* | *0.5%* | *0.5%* | *0.5%* |
| *EPS (MAD)* | *5.23* | *5.05* | *5.55* | *6.31* |
| *P/E (x)* | *44.9* | *46.6* | *42.3* | *37.2* |
| *Dividend Yield* | *1.3%* | *1.0%* | *1.1%* | *1.2%* |
| *P/BV (x)* | *6.2* | *5.8* | *5.4* | *5.0* |
| *Capital Adequacy Ratio* | *10.1%* | *10.6%* | *10.9%* | *10.5%* |
| *Loan Growth* | *45%* | *9%* | *13%* | *15%* |
| *Loans to Deposits* | *76%* | *78%* | *80%* | *84%* |
| *Provisions / NPLs* | *78%* | *84%* | *74%* | *67%* |

*Figures in MAD million, unless otherwise stated*


*Estimate Changes*

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(MAD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *4,125* | *4,373* | *4,224* | *5,442* | *5,354* |
| *Net Banking Income* | *6,018* | *6,341* | *6,760* | *7,546* | *7,625* |
| *Income before Provisions* | *2,117* | *2,586* | *2,469* | *3,115* | *2,647* |
| *Attributable Income* | *830* | *1,042* | *801* | *1,274* | *881* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *MAD3.0 on 30 Jun. 09* |
| *Mkt Val / Shares (mn)* | *MAD37,307 / 159* |
| *Av. Mthly Lid.* | *MAD339.8* |
| *52-Week High / Low* | *MAD295 / 194* |
| *Bloomberg / Reuters* | *BCE MC / BMCE.CS* |
| *Est. Free-Float* | *25%* |

*Prices as at 02 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In MAD million, unless otherwise stated

| | 1H2008 | 2008a | 1H2009 | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **2,028** | **4,125** | **2,065** | **4,224** | **5,354** | **6,075** |
| Fee Income | 627 | 1,150 | 608 | 1,311 | 1,521 | 1,795 |
| Trading & Investment Income | 465 | 503 | 544 | 1,005 | 500 | 510 |
| Other Banking Income | (30) | 240 | 109 | 220 | 250 | 265 |
| **Non-Interest Income** | **1,063** | **1,894** | **1,261** | **2,536** | **2,271** | **2,570** |
| **Total Banking Inco,e** | **3,091** | **6,018** | **3,326** | **6,760** | **7,625** | **8,645** |
| Operating Expenses | (1,853) | (3,901) | (1,998) | (4,291) | (4,978) | (5,824) |
| Operating Profit | 1,238 | 2,117 | 1,328 | 2,469 | 2,647 | 2,821 |
| Provisions | (94) | (89) | (272) | (512) | (465) | (342) |
| Extraordinary & Other Items | 18 | 82 | 17 | 40 | 20 | 25 |
| **Income before Tax** | **1,162** | **2,110** | **1,074** | **1,997** | **2,202** | **2,505** |
| Taxes | (340) | (673) | (301) | (639) | (683) | (776) |
| Minority Interest | (353) | (607) | (320) | (557) | (638) | (726) |
| **Net Income** | **469** | **830** | **453** | **801** | **881** | **1,002** |

Source: BMCE, EFG-Hermes estimates

### Balance Sheet (December Year End)

In MAD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & Due from Central Bank | 8,706 | 8,762 | 8,602 | 9,530 | 10,483 | 11,636 |
| Interbank Loans | 26,830 | 21,586 | 20,743 | 21,918 | 21,280 | 20,421 |
| Customer Loans (Net) | 85,765 | 85,709 | 88,855 | 93,211 | 105,364 | 121,473 |
| Financial Investments | 28,189 | 24,156 | 29,724 | 27,005 | 30,162 | 33,386 |
| Property Investments | 505 | 505 | 535 | 535 | 551 | 568 |
| Goodwill | 178 | 250 | 417 | 250 | 240 | 230 |
| Fixed & Other Assets | 8,187 | 9,493 | 9,927 | 10,012 | 10,389 | 10,633 |
| **Total Assets** | **158,361** | **150,461** | **158,803** | **162,462** | **178,468** | **198,347** |
| Interbank Deposits | 17,996 | 12,647 | 15,631 | 17,868 | 20,966 | 24,726 |
| Customer Deposits | 106,329 | 113,450 | 113,075 | 119,122 | 131,034 | 145,448 |
| Bonds & Subordinated Debt | 7,968 | 8,743 | 10,876 | 9,200 | 10,200 | 10,050 |
| Provisions (Non-Loan) | 297 | 325 | 301 | 358 | 394 | 429 |
| Other Liabilities | 16,253 | 7,030 | 8,956 | 5,864 | 4,740 | 5,305 |
| Minorities | 2,472 | 2,708 | 2,837 | 3,215 | 3,803 | 4,469 |
| **Shareholders' Equity** | **7,046** | **5,557** | **7,127** | **6,834** | **7,331** | **7,919** |
| **Liabilities & Shareholders ' Equity** | **158,361** | **150,461** | **158,803** | **162,462** | **178,468** | **198,347** |

Source: BMCE, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 10.1% | N/A | 10.6% | 10.9% | 10.5% |
| Loans / Deposits | 80.7% | 75.5% | 78.6% | 78.2% | 80.4% | 83.5% |
| NPL Coverage Ratio | N/A | 77.9% | N/A | 84.3% | 74.1% | 67.1% |
| Net Interest Spread* | 3.3% | 3.8% | 2.7% | 3.3% | 3.8% | 3.8% |
| Cost / Income Ratio | 60.0% | 64.8% | 60.1% | 63.5% | 65.3% | 67.4% |
| Provisioning (bps)* | N/A | 1.9 | N/A | 55.0 | 45.0 | 29.0 |
| RoAE* | 13.3% | 13.7% | 14.3% | 12.8% | 13.2% | 13.9% |
| RoAA* | 0.6% | 0.6% | 0.6% | 0.5% | 0.5% | 0.5% |
| EPS* | 5.91 | 5.23 | 5.71 | 5.05 | 5.55 | 6.31 |
| BVPS | 44.38 | 38.00 | 44.90 | 40.63 | 43.57 | 46.98 |
| DPS | - | 3.00 | - | 2.42 | 2.61 | 2.90 |

*Annualised for 1H data

Source: BMCE, EFG-Hermes estimates

# BANQUE CENTRALE POPULAIRE - SHIFT IN STRATEGY

**06 OCTOBER 2009**

MOROCCO | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Neutral | Current Price*: | MAD 267.0 |
| Long-Term Rec. : | Neutral | LT Fair Value : | MAD 296.9 |

- **A Unique Bank in MENA:** Banque Centrale Populaire (BCP), 45% state-owned, is the central body of Credit Populaire du Maroc (CPM), Morocco's largest financial group comprising BCP and a network of regional banks, traditionally focused on the SMEs and household segments. BCP's main role is to manage the excess liquidity and to provide liquidity to the regional banks as well as catering for central services to the group. BCP does not own a retail branch network and does not collect deposits from the retail sector, with most of its funding being sourced from regional banks. BCP has strengthened since 2006 its project finance and large corporate lending activities, to capitalize on the strong growth in this segment in Morocco over the past few years.

