SHUAACAPITAL PSC

Union National Bank (UNB.AD)

Equity Research

Q1 07 Results Update

May 27th 2007

Current Price:	AED 8.32*	**Country:**	United Arab Emirates
Fair value Target:	AED 8.80	**Sector:**	Commercial Banking
Recommendation:	NEUTRAL	**Exchange:**	Abu Dhabi Securities Market

**Price as of May 24th 2007*

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- Union National Bank (UNB) missed our net income estimate for 2006 due to lower than expected capital market related income and slower balance sheet growth. We are projecting AED 999 mn in net profit for 2007, 18% lower than our previous projection and flat compared to 2006 and Q1 07 annualized. The bank took limited provisions in Q1 07 and we believe provisioning will increase later in the year. Overall, a net profit CAGR of 10.2% is anticipated for the forecast period with key drivers being the expansion in Egypt and project financing in Abu Dhabi.

- UNB underperformed the sector in deposits growth in 2006. Deposits grew by 17% versus the sector's 30%. In addition, its volatile deposit base fell by 5% in Q1 07 due to withdrawals in time deposits. Given its expansion in Egypt, UNB's balance sheet should outpace the UAE banking sector in terms of growth in the future. Deposits are set to grow at a CAGR of 15% over the forecast period, versus the sector average of 14%.

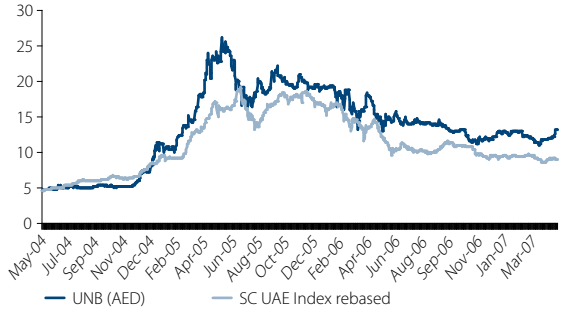
- Although UNB will continue to face low spreads relative to peers, balance sheet growth will supply healthy growth in interest income. Fees and commissions income fell sharply in Q1 07 compared to Q1 06 due to the lack of IPO related income until now in 2007. Using the sustainable Q1 07 results as the basis we are projecting relatively slow growth in non-interest income

- We have lowered our target value for UNB from AED 10.07 to AED 8.80 per share, which compares to a current price of AED 8.29 per share. Given the 5.9% upside potential we have downgraded our investment recommendation for the stock from Buy to Neutral.

Year	Net profit (AED'000)	BV (AED'000)	EPS (AED'000)	BVPS (AED'000)	RoAE (%)	P/E (x)	P/BV (x)
Dec-09E	1,256,879	7,751,527	0.80	4.96	17.0%	10.3	1.7
Dec-08E	1,152,400	7,060,243	0.74	4.52	17.1%	11.2	1.8
Dec-07E	998,702	6,426,423	0.64	4.11	16.2%	13.0	2.0
Dec-06	1,007,782	5,927,072	0.64	3.79	18.1%	12.9	2.2

52-week range (AED)	5.95-11.25
Number of shares (000')	1,562,500
Free Float (%)	40
Market cap (AED' 000)	13,000,000
Market cap (USD' 000)	3,540,594
Div. Yld. 2006 (%)	4.22%

UNB stock performance vs. SC UAE Index rebased



Analysis and revised forecasts

Sources of funds growth to outperform the sector

Deposits to grow by a CAGR of 15% over forecast period

Union National Bank (UNB) underperformed the sector in deposits growth in 2006. Deposits grew by 17% versus the sector's 30%. In addition, its volatile deposit base fell by 5% in Q1 07 due to withdrawals in time deposits. Given its expansion in Egypt, UNB's balance sheet should outpace the UAE banking sector in terms of growth in the future. Deposits are set to grow at a CAGR of 15% over the forecast period, versus the sector average of 14%.

With the strong demand for project finance in the emirate of Abu Dhabi, UNB recently increased its Euro medium term notes (EMTNs) ceiling to USD 3 bn from USD 1.5 bn. We are projecting the proportion of EMTNs to rise from 9% of total assets in 2006 to just below 13% by 2011.

UNB raised the paid up capital of its subsidiary 'Union National Bank Egypt' to EGP 900 mn (AED 576 mn) from EGP 112 mn (AED 72 mn). The capital increase comes as part of a key expansion plan into the Egyptian market. The increase in emphasis on the Egyptian market as well as our positive outlook on the country's banking prospects lead us to conclude that the subsidiary should account for a sizable share in UNB's growth.

