



7 September 2023

Initiation of coverage

Abu Dhabi Commercial Bank

Positioned for growth



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Last close, AED	8.57
Fair value, AED	9.70
Upside	+13.2%
Stock rating	Equal-Weight

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Investment Case

Local roots, government wings

Abu Dhabi Commercial Bank (ADCB) ranks third in the United Arab Emirates (UAE), and sixth in the Gulf Cooperation Council (GCC), across balance-sheet metrics. Its merger with Union National Bank (UNB) and Al Hilal Bank (AHB) in 2019 marked a significant milestone, expanding both scale and competitiveness. Today, the network is heavily concentrated in the UAE, unlike FAB and ENBD, which have achieved international diversification.

The Abu Dhabi government holds a majority stake of 60.2% in the lender via the Mubadala Investment Company, the highest such ownership among UAE banks. This significant and official backing comes with various advantages such as strategic alliances, potential financial support during challenging times, and a higher credit rating from rating agencies.

Well-diversified banking business

ADCB boasts a well-balanced asset base across Consumer, Corporate and Investment Banking, and Treasury and Investments. The former captures the largest share of total revenues at 40%, followed by Wholesale Banking at 34%, then Treasury and Investments at 24%.

The Treasury and Investment division is the most profitable, accounting for over one-third of total assets, yet generating about half of overall net profits. Moreover, this division has maintained an impressively steady average contribution of 50% between 2017 and 2022.

Legacy issues fixed – now positioned for growth

The consolidation of UNB and AHB in 2019, along with the NMC default in 2020, had an adverse impact on ADCB's asset-quality metrics. However, the bank has managed to dramatically improve its risk profile with aggressive write-offs and proactive risk-reduction measures.

With strong liquidity and low leverage, the lender is currently well-positioned for loan growth. The NPL ratio remains in line with the industry average yet exceeds that of benchmark lenders FAB and ENBD. Stage 3 coverage lags the industry, indicating further potential provisions ahead. However, the current focus on quality loans is expected to achieve asset-quality stabilization, and potential monetization of the NMC legacy could provide further qualitative upside.

Net interest margins (NIMs) have improved, albeit slightly less than peers. With the expected Fed pivot potentially resulting in margin weakness, ADCB is proactively looking to optimize its deposit mix. We expect 5% average earnings growth going forward, mostly on the back of loan growth. With a strong capital position and an improved risk profile, ADCB is well-positioned to potentially return to its historical trend of a 50% cash payout ratio.

Balanced risk profile justifies Equal-Weight rating

We initiate our coverage with an equal-weight rating and a fair value of AED 9.70 per share, implying a potential upside of 13.2% from the last closing price. While the bank has significantly improved asset quality and ROE, it still trails the industry and some of its larger competitors on those indicators.

Further NPL and coverage improvement would make us warm up to the shares, while successful NMC monetization could provide a material catalyst for further upside in the stock.

Stock Rating

Current Rating	Equal-Weight
Fair Value	9.70
Former Rating	NA
Previous Fair Value	NA
Target Upside	+13.2%
Listing location	Abu Dhabi
Sector	Banks
Local Exchange	ADCB
Bloomberg	ADCB.UH
Reuters	ADCB.AD

Source: Al Ramz Capital, Refinitiv

Stock Statistics

Last Close, AED	8.57
Market Cap (AED m)	62,732
Avg. Daily Vol 3m (m)	2.77
Shares Out. (m)	7,320
Free Float	43%
YTD Change	+0.2%
52w High (AED)	9.31
52w Low (AED)	7.63

Source: Al Ramz Capital, Refinitiv

Stock price



Source: Al Ramz Capital, Refinitiv

Key ratios

Indicator	2023E
P/TBV	1.1x
P/E	8.8x
Dividend Yield	5.5%
ROTE	13.3%
ROA	1.3%

Source: Al Ramz Capital, Refinitiv

Note: All market prices in this note are as at the close of 6 Sep 2023.



Locally rooted quality banking

Abu Dhabi Commercial Bank (ADCB) is one of the leading banks in the United Arab Emirates (UAE) with a rich history that dates to 1985, when it was formed through the merger of Khalij Commercial Bank, Emirates Commercial Bank, and Federal Commercial Bank.

On May 1, 2019, the group expanded its operations by merging with Union National Bank (UNB) and later the same year acquired Al Hilal Bank (AHB). After the merger, UNB was dissolved as a legal entity and its shares were delisted, while AHB retained its existing identity and continues to operate as a separate Islamic bank within the ADCB group. The full integration of merged entities was completed in April 2020.

ADCB is currently the third-largest bank in the UAE in terms of nearly all key balance sheet metrics. At the end of June 2023, it held a significant market share of approximately 13% in total assets and customer deposits, as well as a 15% market share in gross deposits within the local banking sector. In addition, ADCB is the sixth-largest bank in the GCC based on various balance sheet metrics.

The network consisted of 109 branches at the end of June this year. Of these, the UAE accounted for 56, of which 48 belong to ADCB and 8 to AHB. The international network comprised the remaining 53, including 50 in Egypt and three AHB branches in Kazakhstan.

ADCB has focused primarily on the UAE market as part of its core strategy, generating over 95% of its operating income locally. This has resulted in less diversified operations than those of peers such as FAB and ENBD. The bank also operates in Egypt and Kazakhstan but with a 5% income contribution, international operations remain marginal in the context of the group.

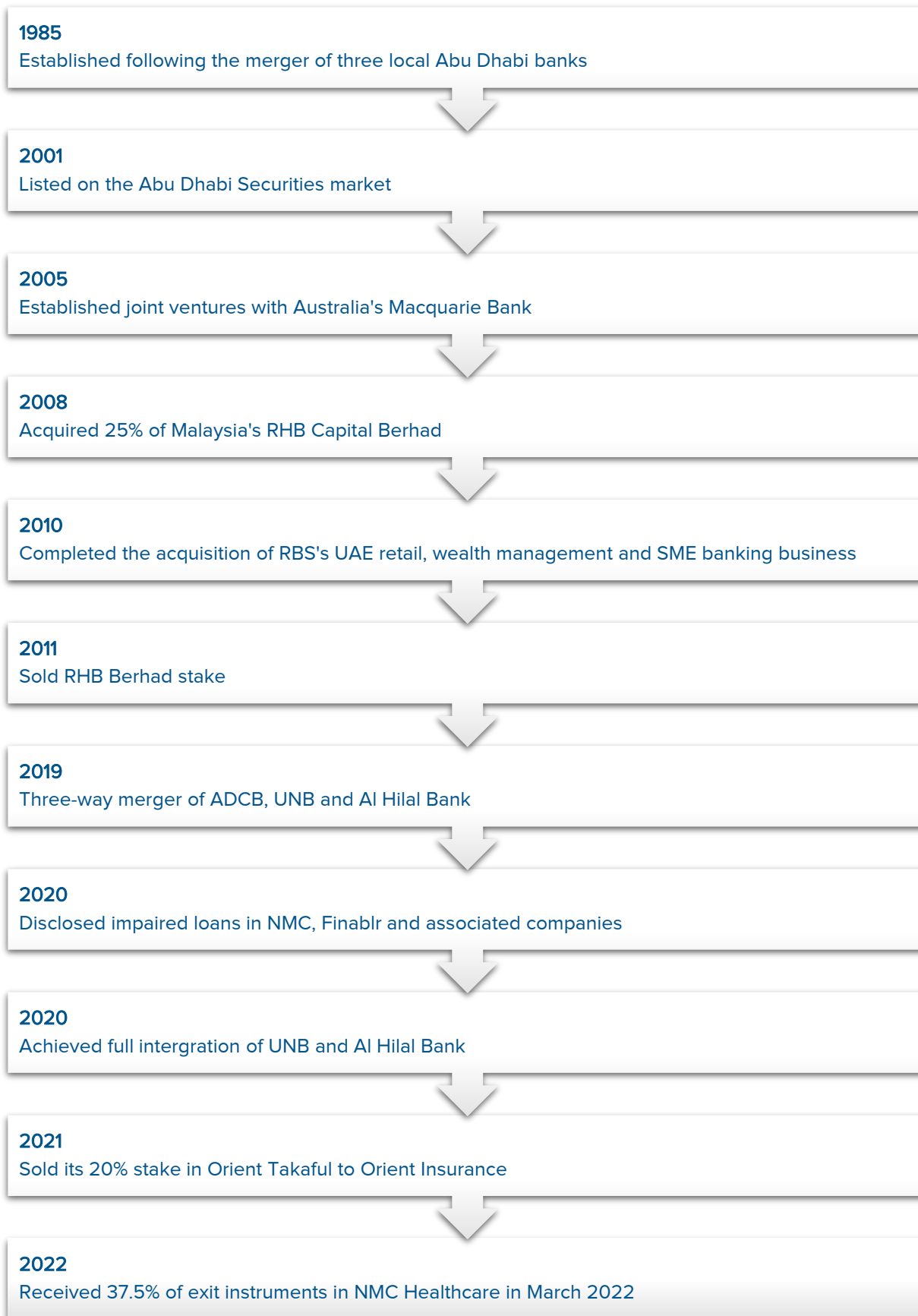
ADCB is headquartered in Abu Dhabi, the capital city of the UAE. The bank is listed on the Abu Dhabi Stock Exchange (ADX) and is part of the MSCI Emerging Markets Index with a weight of 0.10%. As one of the largest lenders in the country, ADCB is classified as a domestic, systemically important bank (D-SIB) by the local central bank (Central Bank of the U.A.E. or the CBUAE).

Chart 1: Branch network and geographical footprint



Source: Al Ramz Investment Research, Company data

Chart 2: Corporate Timeline



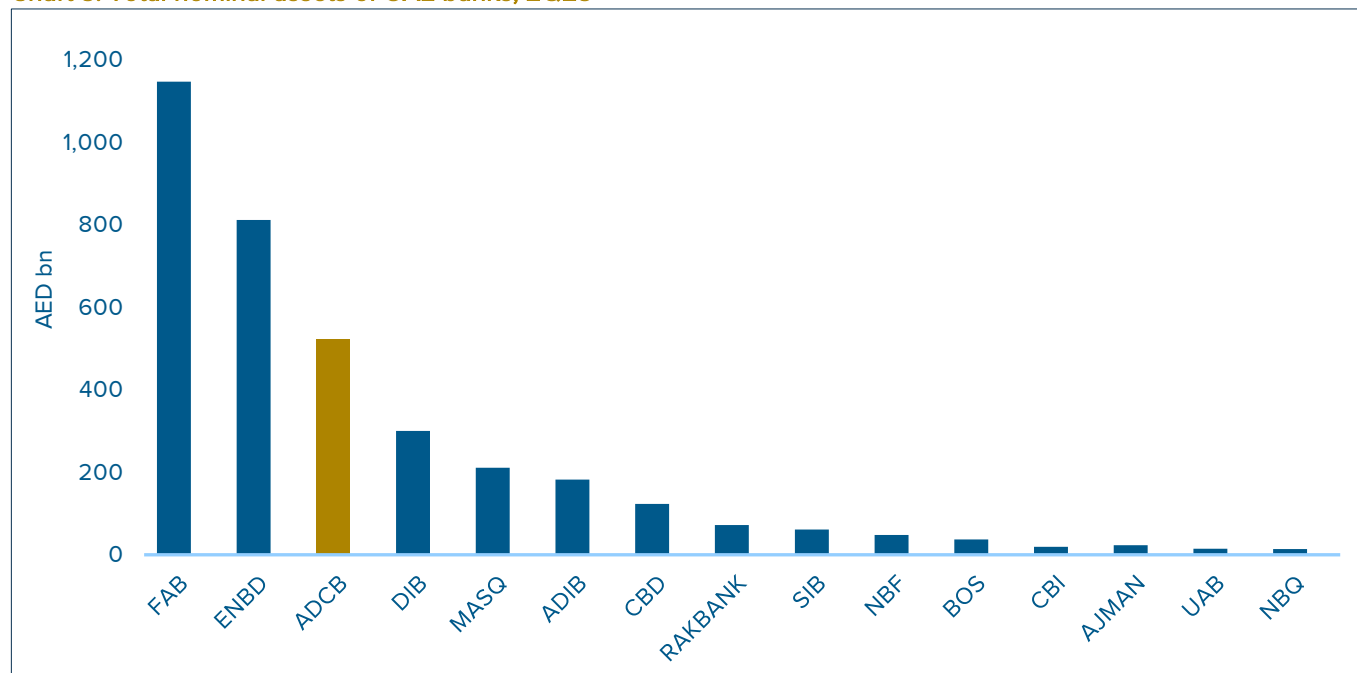
Source: Al Ramz Investment Research, Company data

One of the leading local lenders

ADCB is the third-largest bank in the UAE based on key balance-sheet metrics, including assets, loans, deposits, and equity. At the end of June 2023, ADCB held a market share of c. 13% in total assets and customer deposits and c. 15% in gross loans.

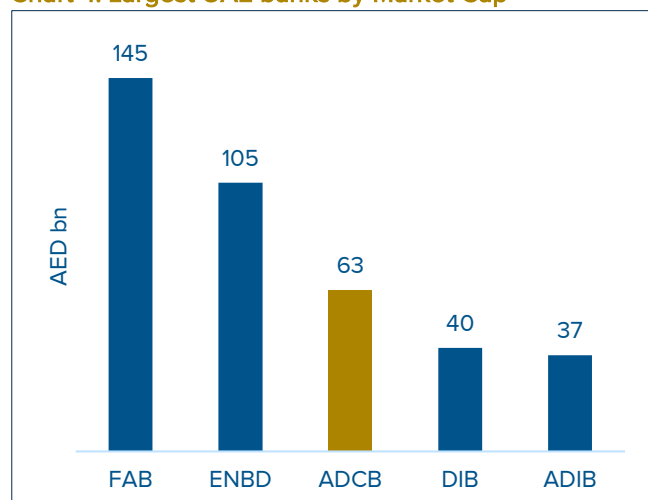
Moreover, it is the third-largest bank in terms of market capitalization, and the third-highest revenue and profit-generating bank in the UAE. This indicates that ADCB has a significant presence in the UAE banking sector and is a major player in the industry.