- **2H2009 Results - Loan Growth Outperforms:** BCP's 1H2009 net profit of MAD718 million increased by 49% Y-o-Y. Growth was strong in all revenue lines, and particularly in net interest income (+47% Y-o-Y) and fee income (+52% Y-o-Y), driven by strong growth in corporate lending. Loan growth of 31% in June 2009 vs. December 2008 was well above the sector average and follows already strong growth of 60% Y-o-Y in 2008. Costs growth picked up strongly and increased by 132% Y-o-Y in 1H2009 relative to revenue growth of 46% Y-o-Y, resulting in operating profit expansion of 29% Y-o-Y. Provisioning remained low and declined Y-o-Y.

- **Lending Growth to Remain Strong:** While we expect loan growth to slowdown in 2H2009e, we still forecast loan growth for FY2009e to remain above sector average at 25% Y-o-Y and 20% Y-o-Y in 2010e. The government's continued investment in infrastructure projects will likely be a key driver of loan growth for BCP, in our view. We expect some downwards pressure in spreads as elsewhere in the Moroccan banking sector, with funding costs rising. We expect provisioning charges to rise in 2H2009e and 2010e, but to remain at low levels. We expect earnings growth of 46% Y-o-Y in 2009e and 12% in 2010e.

- **Reducing Exposure to Government Securities:** BCP's loan-to-asset ratio has increased from just 17% in 2007 to 27% in 1H2009, while the proportion of held-to-maturity investments (mainly government bonds) has fallen from 34% in 2007 to 26% in 1H2009. This trend is consistent with BCP's strategy of increasing lending exposure and reducing its holding of government securities in a declining interest rate environment. BCP's purchase of a 5.9% stake in state-owned OCP, Morocco's largest enterprise, and the world's largest phosphates producer will allow BCP not only to capitalize on lending opportunities to OCP, but also to improve revenue returns from OCP's consistent dividend stream.

- **Valuation and Recommendation**: BCP trades at a 2010e P/E of 15.4x and P/B of 2.2x, with the ROE expected to reach 17.4% by 2010e (from 13.9% in 2008). Our revised LTFV of MAD296.9 (from MAD261) offers 11% upside potential. We like the strong growth prospects for BCP, but given the limited upside potential implied by our LTFV, we assign a ST Neutral / LT Neutral to the stock.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *1,758* | *2,813* | *3,210* | *3,413* |
| *Cost to Income* | *27.9%* | *28.7%* | *27.9%* | *28.6%* |
| *Provisions to Avg. Gross Loans (bps)* | *25.4* | *28.0* | *28.0* | *29.0* |
| *Attributable Income* | *826* | *1,315* | *1,462* | *1,515* |
| *RoAE* | *13.9%* | *19.0%* | *18.4%* | *16.8%* |
| *RoAA* | *0.9%* | *1.3%* | *1.3%* | *1.3%* |
| *EPS (MAD)* | *12.50* | *19.90* | *22.12* | *22.92* |
| *P/E (x)* | *16.8* | *16.3* | *15.4* | *14.2* |
| *Dividend Yield* | *1.8%* | *1.8%* | *1.8%* | *1.9%* |
| *P/BV (x)* | *2.7* | *2.5* | *2.2* | *2.0* |
| *Shareholders' Equity / Assets* | *6.8%* | *6.7%* | *7.5%* | *7.7%* |
| *Loan Growth* | *60%* | *36%* | *17%* | *15%* |
| *Loans to Deposits* | *128%* | *160%* | *170%* | *174%* |
| *Provisions / NPLs* | *N/A* | *N/A* | *N/A* | *N/A* |

*Figures in MAD million, unless otherwise stated*


| *Estimate Changes* | | | | | |
|---|---|---|---|---|---|
| | *2008a* | *2009e* | | *2010e* | |
| *(MAD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *961* | *N/A* | *1,295* | *N/A* | *1,624* |
| *Net Banking Income* | *1,758* | *N/A* | *2,813* | *N/A* | *3,210* |
| *Income before Provisions* | *1,268* | *N/A* | *2,005* | *N/A* | *2,313* |
| *Attributable Income* | *826* | *N/A* | *1,315* | *N/A* | *1,462* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *MAD5.75 on 19 Jun. 09* |
| *Mkt Val / Shares (mn)* | *MAD17,648 / 66* |
| *Av. Mthly Lid.* | *MAD153.6* |
| *52-Week High / Low* | *MAD277 / 201* |
| *Bloomberg / Reuters* | *BCP MC / BCP.CS* |
| *Est. Free Float* | *17%* |

**Prices as at 02 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In MAD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **355** | **961** | **523** | **1,295** | **1,624** | **1,590** |
| Fee Income | 152 | 298 | 232 | 433 | 541 | 638 |
| Trading & Investment Income | 354 | 419 | 594 | 1,035 | 945 | 1,060 |
| Other Income | 75 | 80 | 21 | 50 | 100 | 125 |
| **Non-Interest Income** | **582** | **797** | **847** | **1,518** | **1,586** | **1,823** |
| **Total Banking Income** | **937** | **1,758** | **1,370** | **2,813** | **3,210** | **3,413** |
| Operating Expenses | (159) | (490) | (367) | (808) | (897) | (977) |
| **Operating Profit** | **778** | **1,268** | **1,003** | **2,005** | **2,313** | **2,436** |
| Provisions | (43) | (48) | (18) | (68) | (92) | (124) |
| Other | 21 | 11 | 23 | - | - | - |
| **Pre-Tax Income** | **754** | **1,272** | **1,035** | **2,015** | **2,273** | **2,355** |
| Taxes | (252) | (415) | (280) | (645) | (750) | (777) |
| Net Income | 502 | 857 | 755 | 1,370 | 1,523 | 1,578 |
| Minority Interests | (21) | (31) | (37) | (55) | (61) | (63) |
| **Net Income after Minority Interests** | **481** | **826** | **718** | **1,315** | **1,462** | **1,515** |

Source: Banque Centrale Populaire, EFG-Hermes estimates

### Balance Sheet (December Year End)

In MAD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | N/A | 16,553 | 12,178 | 17,386 | 19,125 | 21,420 |
| Interbank Assets | N/A | 20,210 | 20,375 | 26,080 | 18,930 | 20,983 |
| Customer Loans | N/A | 20,815 | 27,331 | 28,343 | 33,145 | 38,046 |
| Financial Investments | N/A | 33,439 | 36,206 | 35,290 | 37,544 | 39,874 |
| Property Investments | N/A | - | - | - | - | - |
| Goodwill | N/A | - | 362 | - | - | - |
| Other Assets | N/A | 1,655 | 3,119 | 1,829 | 2,033 | 2,136 |
| Fixed Assets | N/A | 1,960 | 2,052 | 2,097 | 2,223 | 2,334 |
| **Total Assets** | **N/A** | **94,632** | **101,623** | **111,026** | **113,000** | **124,793** |
| Deposits from Banks & Other Fin. Inst. | N/A | 66,868 | 67,773 | 69,191 | 75,134 | 83,058 |
| Customer Deposits | N/A | 16,276 | 17,702 | 17,741 | 19,515 | 21,857 |
| Sub debt, Medium-term Loans & Other Debt | N/A | - | 1,517 | - | - | - |
| Other Liabilities | N/A | 4,814 | 6,495 | 16,450 | 9,584 | 9,940 |
| Shareholders' Equity | N/A | 6,454 | 7,706 | 7,389 | 8,471 | 9,599 |
| Minority Interests | N/A | 219 | 430 | 254 | 295 | 338 |
| **Total Liabilities & Shareholders' Equity** | **N/A** | **94,632** | **101,623** | **111,026** | **113,000** | **124,793** |