Loans growth to ease from current dizzying pace

Loans grew by 33% in 2006 and 15% in Q1 07 to AED 29.1 bn. We do not believe the growth witnessed in Q1 07 is sustainable throughout the year especially due to sources of funds limitations. We are forecasting a CAGR of 15.4% over the forecast period. This is driven by the expansion in Egypt as well as the huge potential in real estate and project finance lending in the emirate of Abu Dhabi, where current and planed projects are estimated at AED 732 bn.

Interest spreads to be pressured in 2007

As UNB attempts to recapture time deposits, which accounted for 77% of all customer deposits in Q1 07, its cost of funds is set to rise. This will put pressure on spreads in 2007. Beyond 2007, greater competition over deposits in order to fund loan commitments by big banks is expected to maintain spreads at 1.70%.

Although, UNB will continue to face low spreads relative to peers, balance sheet growth will supply healthy growth in interest income. We are projecting interest income of AED 1.01 bn in 2007, a 14% year on year growth rate. A CAGR of 13% is projected for our five year projection.

Significant percentage of 2006 fee & commission income is IPO related

Fee income is set to grow at a CAGR of 3.4%

Fee and commission income fell sharply in Q1 07 compared to Q1 06 due to the lack of IPO related income until now in 2007. Using the sustainable Q1 07 results as the basis we are projecting AED 375 mn in fees and commissions income, which is 33% lower than in 2006. Hence, total non-interest income is set for a mediocre CAGR of 3.4% over the forecast period.

Cost to income excluding provisions to worsen in 2007

The fall in non interest income in 2007 will cause the cost to income excluding provisions ratio to rise from 25% in 2006 to 30% 2007. Beyond 2007, the ratio should fall gradually to 28% as wage inflation eases in the UAE and further economies of scale are achieved in Egypt.

2007 net income to be flat compared with 2006

Net profits to grow by a CAGR of 10.2% over forecast period

UNB missed our estimate for 2006 due to lower than expected capital market related income and slower balance sheet growth. We are projecting AED 999 mn in net profit for 2007, 18% lower than our previous projection and flat compared to 2006 and Q1 07 annualized. Note that the bank took limited provisions in Q1 07 and we believe provisioning will increase later in the year. Overall, a net profit CAGR of 10.2% is anticipated for the forecast period with key drivers being their expansion in Egypt and project financing in Abu Dhabi.

Balance Sheet AED'000	2006	2007E new	2007E old
Assets	41,539,054	51,246,379	42,248,623
Loans	27,493,904	34,112,061	27,525,482
Deposits	30,046,079	35,907,433	30,247,783
Income Statement			
Net interest income	888,623	1,012,655	984,660
Non interest income	646,517	524,153	767,128
Net income	1,007,782	998,702	1,218,595
Ratios			
Interest spreads	1.81%	1.72%	1.40%
RoaAE	18.1%	16.2%	19.4%

Source: UNB, SHUAA Capital

Valuation

We downgraded our recommendation to Neutral…

…After lowering our target value to AED 8.80 per share

In light of the revised forecasts, we have lowered our target value for UNB from AED 10.07 to AED 8.80 per share, which compares to a current price of AED 8.32 per share. Given the 5.9% upside potential we have downgraded our Buy recommendation for the stock to a Neutral.

	Value per share (AED)	Weight
DECF	8.65	70%
Relative valuation	9.19	30%
Target value	8.80	

Financials

UNB Balance Sheet - AED'000

Year to December	2006	2007E	2008E	2009E	2010E	2011E
Cash & Central Bank	2,634,708	3,814,474	5,044,743	5,575,180	6,196,843	6,898,858
Fixed Income Investments	1,590,300	2,046,724	2,488,062	2,796,892	3,091,477	3,440,170
Equity Investments	749,195	921,510	1,032,091	1,145,621	1,271,639	1,411,520
Due from Banks	13,678	59,936	64,506	61,925	68,737	76,298
Net Loans	7,719,097	8,617,784	9,909,351	11,332,234	11,886,197	12,455,789
Fixed assets	230,256	253,282	278,610	295,326	310,093	325,597
Other assets	897,378	1,256,329	1,407,089	1,575,939	1,702,014	1,787,115
Goodwill	224,216	224,216	224,216	224,216	224,216	224,216
Total assets	**41,539,054**	**51,246,379**	**61,136,906**	**68,756,570**	**75,318,747**	**82,890,884**
Customer deposits	30,046,079	35,907,433	42,897,625	48,222,274	53,301,334	59,313,282
Due to banks	522,638	592,473	697,086	771,556	852,821	949,013
Long term loans	3,855,441	6,355,441	8,355,441	9,755,441	10,155,441	10,555,441
Other liabilities	1,085,556	1,356,945	1,492,640	1,567,271	1,645,635	1,727,917
Total liabilities	**35,509,714**	**44,212,292**	**53,442,792**	**60,316,543**	**65,955,231**	**72,545,652**
Share capital	1,562,500	1,562,500	1,562,500	1,562,500	1,562,500	1,562,500
Reserves	2,283,438	2,383,308	2,498,548	2,624,236	2,772,248	2,936,031
Retained earnings	2,081,134	2,480,615	2,999,195	3,564,791	4,230,842	4,967,868
Total shareholders' equity	**5,927,072**	**6,426,423**	**7,060,243**	**7,751,527**	**8,565,590**	**9,466,399**
Proposed dividends	0	499,351	518,580	565,596	666,052	737,026
Total liabilities and equity	**41,539,054**	**51,246,379**	**61,136,906**	**68,756,570**	**75,318,747**	**82,890,884**