Chart 3: Total nominal assets of UAE banks, 2Q23



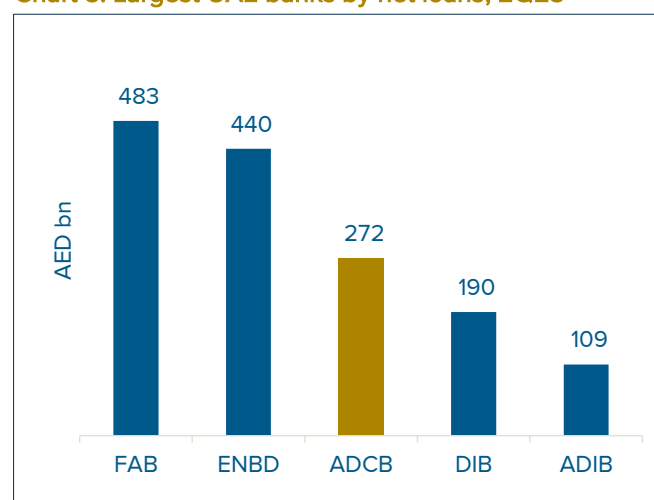
Source: Al Ramz Investment Research, Company data

Chart 4: Largest UAE banks by Market Cap



Source: Al Ramz Investment Research, Company data

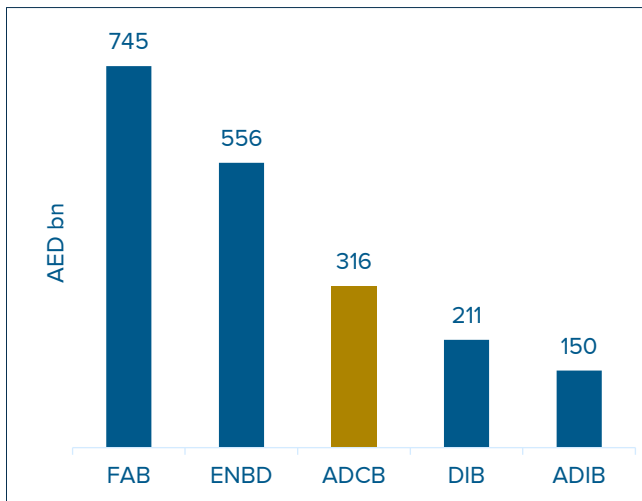
Chart 5: Largest UAE banks by net loans, 2Q23



Source: Al Ramz Investment Research, Company data

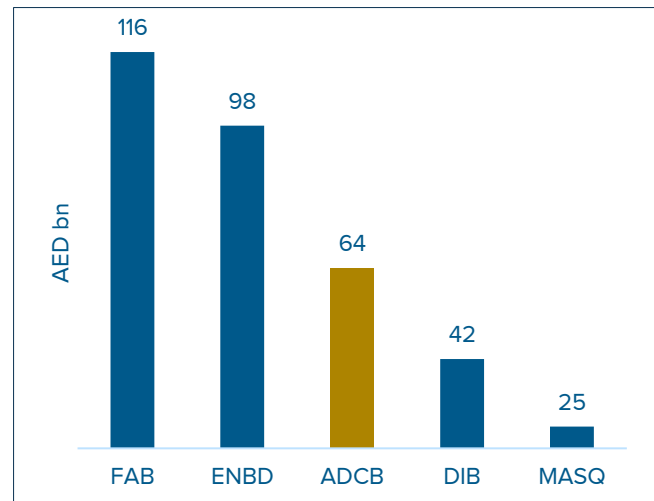


Chart 6: Largest UAE banks by deposits, 2Q23



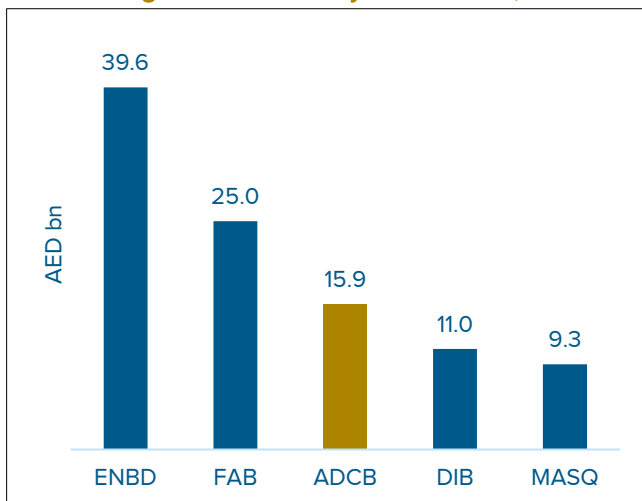
Source: Al Ramz Investment Research, Company data

Chart 7: Largest UAE banks by total equity, 2Q23



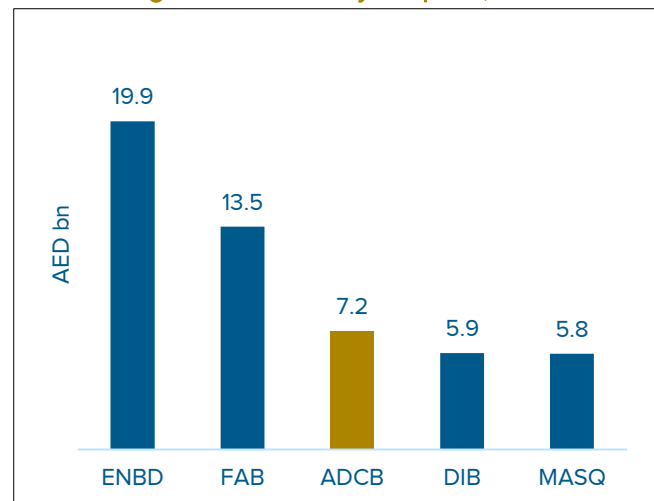
Source: Al Ramz Investment Research, Company data

Chart 8: Largest UAE banks by total income, LTM



Source: Al Ramz Investment Research, Company data

Chart 9: Largest UAE banks by net profit, LTM

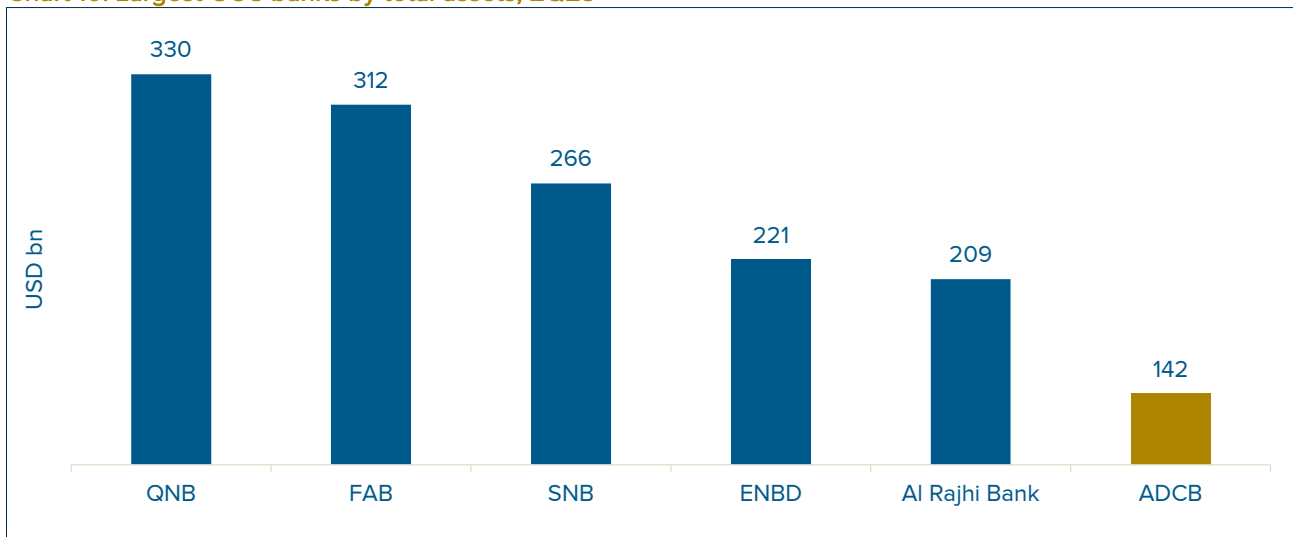


Source: Al Ramz Investment Research, Company data

Part of the GCC's leading pack

The bank's significant presence extends beyond the UAE, as it is also a key contender in the GCC region, ranking sixth in terms of total assets at end- June 2023.

Chart 10: Largest GCC banks by total assets, 2Q23



Source: Al Ramz Investment Research, Company data



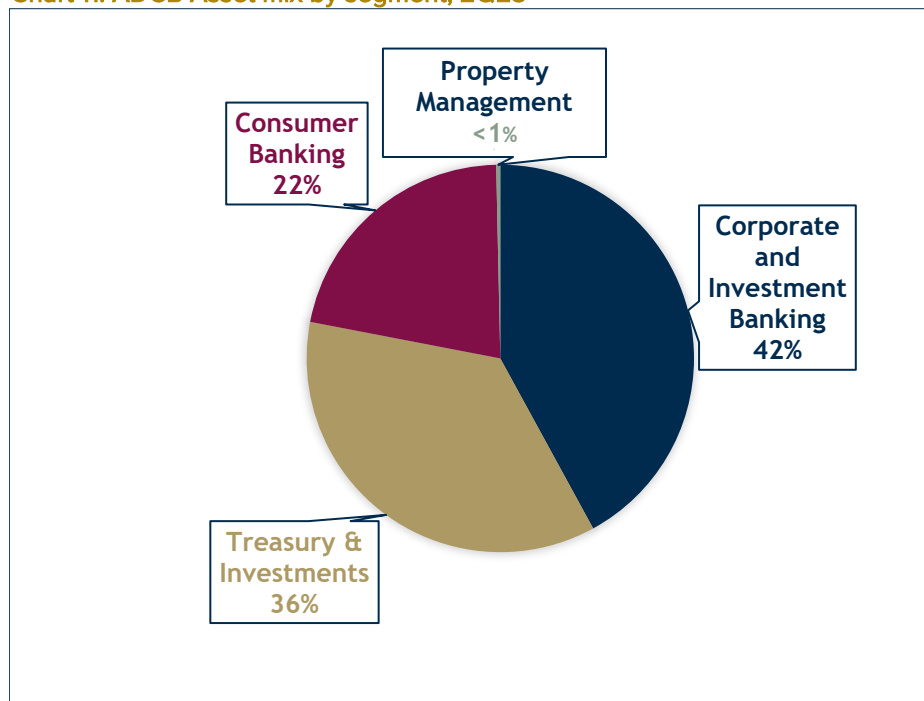
Well-diversified business mix

ADCB has developed a sound business model over the years, with its business mix split into three pillars: Consumer Banking, Corporate and Investment Banking, and Treasury and Investment. It maintains a healthy balance across these segments in terms of total assets. Moreover, it has a small Property Management operation.

To capture the essence of these divisions in a nutshell:

- The Consumer business includes both retail and private banking, offering a broad range of conventional and Shariah-compliant services to individual customers, located primarily in the UAE.
- The Corporate and investment banking portfolio of services includes corporate lending, cash management, trade finance, corporate finance, and investment banking for clients that range from government and government-related entities (GREs) to financial institutions, corporates, and SMEs.
- The Treasury and Investment division provides a range of treasury services including money market, interest rate, currency, and commodity services. This division also manages the group's investment portfolio and risk-management solutions.

Chart 11: ADCB Asset mix by segment, 2Q23



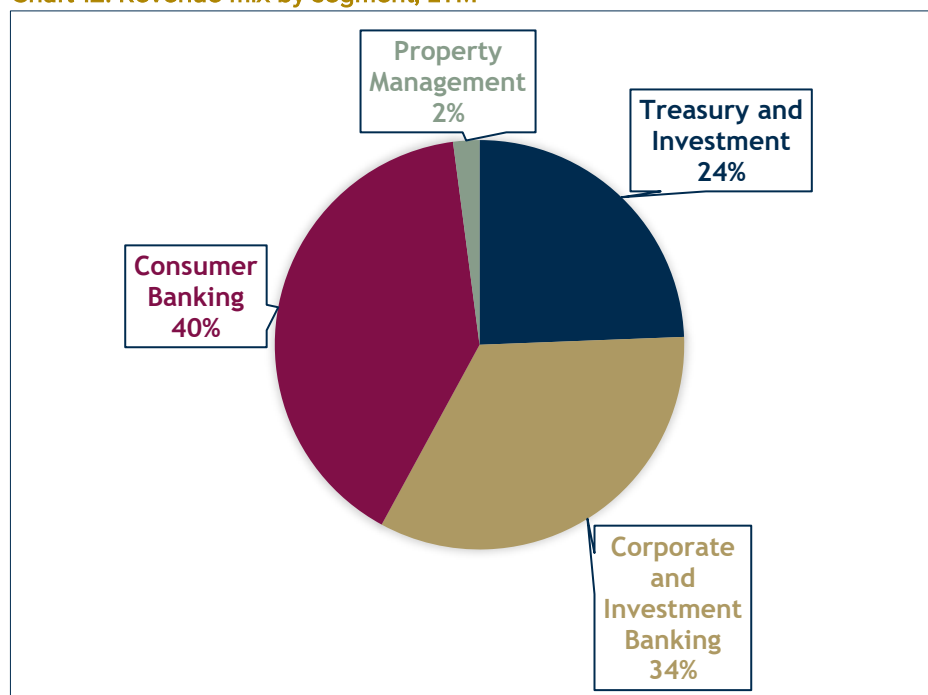
Source: Al Ramz Investment, Company data

Consumer is king

The Consumer division, with a proportion of total assets of just 22%, contributes as much as 40% to total revenues. Conversely, the Wholesale segment contributes only 34% of revenues, even though it consumes nearly half of total assets.