Source: Banque Centrale Populaire, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Shareholders' Equity / Assets | N/A | 6.8% | 7.6% | 6.7% | 7.5% | 7.7% |
| Loans / Deposits | N/A | 127.9% | 154.4% | 159.8% | 169.8% | 174.1% |
| NPL Coverage Ratio | N/A | N/A | N/A | N/A | N/A | N/A |
| Net Interest Spread* | N/A | 0.9% | - | 0.9% | 1.1% | 1.0% |
| Cost / Income Ratio | 16.9% | 27.9% | 26.8% | 28.7% | 27.9% | 28.6% |
| Provisioning (bps)* | N/A | 25.4 | N/A | 28.0 | 28.0 | 29.0 |
| RoAE* | N/A | 13.9% | 18.6% | 19.0% | 18.4% | 16.8% |
| RoAA* | N/A | 0.9% | 1.4% | 1.3% | 1.3% | 1.3% |
| EPS* | 14.54 | 12.50 | 21.73 | 19.90 | 22.12 | 22.92 |
| BVPS | N/A | 91.90 | 116.59 | 106.04 | 122.31 | 139.23 |
| DPS | - | 5.75 | - | 5.75 | 5.85 | 6.00 |

*Annualised for 1H data

Source: Banque Centrale Populaire, EFG-Hermes estimates

# NATIONAL BANK OF KUWAIT - RICH VALUATION

06 OCTOBER 2009

KUWAIT | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Neutral | Current Price*: | KWD 1.28 |
| Long-Term Rec. : | Neutral | LT Fair Value : | KWD 1.27 |

• **A High-Quality Franchise with a Growing Regional Business**: NBK is Kuwait's leading franchise in conventional banking, with market shares in excess of 30% in most business segments. NBK has always been a very conservative bank, and we believe it offers the safest profile amongst Kuwaiti banks from a credit quality perspective. NBK has over the past few years stepped up its efforts to become a regional player, and today is present in Egypt, Iraq, Lebanon, Qatar, Jordan and Turkey. NBK has recently bought a 27.5% stake in Boubyan bank, a start-up Islamic bank, where NBK can increase its stake to up to 40%. The purchase has been expensive at above 5.0x BV but, as Kuwait's Central Bank has been reticent in granting new Islamic banking licenses, acquisitions remain the only option to enter this segment in Kuwait.

• **2Q2009 Results - Loan Growth Weak, Provisioning Rises Q-o-Q:** NBK reported falls in earnings of 33% Y-o-Y and 2% Q-o-Q. Loan growth has been weak throughout 2009 (at 4% vs. December 2008), but spreads have improved substantially from last year on lower funding costs and inspite of declining rates on free funds. NBK has been improving its deposit mix by shedding expensive corporate deposits in favour of lower-cost deposits from government institutions. The provisioning effort has risen both Y-o-Y and Q-o-Q, primarily driven by generic provisions. The NPL ratio has remained unchanged from last year, at 1.96%. NBK has confirmed that its exposure to Saad and Algosaibi is negligible.

• **Expect NPLs to Rise in from 2009e Until 2010e, but the Provisioning Effort will be Manageable:** While NBK has a low exposure to Kuwait's investment companies, which so far seems to be the main source of new NPLs for Kuwaiti banks, we expect the NPL ratio to rise to 3.1% in 2010e from 1.95% in 2008, and the provisioning effort to remain high until then. NBK has a high coverage ratio at c180% and a strong capital position to absorb provisioning shocks, with a capital adequacy ratio of 14.8% in 2009e, most of which is core capital.

• **Will ROE Reverse Back to the High Historical Levels?** ROE has been on a declining trend since 2007, and following the rights issue to finance the purchase of Watany Bank in Egypt in 2007. Our forecasts do not assume ROEs to reverse back to the high level of c25% in 2003-2007, and we expect them to hover around 17% until 2013e and 15% in the longer term.

• **Rating Remains Neutral**: NBK trades at a 2010e P/E of 13.6x and 2.3x P/B, a slight discount to KFH, the most direct peer by size and profitability. Multiples continue to be high in a MENA context (ex-Morocco). We have increased our LTFV estimate to KWD1.27 (from KWD1.14) following a 100bps lowering in our discount rate to 11.5%. We reiterate our LT Neutral rating on NBK, with the share price offering no upside potential to our LTFV. With sentiment towards Kuwait remaining weak given the ongoing political stalemate and the lack of progress on investment spending, we see no short-term triggers that could drive a short-term outperformace of the share price. We reiterate our ST Neutral rating.

| *December Year End* | *2008e* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *508.5* | *536.9* | *576.7* | *641.9* |
| *Cost / Income* | *31%* | *35%* | *36%* | *37%* |
| *Provisions / Average Gross Loans (bps)* | *106.8* | *103.0* | *90.0* | *75.0* |
| *Net Attributable Income* | *255.3* | *250.0* | *279.1* | *318.1* |
| *ROAE* | *17%* | *17%* | *16%* | *17%* |
| *ROAA* | *2.2%* | *2.1%* | *2.1%* | *2.2%* |
| | | | | |
| *EPS (KWD)* | *0.086* | *0.084* | *0.094* | *0.107* |
| *P/E (x)* | *14.9* | *15.2* | *13.6* | *12.0* |
| *Dividend Yield* | *3.0%* | *3.0%* | *3.2%* | *3.8%* |
| *P/BV (x)* | *2.6* | *2.5* | *2.3* | *2.1* |
| *Capital Adequacy* | *15.3%* | *14.8%* | *14.5%* | *14.0%* |
| *Loan Growth* | *17.5%* | *7.4%* | *9.5%* | *12.6%* |
| *Loans / Deposits* | *125.4%* | *120.2%* | *118.7%* | *119.3%* |
| *Provisions / NPLs* | *182.6%* | *155.4%* | *147.5%* | *143.6%* |

*Figures in KWD million, unless otherwise stated*


**Estimate Changes**

| | *2008e* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(KWD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *366.8* | *381.8* | *369.3* | *424.1* | *411.3* |
| *Total Banking Income* | *508.5* | *521.3* | *536.9* | *587.7* | *576.7* |
| *Pre-Provisions Income* | *349.6* | *338.4* | *350.1* | *377.7* | *367.1* |
| *Net Attributable Income* | *255.3* | *260.1* | *250.0* | *291.7* | *279.1* |