Source: UNB, SHUAA Capital

UNB Income Statement - AED'000

Year to December	2006	2007E	2008E	2009E	2010E	2011E
Interest income	2,444,109	2,944,643	3,585,472	4,185,864	4,648,542	5,108,334
Interest expense	-1,555,486	-1,931,988	-2,393,839	-2,822,835	-3,138,001	-3,445,747
Net interest income	**888,623**	**1,012,655**	**1,191,633**	**1,363,028**	**1,510,541**	**1,662,587**
Net fee and commission income	559,115	374,607	434,544	495,380	535,011	577,812
Net gains from FX transactions	24,924	26,170	27,479	28,853	30,295	31,810
Investment gain	13,678	59,936	64,506	61,925	68,737	76,298
Other income	48,800	63,440	68,515	72,626	76,257	80,070
Total non-interest income	646,517	524,153	595,044	658,785	710,301	765,990
Total income from operations	**1,535,140**	**1,536,808**	**1,786,677**	**2,021,813**	**2,220,842**	**2,428,578**
Staff and general expenses	-263,258	-318,542	-369,509	-421,240	-463,364	-500,433
Total provision charge	-138,772	-66,908	-99,518	-168,111	-90,527	-92,450
Depreciation	-24,184	-31,430	-34,573	-37,306	-39,352	-41,320
Other expenses	-99,422	-112,347	-120,211	-126,222	-132,533	-139,159
Total non-interest expenses	**-525,636**	**-529,227**	**-623,811**	**-752,879**	**-725,776**	**-773,363**
Profit before tax	1,009,504	1,007,581	1,162,866	1,268,934	1,495,065	1,655,215
Taxes	0	-2,834	-3,489	-4,441	-5,980	-7,448
Minority Interest	-1,722	-6,045	-6,977	-7,614	-8,970	-9,931
Net profit	**1,007,782**	**998,702**	**1,152,400**	**1,256,879**	**1,480,115**	**1,637,835**

Source: UNB, SHUAA Capital

UNB -Key Ratios %, (unless otherwise stated)

Year to December	2006	2007E	2008E	2009E	2010E	2011E	CAGR
Growth							
Equity	13.3	8.4	9.9	9.8	10.5	10.5	9.8
Assets	18.9	23.4	19.3	12.5	9.5	10.1	14.8
Loans	32.8	24.1	19.5	12.4	10.5	11.3	10.0
Deposits	16.5	19.5	19.5	12.4	10.5	11.3	14.6
Net interest income	28.7	14.0	17.7	14.4	10.8	10.1	13.3
Operating income	-9.2	0.1	16.3	13.2	9.8	9.4	9.6
Net profit	-12.3	-0.9	15.4	9.1	17.8	10.7	10.2
Capital Adequacy							
Capital base/RWA	18.2	15.5	14.2	14.0	14.0	14.0	
Asset Quality							
NPL / Gross Loans	1.5	1.1	1.3	1.5	1.5	1.5	
LLP / NPL	130.8	128.0	110.0	110.0	110.0	110.0	
Margins & profitability							
Interest Spread	1.8	1.7	1.7	1.7	1.7	1.7	
Net interest Margin	2.5	2.3	2.2	2.2	2.2	2.2	
Net Profit Margin	32.6	28.8	27.6	25.9	27.6	27.9	
RoAE	18.1	16.2	17.1	17.0	18.1	18.2	
RoAA	2.6	2.2	2.1	1.9	2.1	2.1	
Efficiency							
Cost/income	34.2	34.4	34.9	37.2	32.7	31.8	
Liquidity							
Loans / Interest Earning Assets	70.0	70.5	70.4	70.2	70.8	71.5	
Loans / Deposits	91.5	95.0	95.0	95.0	95.0	95.0	

Source: UNB, SHUAA Capital

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