Chart 12: Revenue mix by segment, LTM



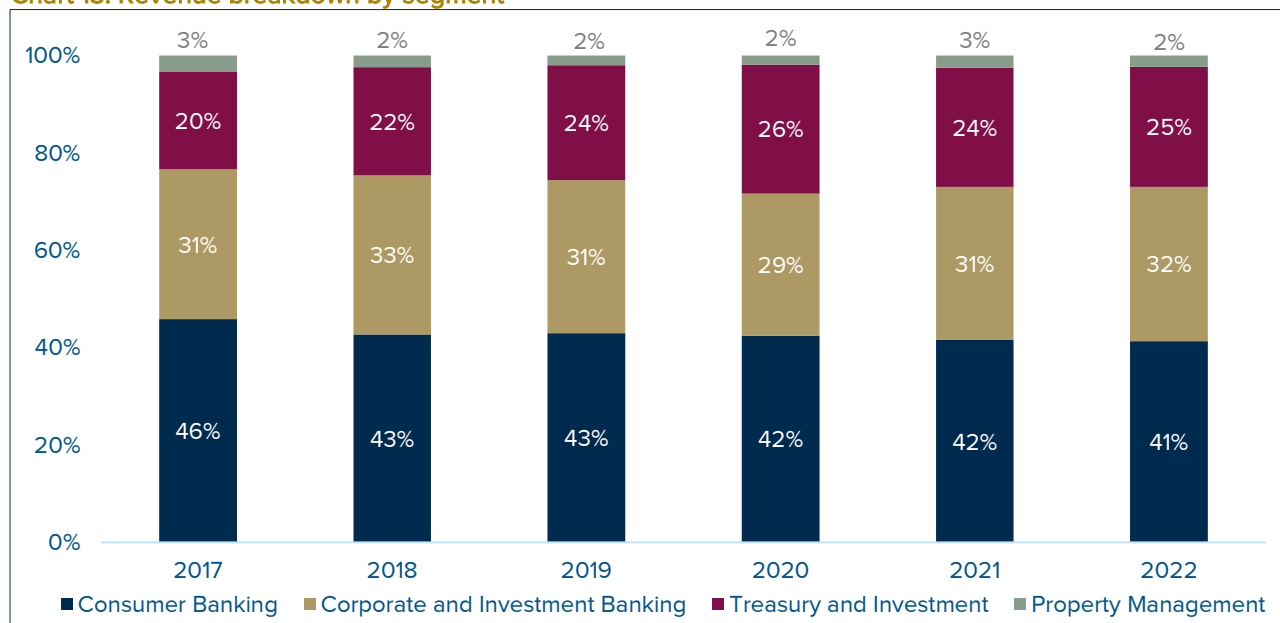
Source: Al Ramz Investment Research, Company data Note: LTM stands for last twelve months

Segmental revenue contribution demonstrates a consistent performance from 2017 to 2022. The Consumer segment is the largest contributor, as it constituted 43% of the revenue mix on average over the period. This also defines ADCB as a consumer franchise, first and foremost, in our opinion. Consumer loans, by their nature, tend to carry higher yields compared to corporate loans, which also explains the higher contribution of this segment.

Wholesale Banking contributes 31% of the mix and remains the second-largest revenue generator. This division benefits from the bank's privileged relationship with the government of Abu Dhabi, which has helped establish a robust corporate franchise.

Finally, the Treasury and Investment portfolio contributes one-fourth of total revenues. Property management is a negligible part of the mix and should probably be divested for better strategic focus, and in line with the stated intention of the bank.

Chart 13: Revenue breakdown by segment



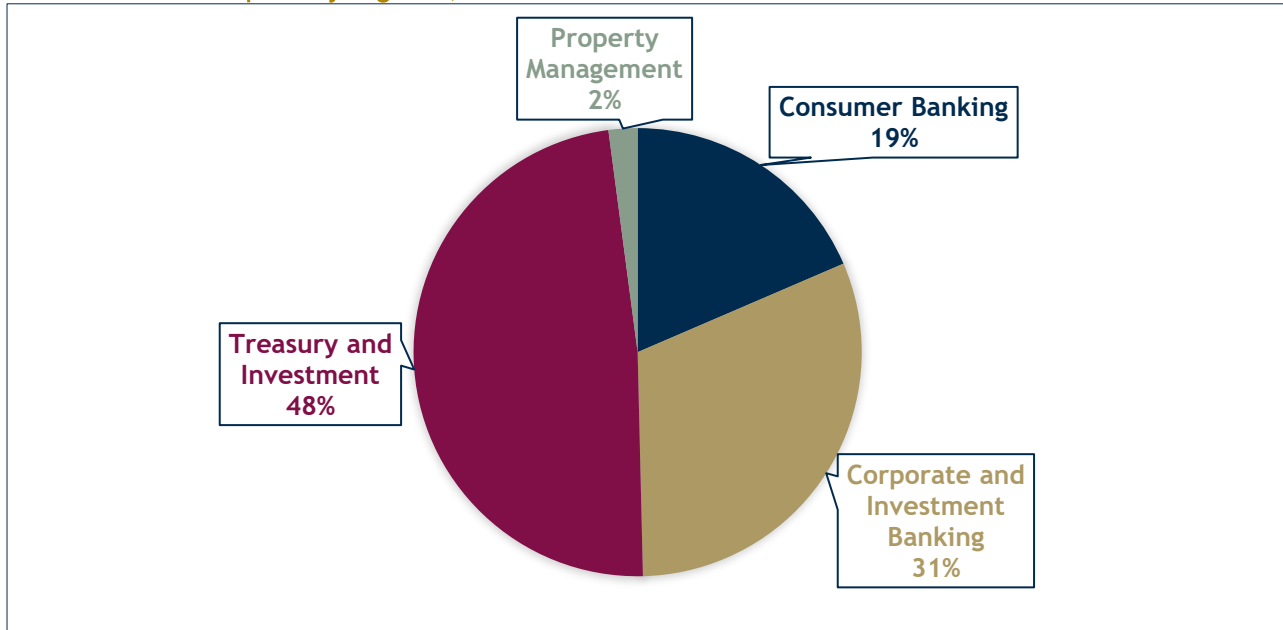
Source: Al Ramz Investment Research, Company data



Some bottom-line concentration

The Treasury and Investment division is the cornerstone of the bank's profitability, as it accounts for more than one-third of total assets and generates roughly half the net profit (based on trailing twelve-month data). Wholesale and Consumer Banking, despite their higher revenue contribution, contribute a relatively smaller portion of the bottom-line.

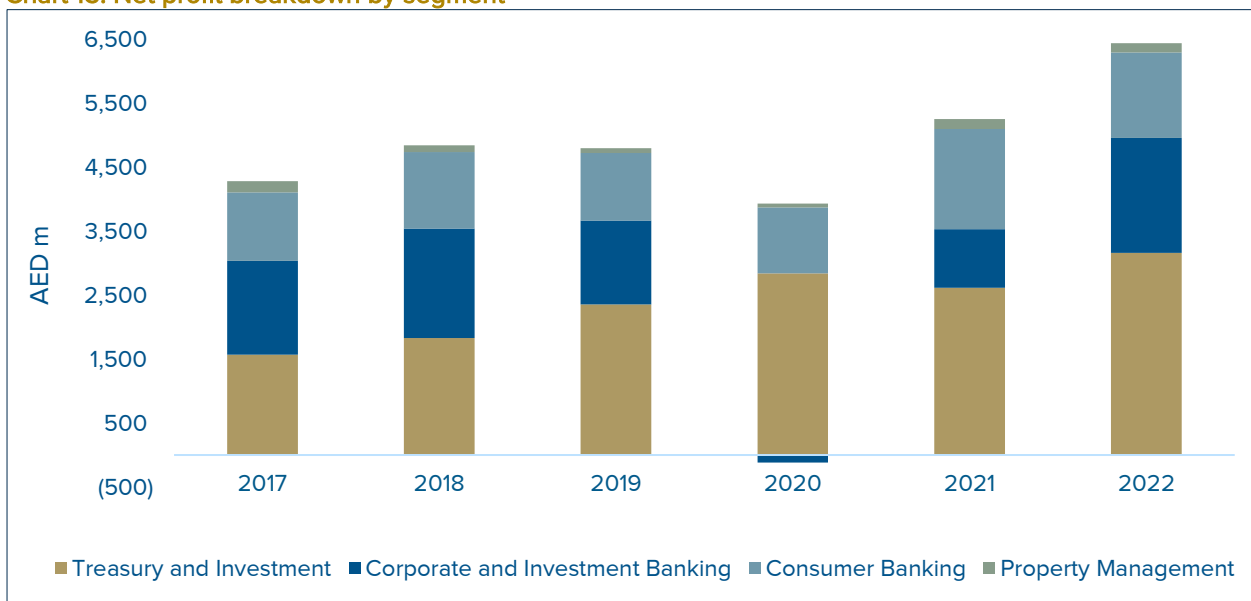
Chart 14: ADCB Net profit by segment, LTM



Source: Al Ramz Investment Research, Company data

Our analysis from 2017-2022 shows that the Treasury and Investments division has exhibited remarkable performance. On average, this division has contributed 50% to the overall profit, consistently outperforming all other segments throughout this period. Notably, the net profit base of this division has doubled over the mentioned timeframe. In contrast, the Wholesale and Consumer segments have experienced slower growth in their profit bases, with the former expanding by only 22% while the latter saw an increase of 25%.

Chart 15: Net profit breakdown by segment



Source: Al Ramz Investment Research, Company data



As per management, the Treasury division serves as a facilitator for imbalances between other divisions. This division acquires funds from deposit-taking units and lends them to asset-generating units within the group.

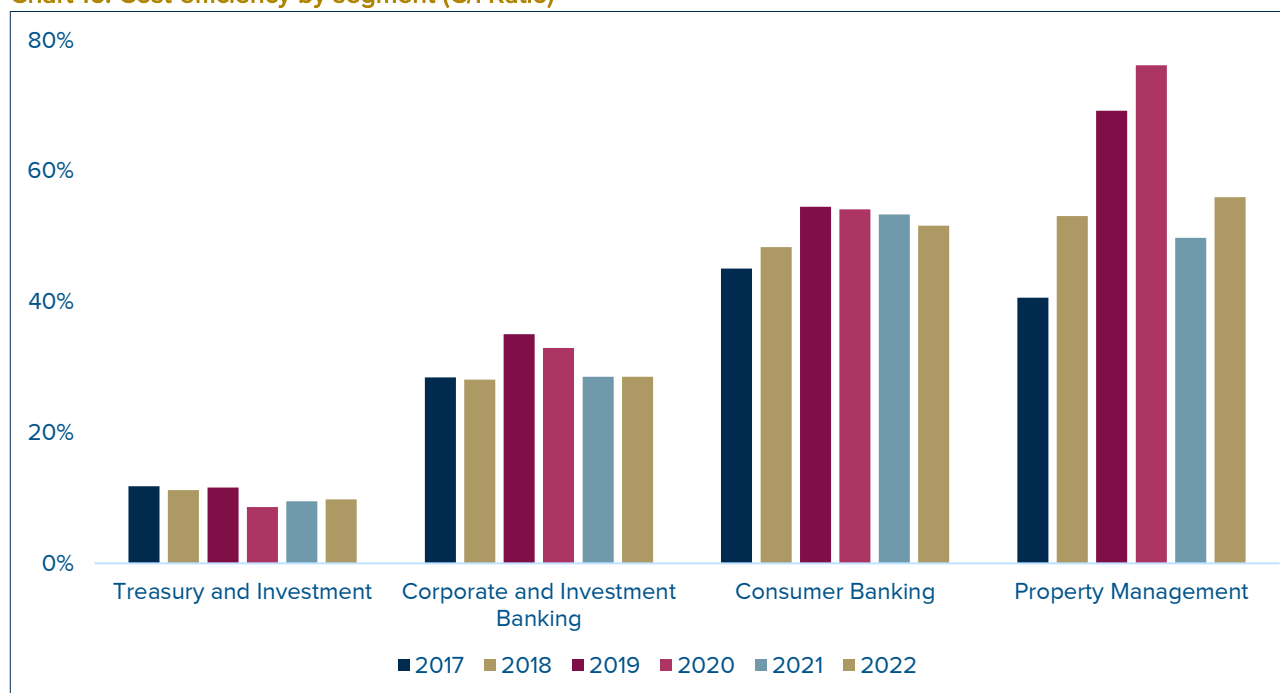
The treasury desk of ADCB uses the internal Fund Transfer Pricing (FTP) mechanism to measure the costs associated with funding and liquidity management and to allocate such costs to the respective units. This practice is widely used across the industry. FTP allows the treasury division to earn a spread by charging higher interest rates on the funds it lends out, compared to the interest rates it pays on the funds it acquires.

In 2022, 56% of the “Treasury and Investment” income came from internal facilitation, while the rest was contributed by external sources such as FX, derivatives, and proprietary investment portfolio income. We note that the contribution to the income from both internal facilitation and external sources varies significantly over the years. The former being influenced by the bank’s overall internal operations, while the latter is due to market volatility.

We also highlight that “Treasury and Investment” has been performing well due to strong relative operational efficiency, with a cost-to-income ratio (C/I) ranging between 9% and 12% over 2017-22, the lowest level group-wide.

In contrast, Consumer and Property Management were the least cost-efficient, with C/I ratios of 51% and 57%, respectively. The C/I ratio of the Wholesale Banking division was 35% on average over the same period.

Chart 16: Cost-efficiency by segment (C/I Ratio)



Source: Al Ramz Investment Research, Company data

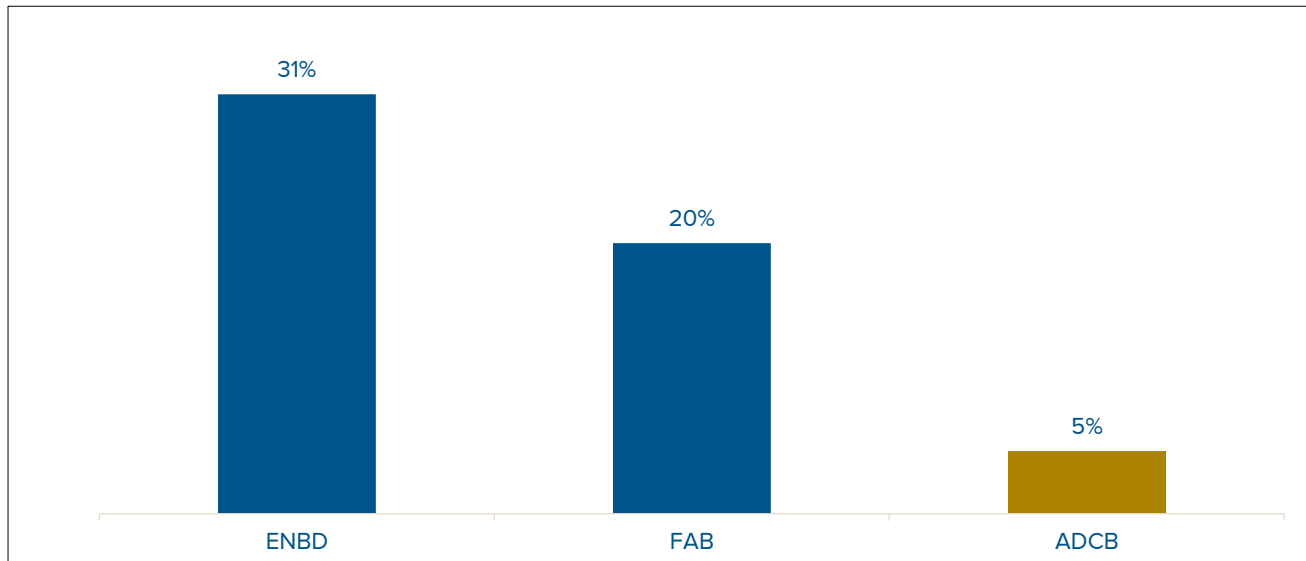
High domestic focus

ADCB’s operations are markedly UAE-centric, with 82% of loans extended locally and 95% of revenues generated at home. This concentration makes the bank somewhat dependent on local economic conditions and vulnerable to any macro weakness. In contrast, other large local networks such as ENBD or FAB, have been able to diversify internationally.