**Stock Data**

| | |
|---|---|
| *Last Dividend* | *KWD0.045 on 23 Feb 09* |
| *Mket Value / Shares (mn)* | *KWD3,806 / 2,973* |
| *Av. Mthly Liqd (mn)* | *KWD150.3* |
| *52-Week High / Low* | *KWD1.66 / 0.74* |
| *Bloomberg / Reuters* | *NBK KK / NBK.KK* |
| *Est. Free Float* | *20%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **187.8** | **366.8** | **193.4** | **369.3** | **411.3** | **455.7** |
| Fee Income | 48.4 | 101.4 | 48.9 | 103.4 | 112.7 | 126.3 |
| Dividend, Trading & Investment Income | 16.3 | 2.4 | 18.1 | 19.8 | 8.7 | 13.8 |
| Property Income | - | - | - | - | - | - |
| Other Income | 16.8 | 37.9 | 21.4 | 44.3 | 44.0 | 46.1 |
| **Non-Interest Income** | **81.5** | **141.7** | **88.3** | **167.6** | **165.4** | **186.3** |
| **Total Banking Income** | **269.3** | **508.5** | **281.7** | **536.9** | **576.7** | **641.9** |
| Total Expenses | (76.0) | (158.9) | (95.0) | (186.8) | (209.6) | ( 239.1) |
| **Operating Profit** | **193.3** | **349.6** | **186.6** | **350.1** | **367.1** | **402.9** |
| Provisions | (12.3) | (58.6) | (30.8) | (77.3) | (73.7) | (68.4) |
| Other | 3.4 | - | (21.4) | - | - | - |
| **Pre-Tax Income** | **184.4** | **268.8** | **134.4** | **262.8** | **293.4** | **334.5** |
| Taxes & Zakat | (8.0) | (11.2) | (7.6) | (10.7) | (11.9) | (13.6) |
| **Net Income** | **176.4** | **257.6** | **126.8** | **252.2** | **281.5** | **320.9** |
| Minority Interests | (1.3) | (2.2) | (0.8) | (2.2) | (2.4) | (2.8) |
| **Net Income after Minority** | **175.1** | **255.3** | **126.1** | **250.0** | **279.1** | **318.1** |

Source: National Bank of Kuwait, EFG-Hermes estimates

### Balance Sheet (December Year End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 1,112 | 1,399 | 1,134 | 1,130 | 1,241 | 1,390 |
| Interbank Assets | 1,639 | 1,162 | 1,225 | 1,242 | 1,586 | 1,621 |
| Customer Loans | 6,146 | 6,955 | 7,259 | 7,468 | 8,180 | 9,210 |
| Financial Investments | 1,729 | 1,834 | 1,861 | 1,837 | 1,980 | 2,155 |
| Associates Investments | 115 | 128 | 132 | 135 | 138 | 142 |
| Goodwill | 247 | 243 | 247 | 243 | 243 | 235 |
| Other Assets | 118 | 119 | 112 | 125 | 130 | 135 |
| Fixed Assets | 115 | 133 | 145 | 142 | 143 | 142 |
| **Total Assets** | **11,221** | **11,973** | **12,114** | **12,322** | **13,640** | **15,031** |
| Deposits from Banks & Other Fin Inst | 4,155 | 4,622 | 4,248 | 4,285 | 4,757 | 5,250 |
| Customer Deposits | 5,207 | 5,545 | 6,044 | 6,211 | 6,894 | 7,721 |
| Sub debt, MT Loans & Other Debt | - | - | - | - | - | - |
| Other Liabilities | 221 | 237 | 202 | 173 | 190 | 79 |
| Proposed Dividend | - | 117 | - | 115 | 120 | 143 |
| **Shareholders' Equity** | **1,629** | **1,440** | **1,608** | **1,525** | **1,664** | **1,819** |
| Minority Interests | 10 | 11 | 12 | 13 | 15 | 18 |
| **Total Liabilities & Shareholders' Equity** | **11,221** | **11,973** | **12,114** | **12,322** | **13,640** | **15,031** |

Source: National Bank of Kuwait, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 15% | N/A | 15% | 14% | 14% |
| Loans / Deposits | 118% | 125% | 120% | 120% | 119% | 119% |
| NPL Coverage Ratio | N/A | 183% | N/A | 155% | 147% | 144% |
| Net Interest Spread* | 3.19% | 3.02% | 3.17% | 3.06% | 3.18% | 3.15% |
| Cost / Income Ratio | 28% | 31% | 34% | 35% | 36% | 37% |
| Provisioning (bps)* | N/A | 106.8 | N/A | 103.0 | 90.0 | 75.0 |
| RoAE* | 22% | 17% | 16% | 17% | 16% | 17% |
| RoAA* | 3.1% | 2.2% | 2.1% | 2.1% | 2.1% | 2.2% |
| EPS* | 0.118 | 0.086 | 0.085 | 0.084 | 0.094 | 0.107 |
| BVPS | 0.548 | 0.484 | 0.541 | 0.513 | 0.560 | 0.612 |
| DPS | - | 0.039 | - | 0.039 | 0.040 | 0.048 |

*Annualised for 1H data

Source: National Bank of Kuwait, EFG-Hermes estimates

# KUWAIT FINANCE HOUSE - STRONG CAPITAL POSITION

06 OCTOBER 2009

KUWAIT | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Neutral | Current Price*: | KWD 1.32 |
| Long-Term Rec. : | Neutral | LT Fair Value : | KWD 1.39 |

- **Expertise in Real Estate:** KFH is Kuwait's leading Islamic bank, having enjoyed a monopolistic position for almost 20 years. KFH has strong brand in the region in Islamic financing services and also has vast expertise in the development and management of real estate. It is currently involved in real estate projects in Bahrain, China and Malaysia. KFH has Islamic banking subsidiaries in Turkey, Bahrain and Malaysia, and has recently launched an investment company subsidiary in Saudi Arabia.

- **2Q2009 - Earnings Fall on Higher Y-o-Y Provisioning Charges:** KFH's 2Q2009 net profit fell by 61% Y-o-Y, and 1H2009 earnings by 54% Y-o-Y. Net interest income increased strongly by 93% on lower deposit costs, although quarterly net interest income has to be looked with caution since the final distribution to depositors is approved only upon the approval of the annual accounts. Investment and property income, while down 20% Y-o-Y, fared better than we expected. The decline in earnings both Y-o-Y and Q-o-Q was mainly due to an increase in the provisioning effort.

- **Cutting Earnings Forecasts:** We have cut our 2009e and 2010e earnings forecasts by 10% following higher than expected provisioning in 1H2009. We assume weak receivables (loan growth) in 2009e of 7% Y-o-Y, which will recover to 10% Y-o-Y by 2010e, as we expect Kuwait's larger banks to gain market share from the weaker, medium-sized banks in the short-term. The provisioning effort should peak in 2009e, although we still expect high provisioning in 2010e. We expect an 18% Y-o-Y decline in 2009e earnings, before recovering to 26% Y-o-Y in 2010e thanks to lower loan loss provisioning. We estimate KFH's ROE will fall to 9.9% in 2009e, from 12% in 2008, and to recover to 13% in 2010e.