International exposure at ADCB is limited to its strategic presence in Egypt since 2006, with a network of 50 branches. In 1H23, Egyptian earnings increased by a substantial +92% YoY to EGP 777m but represented only a negligible 2.5% of consolidated net income after translation into AED.



Chart 17: International income % of total income of main UAE Banks, 1H23



Source: Al Ramz Investment Research, Company data

There have been several unsubstantiated press reports about a potential merger between ADCB and FAB. Both banks have always denied such speculation through official press releases. This topic has also been a recurring favorite among some Abu Dhabi investors.

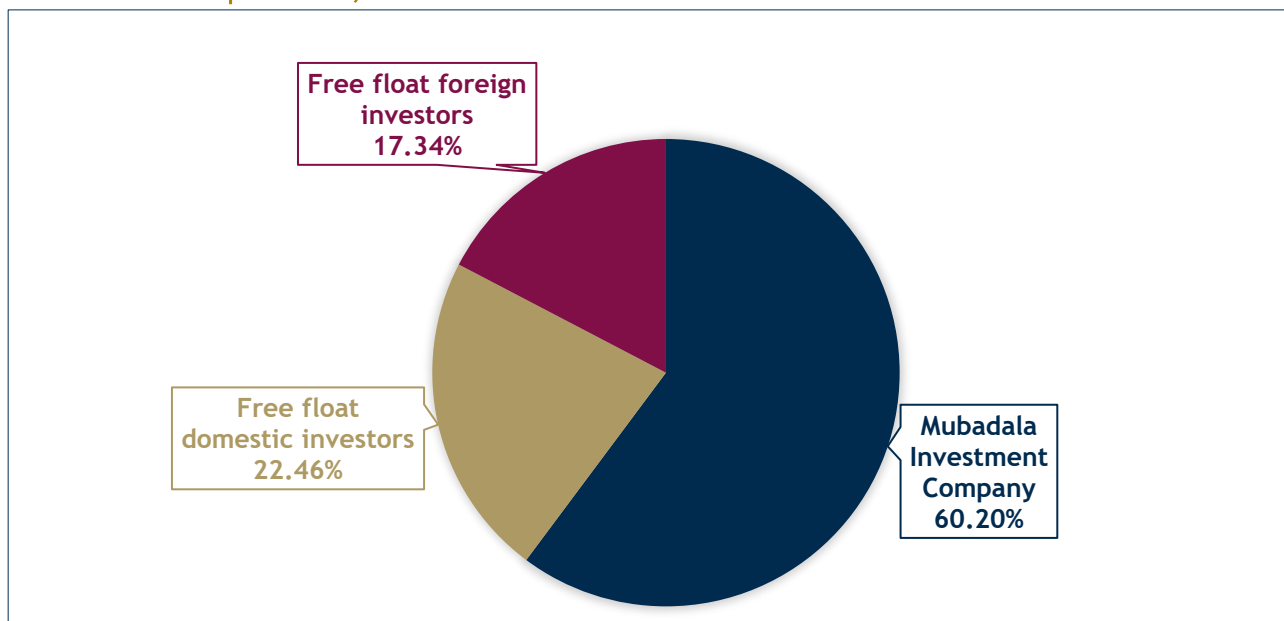
We believe it is unlikely that ADCB and FAB will pursue a merger given their differing strategies. FAB has expressed its interest in cross-border expansion, citing a mature UAE market with saturated growth. Meanwhile, ADCB seems to still be focusing on growth within home boundaries.

Such a merger cannot be ruled out, even if we believe that its industrial logic is unjustified. Bringing together the two largest banking networks in Abu Dhabi would require a government decision, above all, in our opinion.

Strong government patronage

The government of Abu Dhabi is the main shareholder of ADCB, with a 60.2% stake held through the Mubadala Investment Company. The remaining 39.8% is owned by domestic and foreign shareholders.

Chart 18: Ownership structure, 30 June 2023



Source: Al Ramz Investment Research, Company data



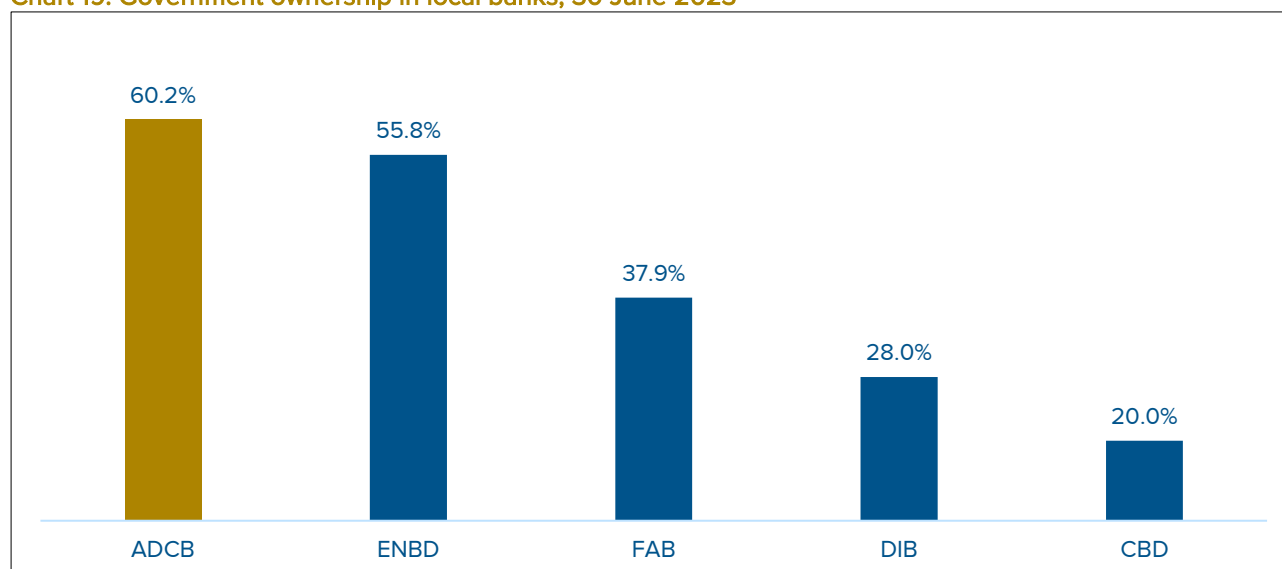
Government ownership in ADCB is the highest among local lenders and provides the bank with several advantages. Firstly, government ownership could provide financial stability in difficult times.

For instance, the UAE authorities provided ADCB with a capital injection of AED 10bn in 2008-09 during the Great Financial Crisis (GFC), through their purchase of Tier 1 notes and Tier 2 capital which helped maintain liquidity and comply with regulatory capital adequacy requirements. The government also extended such support to other Abu Dhabi banks, including NBAD, FGB, UNB, and ADIB.

Secondly, we believe that anchor government presence in the capital of the lender enhances its rating credibility in the eyes of credit agencies. On April 07, 2023, S&P maintained its long-term rating of “A stable” and short-term rating of “A-1”, three notches higher than ADCB’s Baseline Credit Assessment (BCA) of bbb-.

Thirdly, it enables the bank to actively engage in business activities with the government and government related entities (GREs). At the end of 2Q23, loans extended to the government and GREs accounted for 23.2% of the bank’s total loan portfolio.

Chart 19: Government ownership in local banks, 30 June 2023



Source: Al Ramz Investment Research, Company data

In addition, we look at foreign ownership as an indication of institutional backing, lending further credence and stability to the shareholding of a listed company. To that extent, we compare foreign ownership across UAE banks in Table 1 below and note that ADCB has the highest ratio.

This is not fortuitous and results from a voluntary, active, and seemingly successful campaign on behalf of management to attract foreign investors. Actual foreign ownership has increased substantially from 2.6% 14 years ago but remains below the board-approved limit of 40%, as is the case for most UAE banks. We look forward to further increased foreign ownership of UAE banks including ADCB.

Table 1: Foreign ownership limit (FOL) and actual ownership of main UAE banks

Bank	Allowed FOL	Actual ownership
Abu Dhabi Commercial Bank (ADCB)	40.0%	17.9%
First Abu Dhabi Bank (FAB)	40.0%	17.4%
Abu Dhabi Islamic Bank (ADIB)	40.0%	17.2%
Dubai Islamic Bank (DIB)	40.0%	16.8%
Emirates NBD (ENBD)	40.0%	13.7%

Source: Al Ramz Investment Research, ADX, DFM Note: Data as of 6 September 2023.



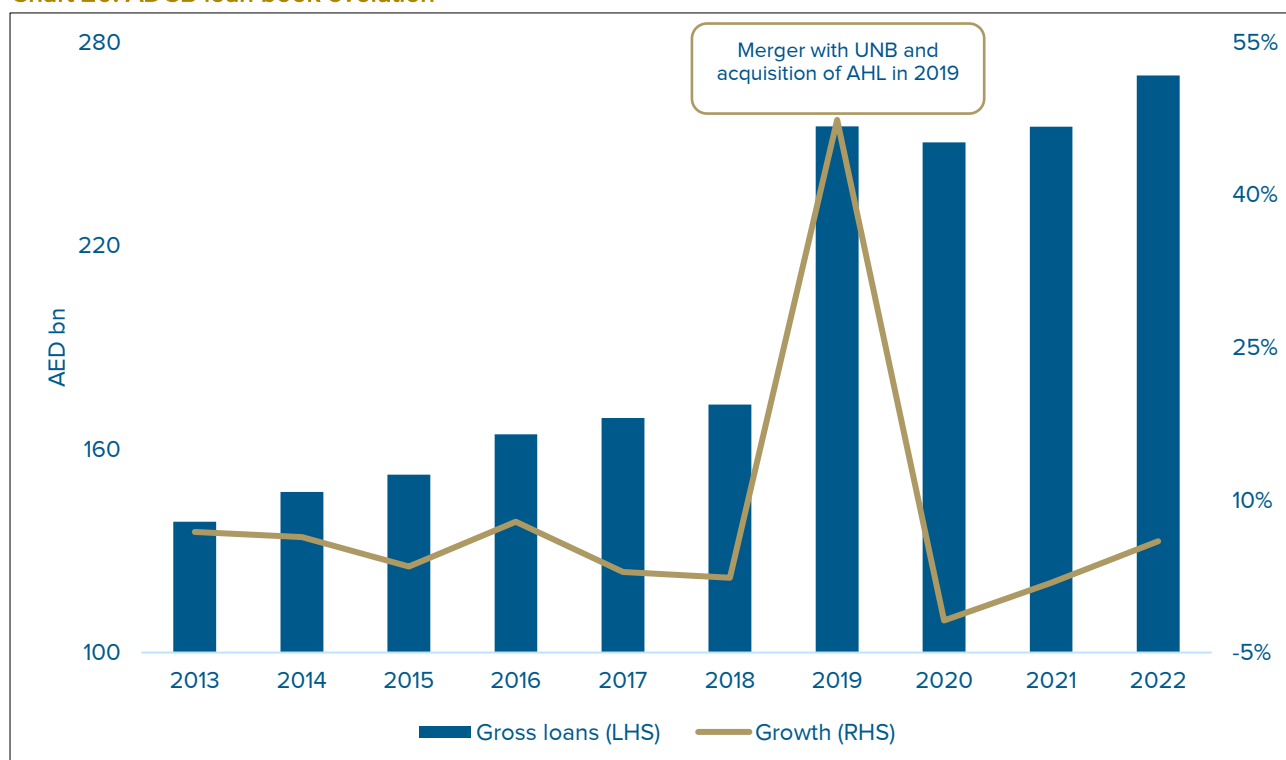
Loan-book ready for growth

Merger boosts loan-book size

In 2019, the integration of UNB and AHB operations into its existing platform was a turning point for ADCB. This strategic move led to the addition of AED 85bn in loans, which were imported from UNB and AHB's books. This accounted for a considerable c. 50% increment in the group's pre-merger loan size. Following this consolidation, ADCB's market share in gross loans increased by c. 470bps.

The successful integration solidified ADCB's position as the third-largest lender in the UAE. Currently, the group maintains a gross loan portfolio of AED 285bn, equating to a 15% share in the local market.