- **Credit Quality, a Concern for Earnings, not for Capital:** NPLs rose almost six-fold in 2008, and the NPL ratio jumped from 2.6% in 2007 to 12.6% in 2008, while the coverage ratio fell from 139% in 2007 to 47% in 2008. Furthermore, according to KFH's annual report, the value of collateral covers just 22% of NPLs. We have had little guidance from management regarding the source of NPLs, but we assume they are related primarily to Kuwait's investment companies. However, KFH's ample capital position (CAR close to 20% even after adjusting for Basel II) provides a degree of comfort to the large jump in NPLs.

- **Upgrading ST Rating to Neutral:** We have upgraded our LTFV to KWD1.39, from KWD1.15, after lowering our discount rate in line with the discount reduction we have applied across our MENA banks universe. Our new LTFV implies only 5% upside potential. KFH trades at a 2010e P/E of 18.7x and P/B of 2.3x, a slight premium to the Kuwait banks' average. While we like KFH's strong franchise, the limited upside potential leads us to assign a LT Neutral rating. We have upgraded our ST rating from Reduce to Neutral, given slightly higher visibility regarding short-term earnings.

| *December Year End* | *2008a* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *586.9* | *607.0* | *599.0* | *657.3* |
| *Cost / Income* | *33.4%* | *43.8%* | *49.6%* | *49.4%* |
| *Provisions / Average Gross Loans (bps)* | *332.9* | *370.0* | *190.0* | *85.0* |
| *Net Attributable Income* | *157.0* | *125.1* | *163.1* | *239.0* |
| *ROAE* | *12.8%* | *9.9%* | *12.2%* | *16.1%* |
| *ROAA* | *1.6%* | *1.2%* | *1.4%* | *1.8%* |
| *EPS (KWD)* | *0.068* | *0.054* | *0.071* | *0.104* |
| *P/E (x)* | *19.4* | *24.3* | *18.7* | *12.7* |
| *Dividend Yield* | *2.1%* | *1.6%* | *2.1%* | *2.7%* |
| *P/BV (x)* | *2.6* | *2.5* | *2.3* | *2.0* |
| *Capital Adequacy* | *22%* | *21%* | *21%* | *20%* |
| *Loan Growth* | *20%* | *9%* | *11%* | *14%* |
| *Loans / Deposits* | *72%* | *73%* | *74%* | *76%* |
| *Provisions / NPLs* | *47%* | *58%* | *64%* | *78%* |

*Figures in KWD million, unless otherwise stated*


*Estimate Changes*

| | *2008e* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(KWD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | *263.3* | *309.0* | *253.3* | *337.0* | *300.0* |
| *Total Banking Income* | *586.9* | *500.0* | *607.0* | *525.0* | *599.0* |
| *Pre-Provisions Income* | *391.0* | *326.0* | *607.0* | *335.0* | *599.0* |
| *Net Attributable Income* | *157.0* | *156.0* | *125.1* | *167.0* | *163.1* |

| *Stock Data* | |
|---|---|
| *Last Dividend* | *KWD0.04 on11 Mar 09* |
| *Mket Value / Shares (mn)* | *KWD3,043 / 2,305* |
| *Av. Mthly Liqd (mn)* | *KWD179.3* |
| *52-Week High / Low* | *KWD2.00 / 0.79* |
| *Bloomberg / Reuters* | *KFIN KK / KFIN.KK* |
| *Est. Free Float* | *57%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **76.9** | **263.3** | **124.2** | **253.3** | **300.0** | **353.0** |
| Fee Income | 35.1 | 70.1 | 31.0 | 61.7 | 64.8 | 74.5 |
| Trading & Investment Income | 143.8 | 167.4 | 106.5 | 170.0 | 129.3 | 132.8 |
| Property Income | - | 56.0 | - | 67.0 | 55.0 | 45.0 |
| Other Income | 21.9 | 30.0 | 19.5 | 55.0 | 50.0 | 52.0 |
| **Non-Interest Income** | **200.8** | **323.6** | **157.0** | **353.7** | **299.1** | **304.4** |
| **Total Banking Income** | **277.7** | **586.9** | **281.2** | **607.0** | **599.0** | **657.3** |
| Total Operating Expenses | (90.3) | (195.8) | (115.7) | (265.6) | (296.8) | (324.6) |
| **Operating Profit** | **187.4** | **391.0** | **165.5** | **341.5** | **302.2** | **332.8** |
| Provisions | (10.4) | (210.9) | (102.2) | (199.2) | (114.6) | (57.9) |
| Other | - | - | - | - | - | - |
| **Pre-Tax Income** | **177.0** | **180.1** | **63.3** | **142.3** | **187.6** | **274.8** |
| Taxes & Zakat | (6.2) | (5.4) | (3.6) | (4.8) | (6.4) | (9.3) |
| **Net Income** | **170.8** | **174.7** | **59.7** | **137.4** | **181.3** | **265.5** |
| Minority Interests | (13.4) | (17.7) | 12.3 | (12.4) | (18.1) | (26.6) |
| **Net Income after Minority** | **157.4** | **157.0** | **72.1** | **125.1** | **163.1** | **239.0** |

Source: Kuwait Finance House, EFG-Hermes estimates

### Balance Sheet (December Year-End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 461 | 368 | 418 | 410 | 436 | 479 |
| Interbank Assets | 1,402 | 1,312 | 1,063 | 1,047 | 1,287 | 1,583 |
| Receivables and Leased Assets | 6,025 | 5,962 | 6,264 | 6,493 | 7,197 | 8,181 |
| Financial Investments | 1,001 | 1,039 | 1,083 | 1,163 | 1,338 | 1,471 |
| Associates Investments | 405 | 449 | 409 | 427 | 470 | 507 |
| Property Investments | 344 | 337 | 346 | 368 | 452 | 526 |
| Other Assets | 211 | 486 | 485 | 480 | 490 | 500 |
| Fixed Assets | 418 | 591 | 734 | 721 | 808 | 897 |
| **Total Assets** | **10,266** | **10,544** | **10,801** | **11,111** | **12,477** | **14,144** |
| Deposits from Banks & Other Fin Inst | 1,592 | 1,595 | 1,434 | 1,556 | 1,712 | 2,005 |
| Customer Deposits | 6,313 | 6,612 | 6,864 | 7,074 | 7,782 | 8,716 |
| Sub debt, MT Loans & Other Debt | - | - | - | - | - | - |
| Other Liabilities | 795 | 738 | 956 | 830 | 1,199 | 1,490 |
| Proposed Dividend | - | 82 | - | 48 | 65 | 84 |
| **Shareholders' Equity** | **1,206** | **1,162** | **1,189** | **1,236** | **1,334** | **1,489** |
| Minority Interests | 360 | 355 | 358 | 367 | 385 | 362 |
| **Total Liabilities & Shareholders' Equity** | **10,266** | **10,544** | **10,801** | **11,111** | **12,477** | **14,144** |