Chart 20: ADCB loan book evolution

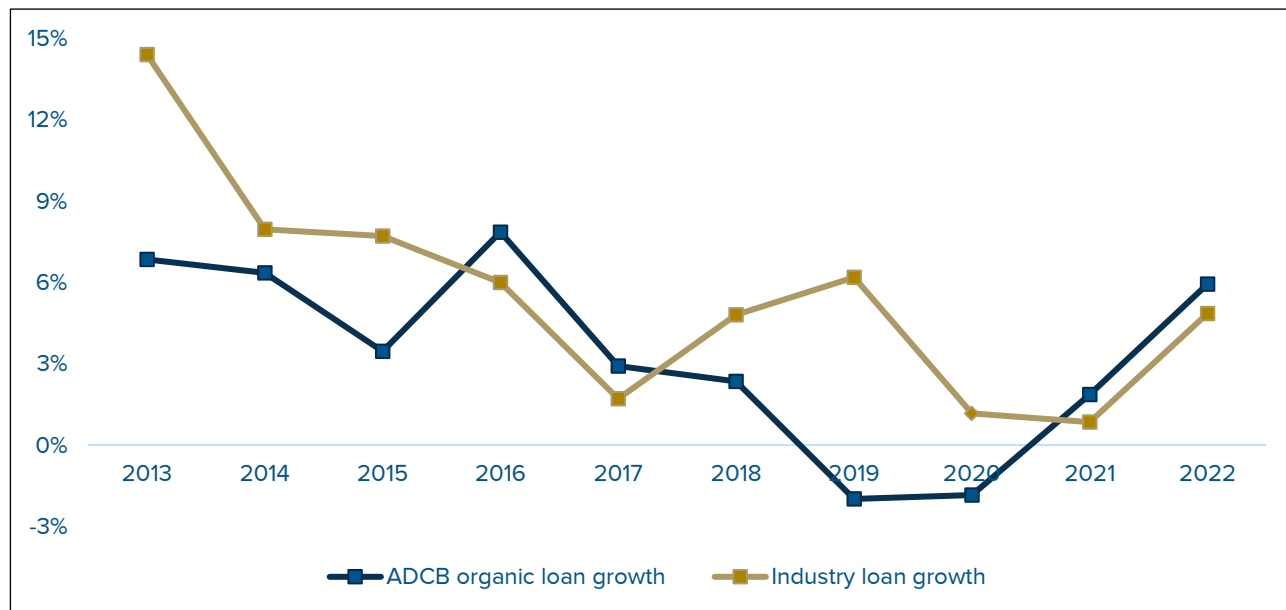


Source: Al Ramz Investment Research, Company data

But organic growth remains muted

Gross loans grew organically at an average rate of 3.4% between 2013 and 2022, below the industry average of 5.6%. The contraction in loan growth became more apparent between 2019 and late 2021 when ADCB adopted a strategic approach to reduce portfolio risk, which may have impacted loan growth. This included addressing prevalent high real-estate exposure at the time.

Chart 21: Organic loan growth of ADCB vs. industry

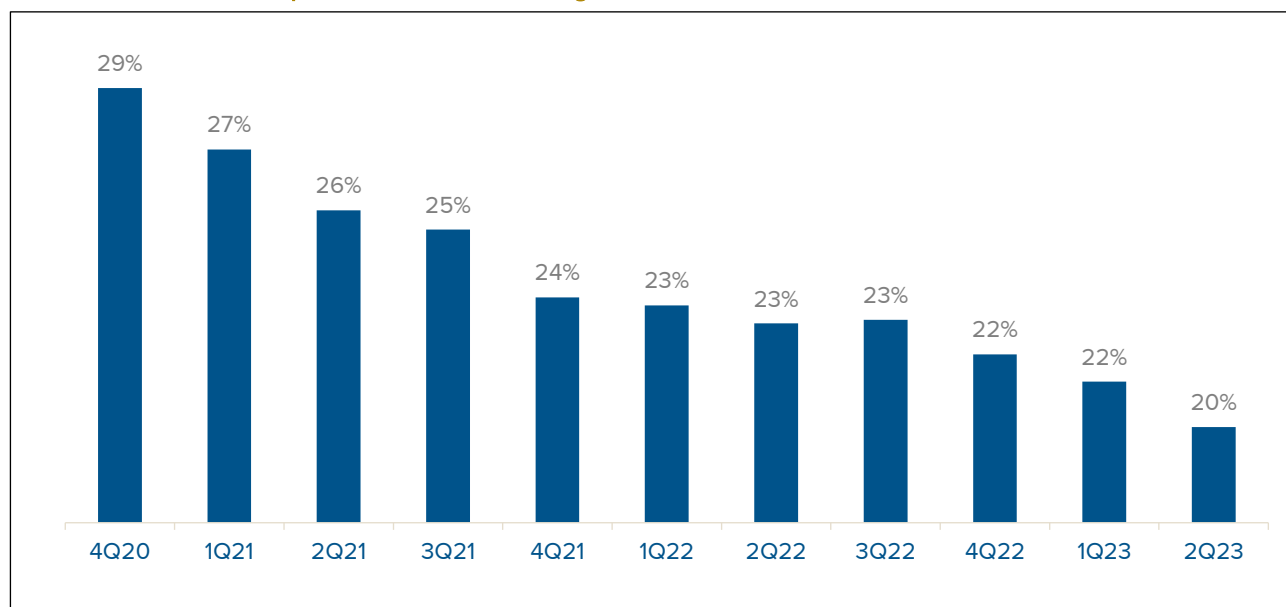


Source: Al Ramz Investment Research, Company data, CBUAE

Scaling down on risky real estate

ADCB reduced its exposure to the highly cyclical and volatile real estate sector to 20.4% in 2Q23 from 29.0% in 4Q20. This move is in line with the broader trend in the banking industry, where banks are moving away from sector concentrations to reduce their risk profile.

Chart 22: Real estate exposure at ADCB, as a % gross loans



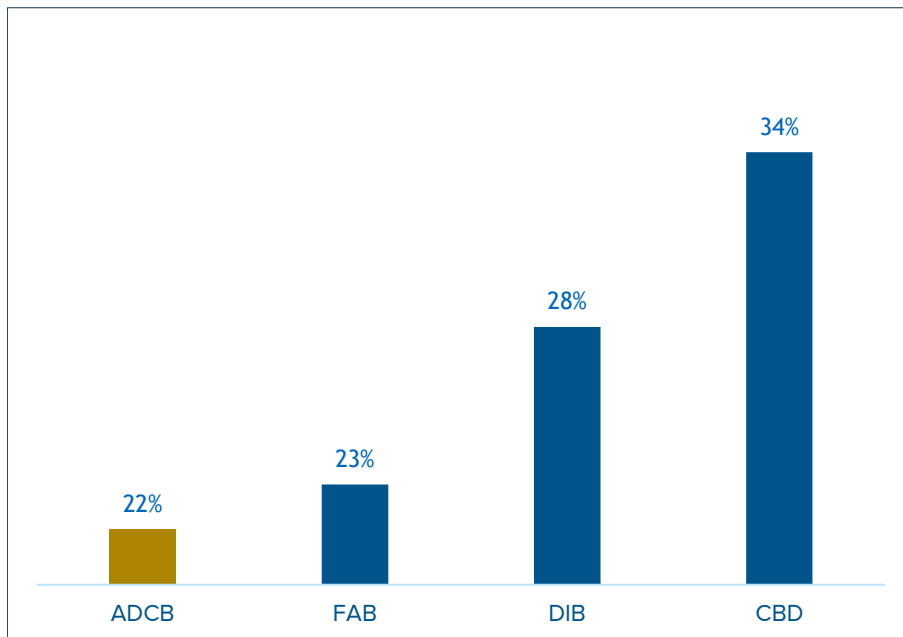
Source: Al Ramz Investment Research, Company data

Total property exposure at ADCB currently represents 22% of credit risk weighted assets (CRWA), including mortgages. This is well below the regulatory limit of 30% set by the CBUAE. ADCB notably has the lowest property exposure ratio amongst peers (FAB, DIB, and CBD).

Management has expressed comfort with the current level of real estate exposure and stated that they don't intend to reduce it further.



Chart 23: Real estate exposure including mortgages as a % of CRWA, 2Q23



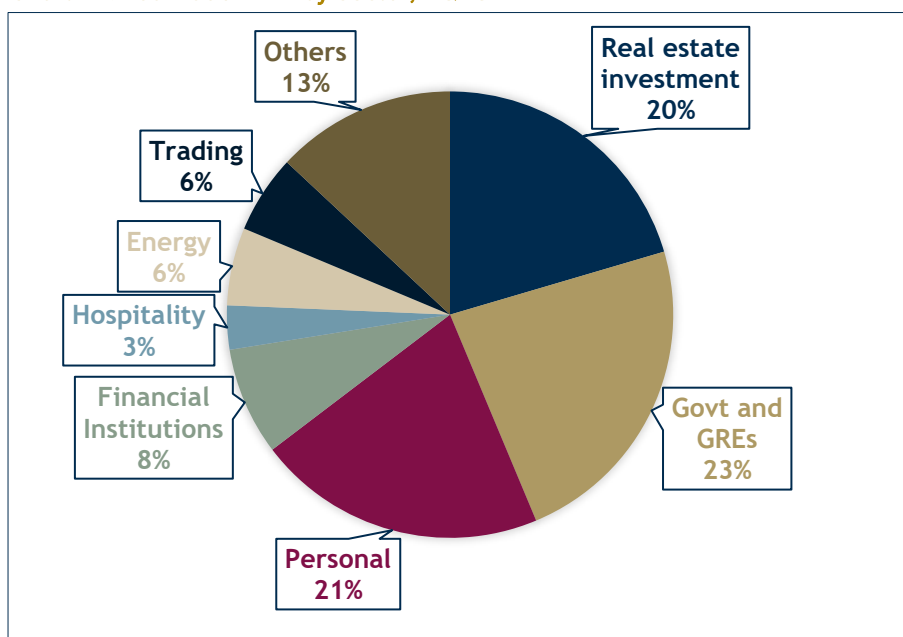
Source: Al Ramz Investment Research, Company data

A balanced loan-mix

The loan-book mix by sector shows an even distribution across three main segments for two-thirds of the portfolio: government and government-related entities, real estate, and personal loans. The remaining third is spread across various sectors such as financial institutions, energy, trading, and hospitality.

This makeup provides solid diversification in our opinion and allows the bank to benefit in economic up and down cycles, as sovereign loans help mitigate risks during slowdowns while real estate and personal loans typically yield better returns, especially in times of expansion, and can help enhance profitability.

Chart 24: Loan-book mix by sector, 2Q23

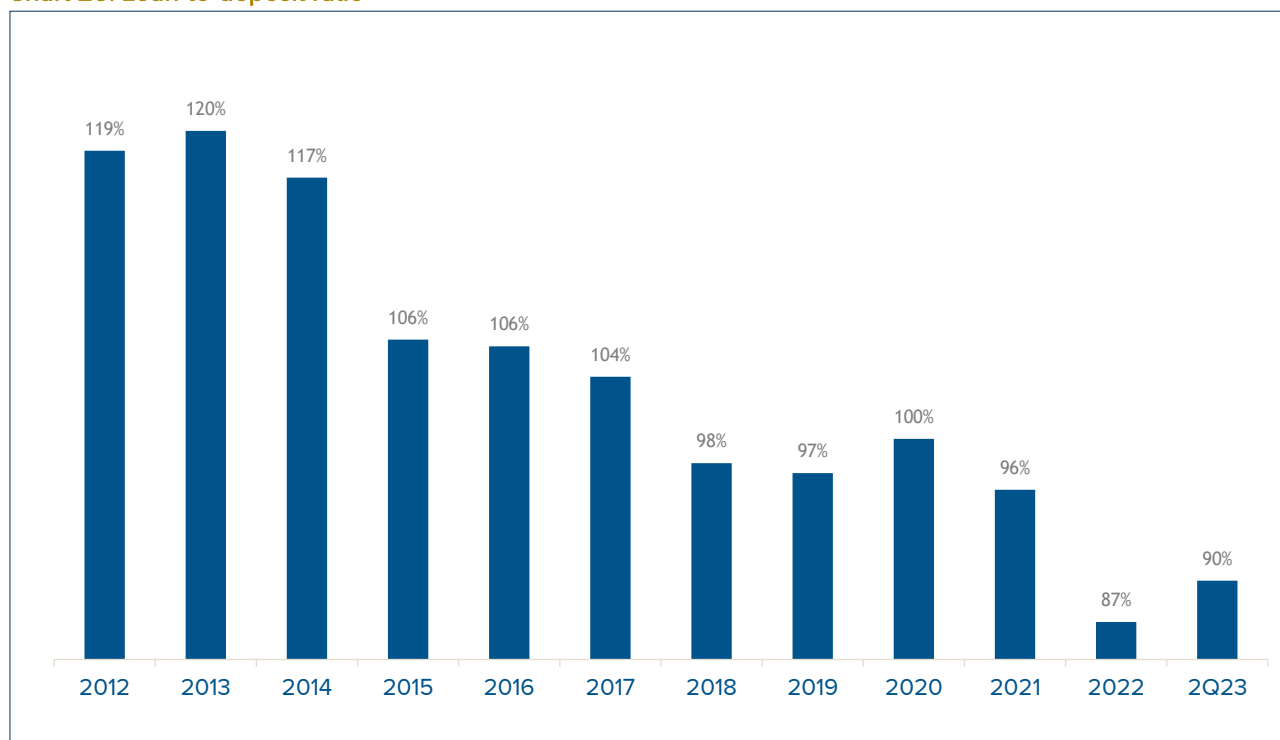


Source: Al Ramz Investment Research, Company data

Low leverage should provide room for further lending

The loan-to-deposit ratio (LDR) is a measure of a bank's liquidity and the proportion of loans it has distributed relative to the deposits it has received from customers. The bank's LDR of 90% at the end of 2Q23 was higher than the sector average of 82%. However, it remains well below its own historical annual average of 105% over the past decade and leaves room for further loan expansion.

Chart 25: Loan-to-deposit ratio



Source: Al Ramz Investment Research, Company data

Chart 25 shows a declining LDR for a decade, with an exception in 2020. This downtrend is probably because deposits have historically grown faster than loans. In 2022, the sharp decline to 87% can be attributed to conservative, quality-driven lending towards the end of the pandemic against throbbing deposits in the context of rising rates. ADCB has been focusing on quality over quantity in its lending practices as part of its de-risking strategy.

All in all, with an improved risk profile and a relatively low LDR, we believe the bank is now well-positioned to resume its loan growth trajectory.

This year, ADCB so far achieved net loan growth of 5.2%, slightly more than the sector average of 3.5%. We expect the book to grow by +7.8% in 2023E and +6.3% annually thereafter until 2027E.



Chart 26: Loan growth vs. deposit growth



Source: Al Ramz Investment Research, Company data

Note: Loan and deposit growth figures exclude inorganic growth related to M&A activity in 2019

Recovering loan quality

Merger impact and NMC default

Asset-quality metrics have been volatile at ADCB in recent years, from a deterioration in loan book quality following the UNB merger and AHB acquisition. Subpar asset quality at AHB, with high NPLs and low coverage, significantly impacted overall loan book quality. As a result, group NPLs increased from 3.0% in 2018 to 4.8% in 2019, while provision coverage more than halved to 60% from 130%.