Source: Kuwait Finance House, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 21.7% | N/A | 21.1% | 20.6% | 20.0% |
| Loans / Deposits | 95% | 72% | 91% | 73% | 74% | 76% |
| NPL Coverage Ratio | N/A | 47% | N/A | 58% | 64% | 78% |
| Net Interest Spread* | 2.09% | 3.62% | 3.45% | 3.30% | 3.55% | 3.65% |
| Cost / Income Ratio | 33% | 33% | 41% | 44% | 50% | 49% |
| Provisioning (bps)* | N/A | 333 | N/A | 370 | 190 | 85 |
| RoAE* | 26% | 13% | 12% | 10% | 12% | 16% |
| RoAA* | 3.20% | 2% | 1.35% | 1% | 1% | 2% |
| EPS* | 0.137 | 0.068 | 0.063 | 0.054 | 0.071 | 0.104 |
| BVPS | 0.523 | 0.502 | 0.516 | 0.536 | 0.578 | 0.646 |
| DPS | - | 0.027 | - | 0.021 | 0.028 | 0.036 |

* Annualised for 1H data

Source: Kuwait Finance House, EFG-Hermes estimates

# COMMERCIAL BANK OF KUWAIT - POOR SHORT TERM OUTLOOK

**06 OCTOBER 2009**

KUWAIT | BANKS

| | | | |
|---|---|---|---|
| Short-Term Rec.: | Reduce | Current Price*: | KWD 1.00 |
| Long-Term Rec. : | Reduce | LT Fair Value : | KWD 0.78 |

- **The Most Geared to a Domestic Recovery:** Unlike other Kuwaiti banks that have a more diversified geographical earnings profile, Commercial Bank of Kuwait's (CBK) revenues are primarily sourced domestically. Although the strategic ambitions of the group were to expand regionally, these plans have now been postponed, given the deterioration in economic conditions. CBK's only foreign ventures are a minority stake in Al Cham Bank in Syria and a representative office in Iraq.

- **2Q2009 Earnings Negative on High Provisioning Charges:** CBK reported a net loss of KWD2.4 million in 2Q2009 and a net profit of KWD0.9 million in 1H2009. CBK's earnings have been hit the most by high provisioning compared to other Kuwaiti banks. While we assume that most of the credit quality deterioration is originated from Kuwait's investment sector, the large Q-o-Q rise in provisioning in 2Q2009 might suggest some exposure to the troubled Saudi conglomerates Saad and Algosaibi, although this has not been confirmed by CBK. Revenue growth was solid at 12% Y-o-Y and 51% Q-o-Q in 2Q2009. While this was helped by an investment gain, CBK has also mproved its net interest spread Q-o-Q by shifting its deposit mix in favour of lower cost deposits.

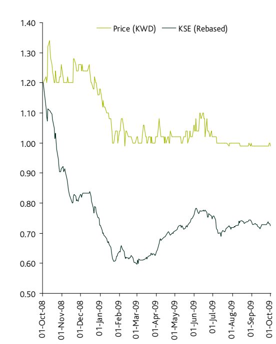
- **Short-Term Earnings Outlook Remains Weak:** We do not expect any significant improvement in profitability in 2H2009e and assume that most operating earnings will be used to increase loan loss provisions. We assume a significant rise in earnings in 2010e vs. 2009e, although this reflects our expectation of a lower provisioning effort in 2010e. We nevertheless expect the bank's ROE to remain depressed in 2010e at 11% vs. an average of 25% over the past five years (ex-2008). We are expecting loan growth to be almost flat in 2009e and to resume only slightly in 2010e to 7%. We have cut earnings by 90% in 2009e and by an average of 20% between 2010e and 2013e.

- **Capital Position Should be Sufficient to Absorb Provisioning:** CBK's capital adequacy ratio stood at 15.5% at the end of 2008. Given our expectation of weak asset growth and despite low profitability in 2009e and 2010e, we estimate that the current capital position should allow CBK to absorb large provisioning losses. We expect the NPL ratio to jump to 8.3% in 2010e from 5.2% in 2008. We calculate that for the CAR to fall below the 12% minimum required by the Central Bank, NPL ratios would have to rise above 18%, assuming the coverage ratio remained at 100%.

- **Valuation Remains Rich**: CBK trades at a 2010e P/E of 24.9x and P/B/ 2.7x still at a significant premium to the average multiples of both Kuwaiti and MENA banks. Fundamentally, we believe the stock is overvalued, with our revised LTFV of KWD0.78 implying 22% downside potential, and we therefore downgrade our LT rating to Reduce from Neutral. We leave our ST Reduce recommendation unchanged.

| *December Year End* | *2008e* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | 198.0 | 163.3 | 156.3 | 170.5 |
| *Cost / Income* | 17.7% | 21.1% | 24.4% | 25.1% |
| *Provisions / Avg. Gross Loans (bps)* | 114 | 300 | 140 | 70 |
| *Net Attributable Income* | 101 | 11 | 50 | 95 |
| *ROAE* | 23.1% | 2.5% | 11.2% | 19.3% |
| *ROAA* | 2.3% | 0.3% | 1.3% | 2.3% |
| | | | | |
| *EPS (KWD)* | 0.079 | 0.009 | 0.040 | 0.075 |
| *P/E (x)* | 12.5 | 112.1 | 24.9 | 13.3 |
| *Dividend Yield* | 4.0% | 0.0% | 1.8% | 3.4% |
| *P/BV (x)* | 2.8 | 2.8 | 2.7 | 2.4 |
| *Capital Adequacy* | 15.5% | 15.2% | 14.4% | 15.2% |
| *Loan Growth* | 9.8% | -0.1% | 7.0% | 11.2% |
| *Loans / Deposits* | 92% | 119% | 116% | 116% |
| *Provisions / NPLs* | 143% | 143% | 130% | 128% |

*Figures in KWD million, unless otherwise stated*




**Estimate Changes**

| | *2008a* | *2009e* | | *2010e* | |
|---|---|---|---|---|---|
| *(KWD mn)* | | *Old* | *New* | *Old* | *New* |
| *Net Interest Income* | 117 | 135 | 98 | 150 | 99 |
| *Total Banking Income* | 198 | 190 | 163 | 213 | 156 |
| *Pre-Provisions Income* | 163 | 152 | 129 | 169 | 118 |
| *Net Attributable Income* | 101 | 118 | 11 | 135 | 50 |

**Stock Data**

| | |
|---|---|
| *Last Dividend* | *KWD0.04 on 15 Mar 09* |
| *Mkt Value / Shares (mn)* | *KWD1,259 / 1,272* |
| *Av. Mthly Liqd (mn)* | *KWD31.4* |
| *52-Week High / Low* | *KWD1.34 / 0.99* |
| *Bloomberg / Reuters* | *CBK KK / CBK.KK* |
| *Est. Free Float* | *50%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)
In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **60.4** | **116.6** | **49.7** | **97.8** | **98.8** | **106.2** |
| Fee Income | 16.7 | 33.6 | 18.6 | 36.7 | 40.3 | 43.6 |
| Dividend, Trading & Investment Income | 34.3 | 40.5 | 14.1 | 20.2 | 8.2 | 11.4 |
| Property Income | - | - | - | - | - | - |
| Other Income | 3.3 | 7.3 | 1.2 | 8.6 | 8.9 | 9.3 |
| **Non-Interest Income** | **54.4** | **81.4** | **33.9** | **65.5** | **57.5** | **64.3** |
| **Total Banking Income** | **114.7** | **198.0** | **83.6** | **163.3** | **156.3** | **170.5** |
| Total Expenses | (16.7) | (35.0) | (16.7) | (34.4) | (38.1) | (42.7) |
| **Operating Profit** | **98.0** | **163.0** | **66.9** | **128.9** | **118.2** | **127.8** |
| Provisions | (24.2) | (57.7) | (66.1) | (117.0) | (64.3) | (26.5) |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Pre-Tax Income** | **73.8** | **105.3** | **0.8** | **11.9** | **53.8** | **101.3** |
| Taxes & Zakat | (3.2) | (4.6) | (0.0) | (0.5) | (2.3) | (4.4) |
| **Net Income** | **70.6** | **100.7** | **0.9** | **11.3** | **51.5** | **96.9** |
| Minority Interests | - | (0.1) | - | (0.1) | (1.0) | (1.9) |
| **Net Income after Minority** | **70.6** | **100.7** | **0.9** | **11.2** | **50.5** | **95.0** |

Source: Commercial Bank of Kuwait, EFG-Hermes estimates

### Balance Sheet (December Year End)
In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 192 | 320 | 53 | 81 | 157 | 174 |
| Interbank Assets | 1,281 | 939 | 602 | 632 | 650 | 722 |
| Customer Loans | 2,293 | 2,430 | 2,438 | 2,429 | 2,598 | 2,889 |
| Financial Investments | 450 | 382 | 539 | 541 | 582 | 642 |
| Associates Investments | - | - | - | - | - | - |
| Goodwill | - | 19 | 19 | 19 | 19 | 19 |
| Other Assets | 53 | 186 | 17 | 22 | 32 | 34 |
| Fixed Assets | 29 | 31 | 31 | 32 | 35 | 37 |
| **Total Assets** | **4,298** | **4,307** | **3,698** | **3,757** | **4,073** | **4,517** |
| Deposits from Banks & Other Fin Inst | 1,106 | 1,043 | 1,103 | 1,100 | 1,142 | 1,268 |
| Customer Deposits | 2,596 | 2,645 | 2,056 | 2,037 | 2,240 | 2,487 |
| Sub debt, MT Loans & Other Debt | 16 | - | - | - | - | - |
| Other Liabilities | 103 | 122 | 86 | 173 | 193 | 192 |
| Proposed Dividend | 0 | 51 | 0 | 0 | 23 | 43 |
| **Shareholders' Equity** | **476** | **446** | **451** | **447** | **475** | **527** |
| Minority Interests | 1 | 1 | 1 | 1 | 1 | 1 |
| **Total Liabilities & Shareholders' Equity** | **4,298** | **4,307** | **3,698** | **3,757** | **4,073** | **4,517** |

Source: Commercial Bank of Kuwait, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 15.5% | N/A | 15.2% | 14.4% | 15.2% |
| Loans / Deposits | 88% | 92% | 119% | 119% | 116% | 116% |
| NPL Coverage Ratio | N/A | 143% | N/A | 143% | 130% | 128% |
| Net Interest Spread* | 2.41% | 2.62% | 2.36% | 2.48% | 2.57% | 2.50% |
| Cost / Income Ratio | 15% | 18% | 20% | 21% | 24% | 25% |
| Provisioning (bps)* | N/A | 114 | N/A | 300 | 140 | 70 |
| RoAE* | 31% | 23% | 0% | 3% | 11% | 19% |
| RoAA* | 3% | 2% | 0% | 0% | 1% | 2% |
| EPS* | 0.111 | 0.079 | 0.001 | 0.009 | 0.040 | 0.075 |
| BVPS | 0.374 | 0.350 | 0.355 | 0.351 | 0.373 | 0.414 |
| DPS | - | 0.040 | - | - | 0.018 | 0.034 |

*Annualised for 1H data

Source: Commercial Bank of Kuwait, EFG-Hermes estimates

# BURGAN BANK - GOING REGIONAL

06 OCTOBER 2009

KUWAIT | BANKS

| | |
|---|---|
| Short-Term Rec.: Neutral | Current Price*: KWD 0.38 |
| Long-Term Rec. : Buy | LT Fair Value : KWD 0.63 |

- **Going Regional:** Burgan, 55% owned by KIPCO, recently purchased majority stakes in Jordan Kuwait Bank (JKB), Algeria Gulf Bank (AGB) and Bank of Baghdad (BoB) from UGB, also a subsidiary of KIPCO. Burgan also plans to complete its acquisition of Tunis International Bank within a year. These subsidiaries are already profitable and do not require major restructuring, although integration of central functions and alignment of best practices might be a longer-term process. We believe its exposure to Algeria is particularly attractive, given the current low level of international competition and the under-penetrated nature of the market.

- **2Q2009 Earnings Weak on High Provisioning Charges:** Burgan Bank's 2Q2009 earnings declined by 95% Y-o-Y and 90% Q-o-Q, to KWD1.1 million, following a large increase in the provisioning effort. Operating earnings grew strongly by 50% Y-o-Y and 63% Q-o-Q, but these are not like-for-like comparisons owing to the consolidation of JKB in July 2008 and of AGB and BoB in April 2009. NPLs are not available on a quarterly basis, but the large increase in provisioning highlights a significant deterioration in credit quality.

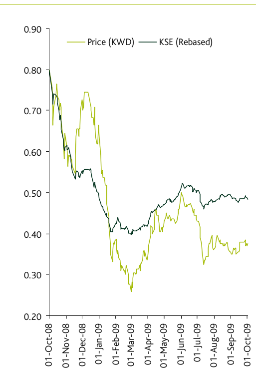
- **Cutting Earnings Forecasts:** We have cut our 2009e earnings forecasts by 35% following weaker than expected 2Q2009 results. We expect provisioning to peak in 2009e but to remain high in 2010e. Management have indicated that the NPL ratio could possibly triple over the next two years, and we incorporate this guidance into our assumptions. We are factoring weak (like-for-like) loan growth of 6% in both 2009e and 2010e. The main reason behind our conservative forecasts is the lack of attractive lending opportunities in Kuwait, given the lack of momentum in government spending.

- **Rights Issue Still a Possibility:** Burgan financed its purchases through a combination of cash and an increase in subordinated debt, as it failed to obtain Amiri approval to launch a rights issue at the end of last year to finance the deals. Burgan's total CAR stood at 13.7% at December 2008, but the tier-1 ratio is significantly weaker than the sector average at 9%, providing a weaker cushion to absorb any shock in provisioning charges. An increase in core-capital in 2009e-2010e cannot therefore be ruled out.