The NMC Health default further weighed on asset quality. NMC went into administration in April 2020 following months of turmoil over its finances after misreporting the value of its assets, profits, cash balances, and debts. It disclosed more than USD 4bn in hidden debt, leaving many lenders exposed to large write-offs.

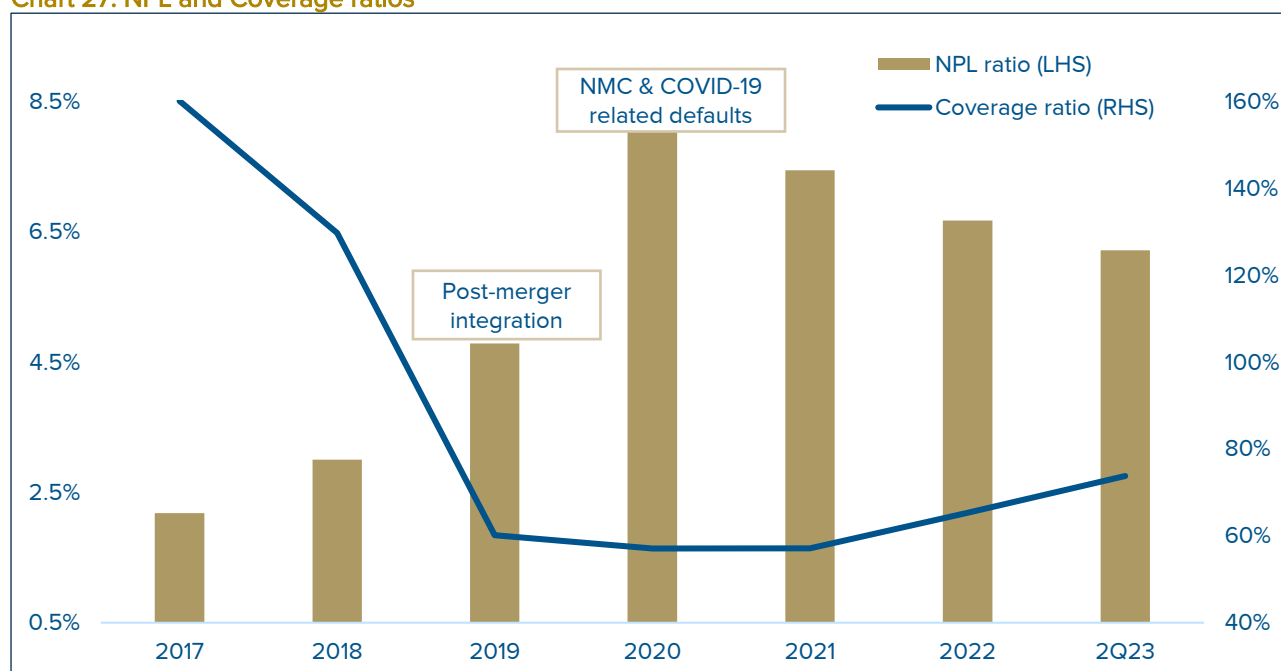
ADCB had lent USD 981m (AED 3.6bn) to NMC and USD 182m (AED 0.7bn) to Finabl, a sister company. This led to a rise in NPL ratio by 160bps to 6.4% and coverage ratio fell by 490bps to 55.2% in 1Q20 from year end 2019.

In March 2022, as NMC exited from administration in the UAE, ADCB received 37.5% of transferable exit instruments in a USD 2.25bn (AED 8.3bn) facility. These instruments were issued by a new holding company which owns and operates core healthcare operations in the UAE and Oman.

According to a press release by ADCB on 25 March 2022, the holders of these NMC exit instruments, including ADCB itself, will eventually be repaid as the business is progressively monetized. Holders of these instruments are expected to benefit from potential future value created by NMC.

ADCB fully provisioned and wrote-off the exposure related to Finabl. For NMC Health, it has provisioned 32% or AED 1.14bn so far, as management believes it to be an appropriate level considering the restructuring progress.

Chart 27: NPL and Coverage ratios



Source: Al Ramz Investment Research, Company data

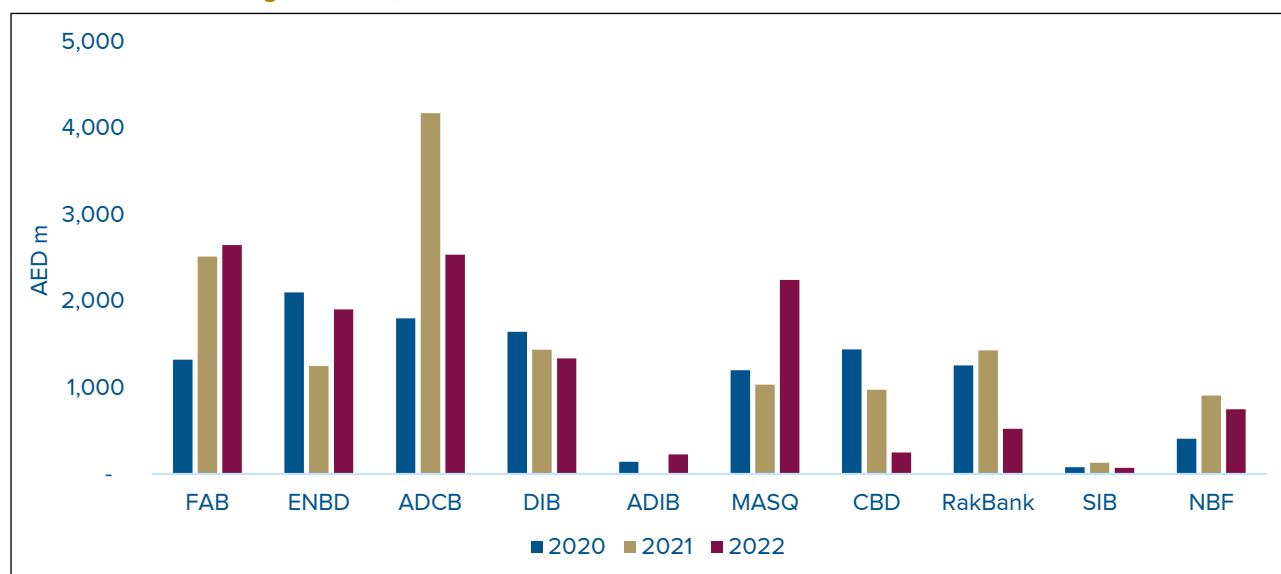
Note: NPL ratio is computed by taking into account Stage 3 loans and purchased or originated credit-impaired loans

Write-offs improve book quality

ADCB significantly reduced its NPL ratio to 6.2% by mid this year from 8.0% at the end of 2020. This remarkable improvement can be largely attributed to the bank's active management of NPLs, which involved write-offs and the sale of problematic loans, along with a strategic reduction in exposure to the riskier property sector.

Cumulative write-offs in 2020-22 totaled AED 8.5bn, which represents 3% of the current portfolio and 48% of NPLs. ADCB implemented record write-offs during this period, as per the chart below.

Chart 28: UAE banking write-offs, 2020-22A



Source: Al Ramz Investment Research, Bloomberg

Table 2 shows write-offs as a percentage of gross loans with a three-year average run-rate of 1.1% for ADCB, higher than the sector average and much higher than its closest peers FAB, ENBD, DIB, and ADIB. The elevated write-off rate at ADCB points to a proactive effort to address problematic loans to clean its balance sheet.

This also highlights the extent to which write-offs have contributed to improving the NPL ratio – by as much as 330bps in three years.

Table 2: Write-offs as a % of gross loans

	FAB	ENBD	ADCB	DIB	ADIB	MASQ	CBD	RAK BANK	SIB	NBF	Wt. Avg.
2020	0.3%	0.4%	0.7%	0.8%	0.2%	1.5%	2.1%	3.9%	0.2%	1.5%	0.7%
2021	0.6%	0.3%	1.6%	0.7%	0.0%	1.2%	1.2%	4.2%	0.4%	3.3%	0.8%
2022	0.6%	0.4%	0.9%	0.7%	0.2%	2.4%	0.3%	1.4%	0.2%	2.6%	0.7%
3-Y avg.	0.5%	0.4%	1.1%	0.7%	0.1%	1.7%	1.2%	3.2%	0.3%	2.4%	0.7%
3-Y sum	1.5%	1.1%	3.3%	2.2%	0.4%	5.1%	3.6%	9.5%	0.9%	7.3%	2.2%

Source: Al Ramz Investment Research, Bloomberg



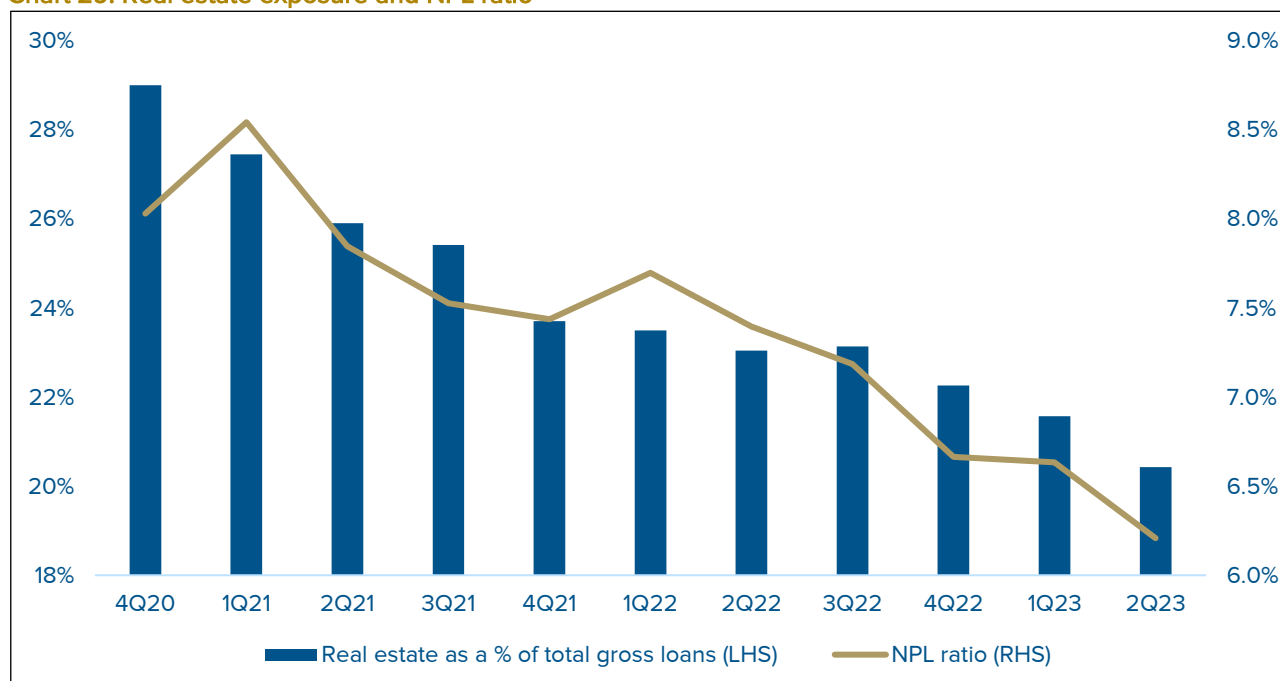
ADCB also sold AED 5.5bn of bad loans at the end of 2022, resulting in an estimated one-time gain of AED 0.5bn. Although this sale did not impact the NPL ratio, it demonstrates the commitment of ADCB to improving loan-book quality and to cleaning up the balance sheet.

Real estate downsizing helps reduce NPLs

In addition to write-offs and the disposal of bad loans, ADCB deliberately decreased real estate exposure to improve the risk profile of its loan portfolio.

Property currently represents 20% of total loans against 29% at the end 2020. In nominal terms, this is a significant decrease of nearly AED 15bn in less than three years, from AED 58.2bn to AED 72.6bn. As property exposure came down, so did the NPLs, as per the chart below.

Chart 29: Real estate exposure and NPL ratio



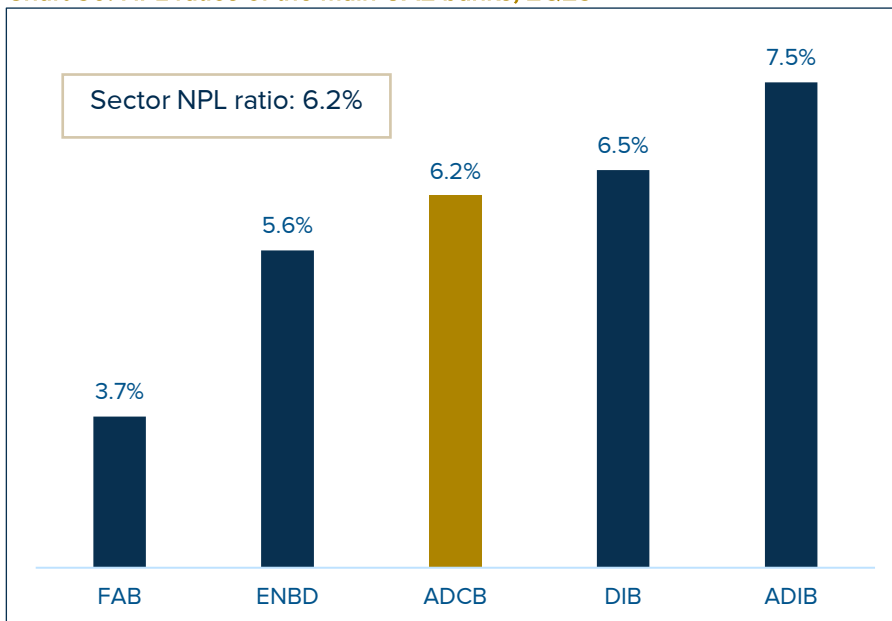
Source: Al Ramz Investment Research, Company data

NPL ratio stabilization

With NPLs at 6.2% at mid-year, ADCB is now on par with the industry average, lower than DIB and ADIB but higher than FAB and ENBD. We expect stability in loan quality from here, with any NMC monetization likely to significantly improve overall metrics.



Chart 30: NPL ratios of the main UAE banks, 2Q23



Source: Al Ramz Investment Research, Company data

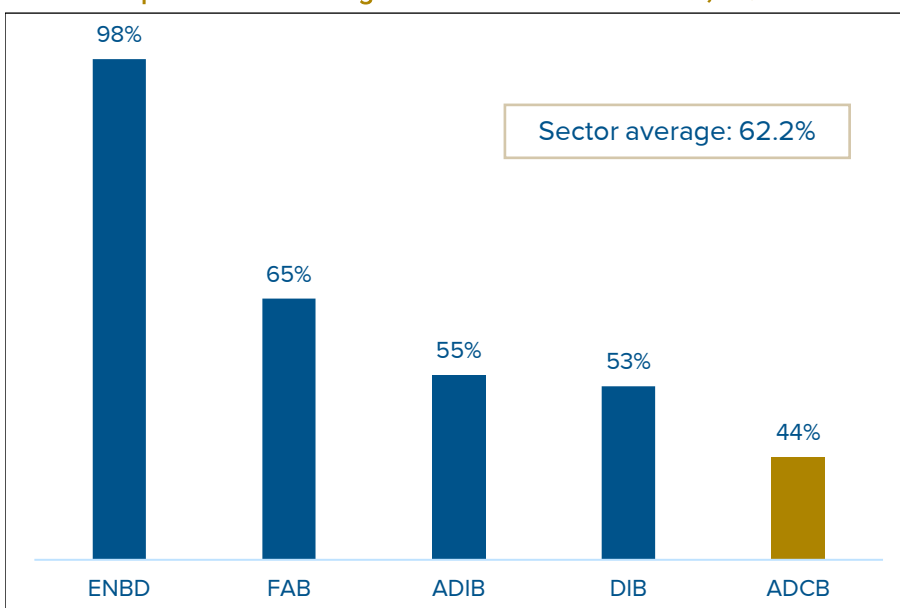
Note: Sector NPL ratio is based on latest CBUAE available data as of 2Q23

Better coverage still lags industry average

We comparatively look at provision coverage for stage 3 loans including POCI (Purchased or Originated Credit-Impaired) to assess the capacity of ADCB to absorb potential credit losses.

We find significant improvement at mid-year 2023, with a coverage ratio of 43.9% up from 29.7% in 2Q20, but with more to go for the bank to catch up with the industry average of 62.2%.

Chart 31: Impaired loan coverage ratios of main UAE lenders, 2Q23



Source: Al Ramz Investment Research, Company data

Note: Sector coverage ratio is based on latest CBUAE available data as of 2Q23

Coverage calls for higher provisions

ADCB has set aside relatively low specific provisions to mitigate potential losses from NPLs. Given the current environment of higher interest rates and the generally challenging macro, there is a risk of new impaired loans forming in the near term that could expose the bank to potential credit losses. Therefore, we believe ADCB should increase its credit costs to build sufficient buffers against such potential losses.

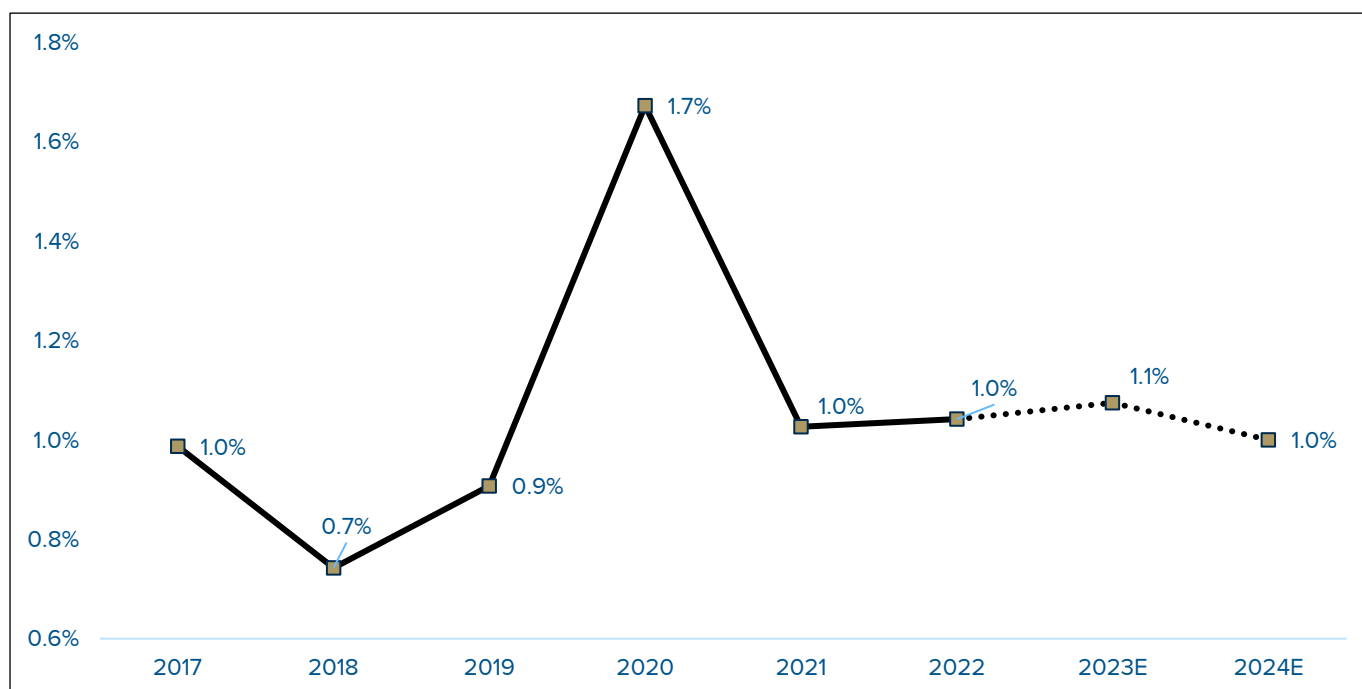
To bring specific coverage in line with the sector average of c. 62%, and assuming constant NPLs, we estimate that ADCB would need to set aside an additional amount of AED 3.2bn which is equivalent to 51% of its 2022 earnings or 1.1% of its gross loans.

The cost of risk is a crucial metric that measures a bank's ability to manage potential credit losses. It is calculated as loan-loss charges / total average gross loans over a given period, annualized, and expressed in basis points (bps).

ADCB's average cost of risk stood at 1.06% (106 bps) between 2017 and 2022, with a sharp increase in 2020 to 167bps, from the AED 1.5bn NMC and Finabl provisioning. Excluding the latter, the cost of risk would have been at 1.07%, consistent with the historical average.

In line with the higher interest rate environment, we conservatively estimate a higher cost of risk at 1.1% in 2023E, compared with the normalized historical average of c. 1.0%.

Chart 32: Cost of risk at ADCB



Source: Al Ramz Investment Research, Company data



Modest earnings growth ahead

Margin stabilization

The net interest margin (NIM) of ADCB rose by 31bps to 2.74% YoY at the end of 1H23, improving significantly from the modest 8bps gain of 2022.

Still, NIM expansion was relatively slower than that of other networks such as ADIB, ENBD, or DIB. This was on the back of a negative double-whammy where low-cost CASA (Current Account Saving Account) decreased, while more costly term deposits increased, in the context of rising interest rates.

Table 3: NIMs of main UAE banks, 1H23

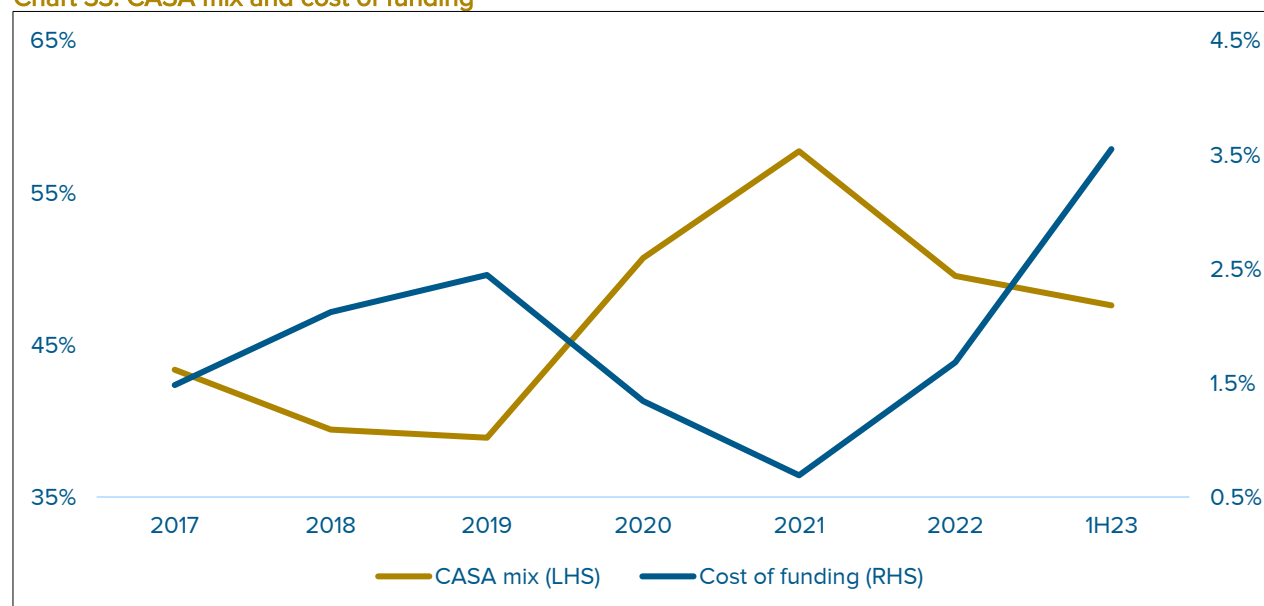
	NIM	YoY expansion
ADIB	4.41%	128bps
ENBD	3.96%	110bps
DIB	3.20%	40bps
ADCB	2.74%	31bps
FAB	1.67%	12bps

Source: Al Ramz Investment Research, Company data

CASA had jumped to 57.7% at the end of 2021, gaining as much as 18.8% in 2 years from a conjunction of pandemic impact and low interest rates. This trend reversed last year after the rapid interest-rate pickup, causing CASA to drop to 47.6% by mid-2023, while fixed deposits increased to 52.4% from 42.3%. This contributed to keeping funding costs high, subsequently putting pressure on margins.

Any slowdown in the hiking cycle, or outright Fed pivot, should help improve the CASA deposit mix at ADCB, thereby offsetting any pressure on asset yields from a decline in interest rates.

Chart 33: CASA mix and cost of funding



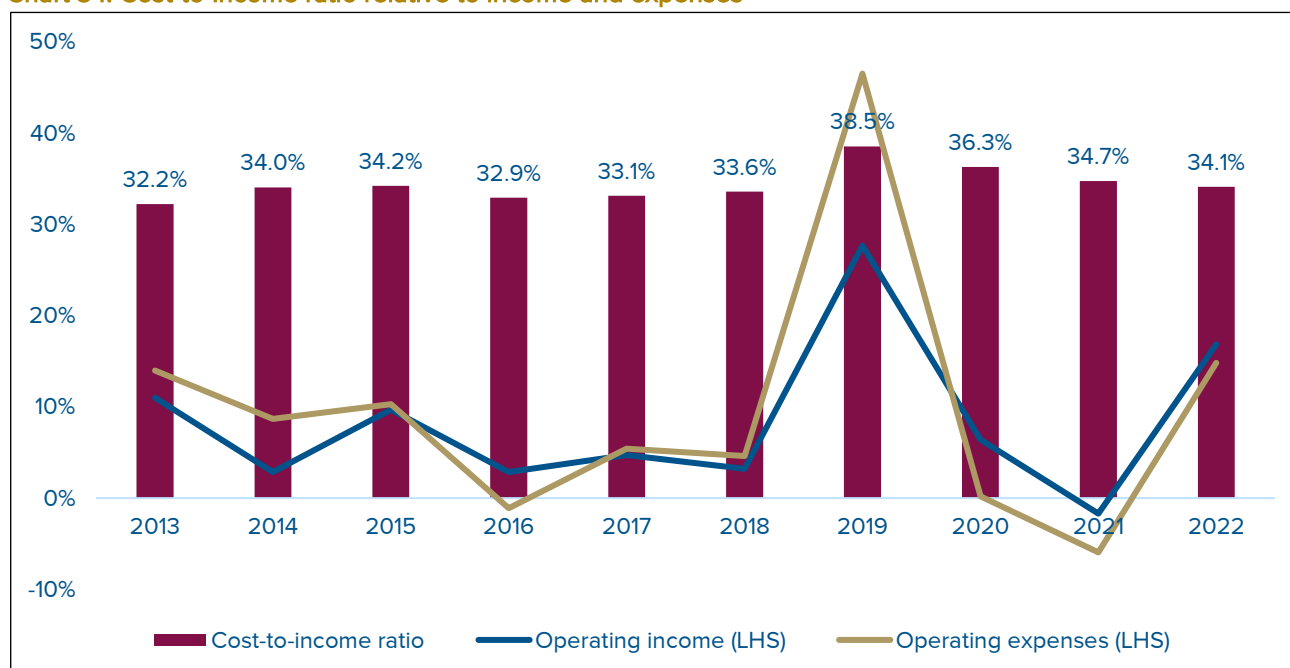
Source: Al Ramz Investment Research, Company data

Stable but relatively unimpressive cost efficiency

ADCB has maintained a relatively stable cost efficiency over the past decade, as evidenced by its C/I ratio, which is a measure of how efficiently a bank manages its expenses relative to its income.

The bank's C/I ranged from 32.2% to 38.5% between 2013 and 2022. It reached a record high of 38.5% in 2019 due to integration costs related to the merger (ex-integration: 35.6% in 2019).

Chart 34: Cost-to-Income ratio relative to income and expenses



Source: Al Ramz Investment Research, Company data

UNB/AHL merger synergies totaled AED 764m in 2020 or 16.8% of total operating expenses, and AED 1.1bn in 2021 (27% of opex). These numbers were well ahead of budget for both years and were realized through various measures, including reducing staff costs, and utilizing the integrated network, digital platforms, and IT systems.

Cost synergies resulted in flat annual operating expenses in 2020 and a decline of 6% in 2021. Cost savings effectively mitigated the impact of slow revenue growth over these two years.

In 2022, operating expenses increased by 14.8% from inflationary pressures and a low base-effect. However, the bank still managed to improve its C/I ratio by 60bps by recording strong revenue growth of 16.8%.