- **Good Value, but Keeping ST Rating at Neutral**: Burgan's multiples valuation is undemanding, with a 2010e P/E of 7.3x and P/B of 1.1x. While we expect ROE to remain low by MENA standards at 13% in 2010e, our forecasts assume an increase to 18% in the medium-term. We have increased our LTFV estimate to KWD0.63, from KWD0.59, following a 70bps in a discount rate to 12.4%. We continue to see good value in the shares, with our revised LTFV implying 65% upside potential. We nevertheless stick to ST Neutral, as we do not see short-term catalysts for the shares and we expect quarterly earnings to continue to be negatively impacted by high provisioning.

| *December Year End* | *2008e* | *2009e* | *2010e* | *2011e* |
|---|---|---|---|---|
| *Total Banking Income* | *121.1* | *161.5* | *188.3* | *204.2* |
| *Cost / Income* | *26%* | *27%* | *27%* | *29%* |
| *Provisions / Average Gross Loans (bps)* | *55.0* | *290.0* | *185.0* | *60.0* |
| *Net Attributable Income* | *36.5* | *21.1* | *52.3* | *78.1* |
| *ROAE* | *10.3%* | *5.7%* | *12.5%* | *15.9%* |
| *ROAA* | *1.1%* | *0.5%* | *1.2%* | *1.6%* |
| *EPS (KWD)* | *0.036* | *0.021* | *0.051* | *0.077* |
| *P/E (x)* | *10.5* | *18.1* | *7.3* | *4.9* |
| *Dividend Yield* | *0.0%* | *1.7%* | *7.5%* | *11.3%* |
| *P/BV (x)* | *1.2* | *1.2* | *1.1* | *1.0* |
| *Capital Adequacy* | *13.8%* | *13.3%* | *12.4%* | *12.0%* |
| *Loan Growth* | *50.1%* | *11.5%* | *4.1%* | *9.9%* |
| *Loans / Deposits* | *88.3%* | *92.9%* | *88.7%* | *88.6%* |
| *Provisions / NPLs* | *199.0%* | *154.9%* | *148.1%* | *153.6%* |

*Figures in KWD million, unless otherwise stated*




*Estimate Changes*

| *(KWD mn)* | *2008a* | *2009e Old* | *2009e New* | *2010e Old* | *2010e New* |
|---|---|---|---|---|---|
| *Net Interest Income* | *68.0* | *82.0* | *99.5* | *88.0* | *111.1* |
| *Total Banking Income* | *121.1* | *112.0* | *161.5* | *128.0* | *188.3* |
| *Pre-Provisions Income* | *89.0* | *79.0* | *117.9* | *90.0* | *137.0* |
| *Net Attributable Income* | *36.5* | *62.0* | *21.1* | *71.0* | *52.3* |

*Stock Data*

| | |
|---|---|
| *Last Dividend* | *KWD0.06 on 25 Mar 08* |
| *Mket Value / Shares (mn)* | *KWD391 / 1,041* |
| *Av. Mthly Liqd (mn)* | *KWD28* |
| *52-Week High / Low* | *KWD0.84 / 0.29* |
| *Bloomberg / Reuters* | *BURG KK / BURG.KK* |
| *Est. Free Float* | *48%* |

**Prices as at 01 October 2009*

## FINANCIAL STATEMENTS

### Income Statement (December Year End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| **Net Interest Income** | **27** | **68** | **49** | **99** | **111** | **123** |
| Fee Income | 10 | 22 | 15 | 31 | 37 | 43 |
| Trading & Investment Income | 24 | 26 | 4 | 11 | 19 | 17 |
| Property Income | - | - | - | - | - | - |
| Other Income | 15 | 4 | 26 | 19 | 21 | 22 |
| **Non-Interest Income** | **39** | **53** | **30** | **62** | **77** | **81** |
| **Total Banking Income** | **66** | **121** | **78** | **161** | **188** | **204** |
| Total Operating Expenses | (13) | (32) | (21) | (44) | (51) | (60) |
| **Operating Profit** | **53** | **89** | **57** | **118** | **137** | **144** |
| Provisions | (4) | (36) | (28) | (68) | (48) | (17) |
| Other | - | - | (3) | - | - | - |
| **Pre-Tax Income** | **49** | **42** | **27** | **40** | **84** | **126** |
| Taxes & Zakat | (2) | (5) | (5) | (7) | (14) | (22) |
| **Net Income** | **47** | **37** | **22** | **32** | **70** | **104** |
| Minority Interests | - | (1) | (10) | (11) | (17) | (26) |
| **Net Income after Minority** | **47** | **36** | **22** | **21** | **52** | **78** |

Source: Burgan Bank, EFG-Hermes estimates

### Balance Sheet (Year End)

In KWD million, unless otherwise stated

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Cash & CB Deposits | 568 | 551 | 511 | 487 | 558 | 614 |
| Interbank Assets | 681 | 532 | 528 | 634 | 748 | 860 |
| Customer Loans | 1,573 | 2,133 | 2,319 | 2,379 | 2,475 | 2,721 |
| Financial Investments | 466 | 495 | 501 | 554 | 598 | 640 |
| Associates Investments | - | - | - | 15 | 18 | 20 |
| Goodwill | - | 101 | - | 125 | 125 | 120 |
| Other Assets | | 76 | | 100 | 115 | 115 |
| Fixed Assets | 18 | 25 | 30 | 26 | 27 | 27 |
| **Total Assets** | **3,371** | **3,913** | **4,104** | **4,318** | **4,664** | **5,117** |
| Deposits from Banks & Other Fin Inst | 814 | 795 | 970 | 1,076 | 1,145 | 1,228 |
| Customer Deposits | 2,084 | 2,416 | 2,406 | 2,561 | 2,792 | 3,071 |
| Sub debt, MT Loans & Other Debt | 76 | 198 | 182 | 204 | 200 | 196 |
| Other Liabilities | 64 | 148 | 213 | 89 | 76 | 94 |
| Proposed Dividend | | - | | 6 | 29 | 43 |
| Shareholders' Equity | 334 | 311 | 332 | 326 | 349 | 385 |
| Minority Interests | - | 45 | - | - | - | - |
| **Total Liabilities & Shareholders' Equity** | **3,371** | **3,913** | **4,104** | **4,318** | **4,664** | **5,117** |

Source: Burgan Bank, EFG-Hermes estimates

### Ratios

| | 1H2008a | 2008a | 1H2009a | 2009e | 2010e | 2011e |
|---|---|---|---|---|---|---|
| Capital Adequacy Ratio | N/A | 13.8% | N/A | 13.3% | 12.4% | 12.0% |
| Loans / Deposits | 75% | 88% | 96% | 93% | 89% | 89% |
| NPL Coverage Ratio | N/A | 199% | N/A | 155% | 148% | 154% |
| Net Interest Spread* | 1.43% | 1.79% | 2.38% | 2.48% | 2.60% | 2.60% |
| Cost / Income Ratio | 20% | 26% | 27% | 27% | 27% | 29% |
| Provisioning (bps)* | N/A | 55 | N/A | 290 | 185 | 60 |
| RoAE* | 29% | 10% | 13% | 6% | 12% | 16% |
| RoAA* | 2.8% | 1.1% | 1.1% | 0.5% | 1.2% | 1.6% |
| EPS* | 0.092 | 0.036 | 0.044 | 0.021 | 0.051 | 0.077 |
| BVPS | 0.328 | 0.306 | 0.326 | 0.320 | 0.343 | 0.378 |
| DPS | - | - | - | 0.006 | 0.028 | 0.042 |

*Annualised for 1H data

Source: Burgan Bank, EFG-Hermes estimates

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|---|---|
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