Table 4: Synergies post-merger (UNB) and acquisition (AHB)

AED m	2019	2020	2021
Gross synergies	350	917	1150
Integration cost	(346)	(153)	0
Net synergy flows	4	764	1,150
Total opex	4,518	4,526	4,257
Net synergies % total opex	0%	17%	27%

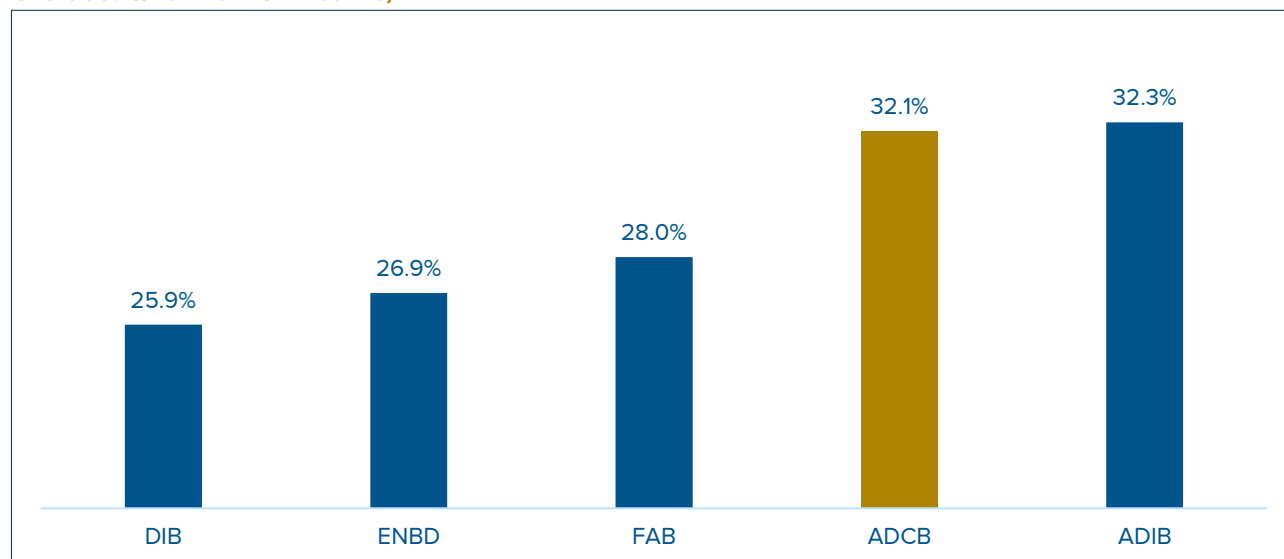
Source: Al Ramz Investment Research, Company data

ADCB's C/I ratio still lags its main peers and points to better cost efficiency elsewhere, as shown in the following chart. This may be due to faster peer topline growth from better geographical diversification.



Medium-term C/I management guidance has been in the range of 29% to 32%. This target should be achievable, especially in the event of successful NMC monetization.

Chart 35: C/I of main UAE banks, LTM



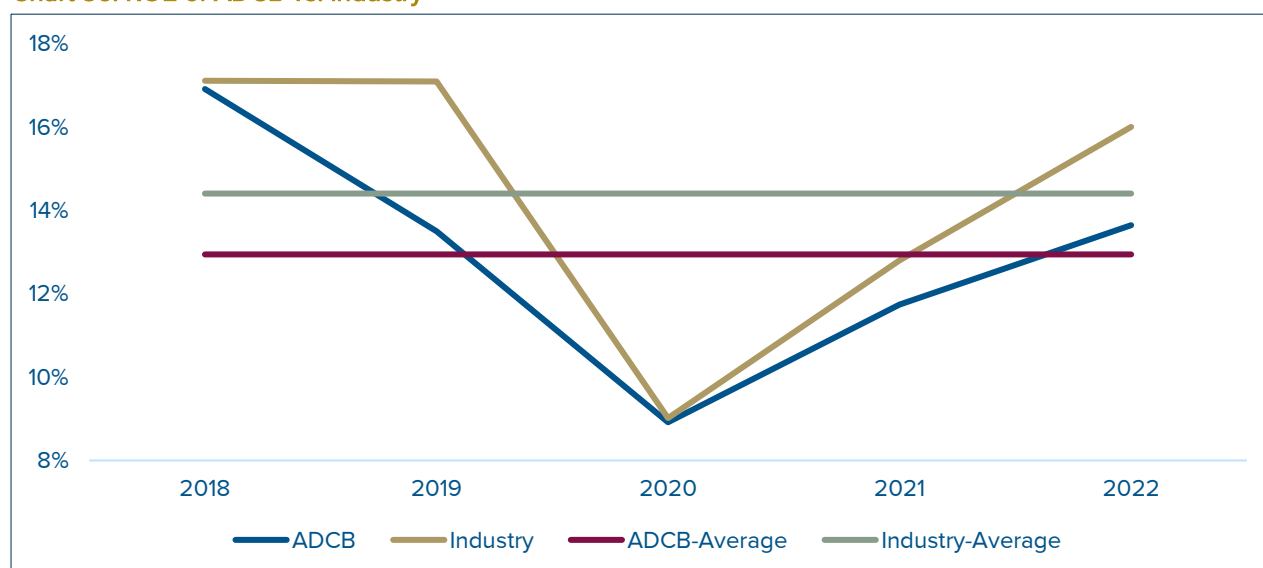
Source: Al Ramz Investment Research, Company data

ROE improving

Looking at ADCB's tangible ROE since 2018, we note a substantial improvement in the last two years, to 13.6% in 2022A – Slightly higher than the 2019 pre-pandemic level of 13.5%. This indicates the successful implementation of risk management strategies.

However, equity returns remain below industry average overall, despite the improvement. On average, ADCB has come in below industry ROE metrics over the past five years, with an average return of 12.9% against the industry average of 14.4%.

Chart 36: ROE of ADCB vs. Industry

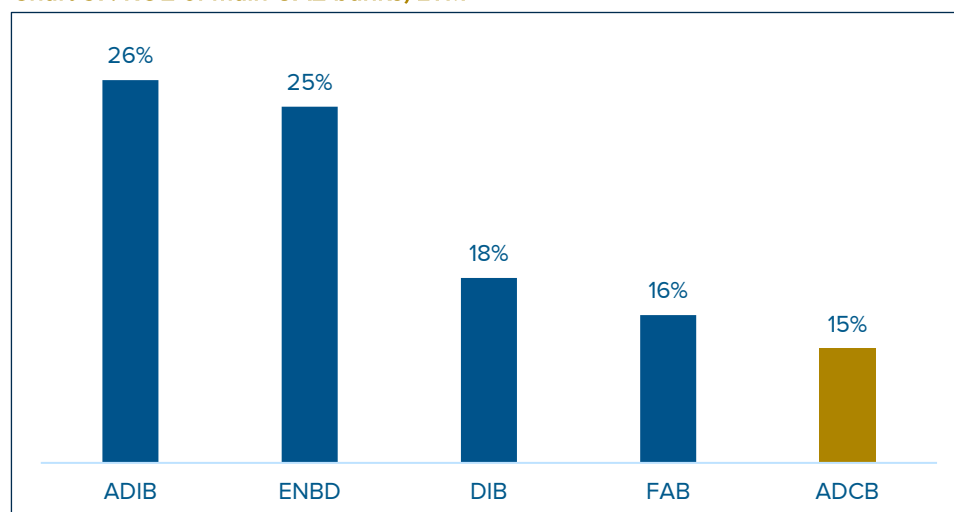


Source: Al Ramz Investment Research, Company data

ADCB's trailing twelve-month ROE comparison with key peers reveals that the bank currently lags most counterparts. Despite notable efforts to enhance profitability, there remains a distinct gap between ADCB and its peers in terms of ROE. One way for the lender to address this disparity is to diversify geographically outside the UAE, in our view.



Chart 37: ROE of main UAE banks, LTM



Source: Al Ramz Investment Research, Company data

We expect earnings growth of 13% in 2023E, on the back of loan growth and NIM expansion. However, 2024E earnings may witness a decline of 11% due to the upcoming corporate tax. We expect a net income CAGR of 5% over 2027E, lower than the historical 8% (2013-22).

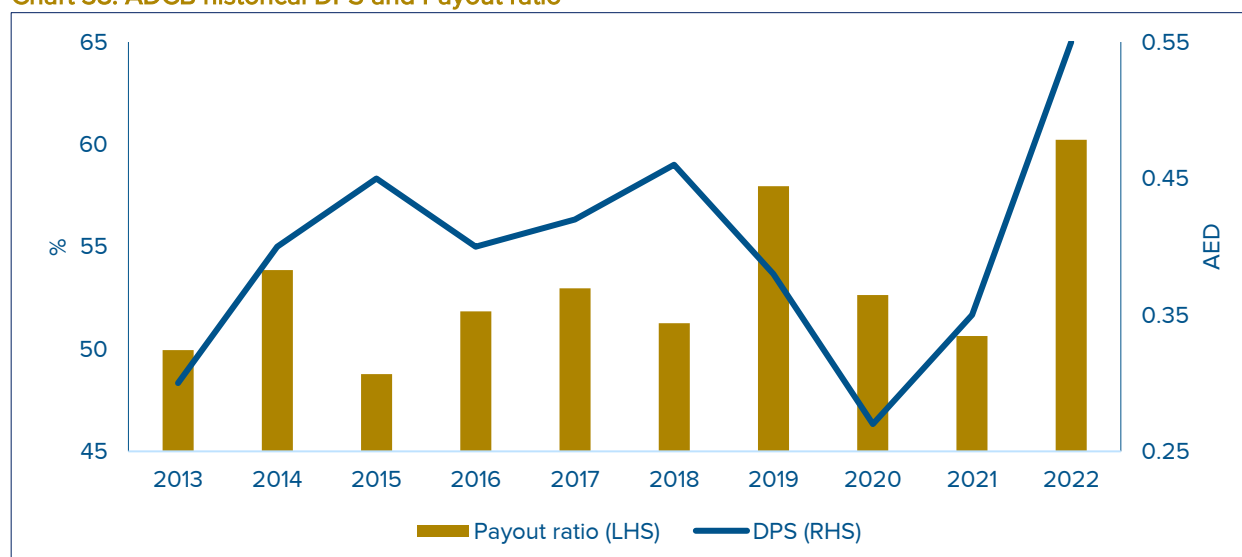
Historical payout back in sight

ADCB usually follows a stable dividend policy, distributing c. 50% of net profits as cash dividends. However, it reduced its cash payout to 20% last year and compensated for this decrease with a 40% stock dividend. This resulted in a total blended dividend of AED 0.55 per share, equivalent to a 60% payout.

The objective behind the lower cash distribution in 2022 could be to 1) boost stage 3 coverage ratio, or 2) use retained earnings to fund future loan growth in higher-yielding sectors, or 3) build capital for inorganic growth.

That said, ADCB's strong capital ratios, including a 13.4% CET1 ratio and 16.1% CAR, indicate that the bank has sufficient capital buffers to support higher cash payouts. This suggests that the bank may be able to resume its historical trend of a 50% cash payout ratio in line with its medium-term guidance.

Chart 38: ADCB historical DPS and Payout ratio



Source: Al Ramz Investment Research, Company data

Note: 2022 DPS of AED 55 fils is composed of 18 fils/share in cash and 37 fils/share in stock



We initiate with equal-weight

We see three distinct phases to the ADCB stock over the past five years: outperformance until the pandemic, performance in-line during covid, underperformance since the pandemic exit, in March 2022.

Where the stock goes next will depend on multiple factors, such as: The NMC wind-down, the interest-rate path, or the sustainability of economic growth.

Chart 39: 5-year stock performance against ADX



Source: Al Ramz Investment Research, Refinitiv

From a valuation perspective, we use three methods to arrive at a blended fair value of **AED 9.70 per share**, which implies an upside of 13.2% to the last closing price. We therefore **initiate our coverage with an equal-weight rating**.

Table 5: Blended valuation summary

Valuation method	Weight	Fair value, AED
Dividend discount model	1/3	9.04
Residual income model	1/3	9.01
Relative valuation	1/3	11.06
Blended fair value		9.70
Last closing price		8.57
Up/downside to fair value		+13.2%

Source: Al Ramz Investment Research



Growth and return assumptions

We detail below the assumptions used in our valuation models:

- Risk-free rate (Rf): The basis of our risk-free rate is the Starmine inflation-adjusted risk-free rate, which currently stands at 4.2%.
- Beta (B): Our beta is based on the regression of daily price changes against the local index (ADX) over the past five years. Daily prices are sourced from Refinitiv.
- Equity risk premium (ERP): Based on the long-term historical average return for the UAE equity market return and risk-free rate, we approximate an ERP of 5.5%.
- Cost of equity (r): We derive our cost of equity using the capital asset pricing model (CAPM): $R_f + (B \times ERP)$.
- Terminal growth (g): We assume that ADCB's returns should grow to perpetuity in line with the long-term real GDP of the UAE. Our terminal growth rate is based on the historical average of UAE real GDP growth from 1980 to 2022.
- Sustainable ROE: Our sustainable ROE is derived from our financial model and forecasts.
- Justified P/B ratio: This ratio is determined by the differential between the ROE and the cost of equity: $(ROE - g) / (r - g)$.

Table 6: Valuation Assumptions

Valuation parameter	Assumed rate
Risk-free rate	4.2%
Market risk premium	5.5%
5-year Beta	1.2
Cost of equity	10.7%
Terminal growth rate (g)	3.5%
Tangible sustainable ROE	12.0%
Justified tangible P/B	1.2

Source: Al Ramz Investment Research

Dividend discount model: AED 9.04 per share

We value ADCB at AED 9.04 based on a two-stage Gordon growth valuation model, which is made up of future dividend distributions for the forecasting period and a terminal P/B thereafter.

The details of Terminal P/B are given in the assumptions above. We use it to derive terminal book value, which is then discounted back to its present value at the cost of equity.

Table 7: Dividend discount valuation summary

AED m		2023E	2024E	2025E	2026E	2027E	After 2027
Net profits		7,109	6,859	6,762	7,466	8,125	
Dividend payout ratio	x	48%	50%	51%	49%	50%	
Dividend (E)	=	3,440	3,440	3,440	3,660	4,026	
Discount factor	x	n/a	0.87	0.79	0.71	0.64	
PV of dividends	=	3,440	3,009	2,718	2,613	2,596	
Terminal P/B (exit multiple)							1.18
Tangible book value	x					67,836	
Terminal value	=						80,267
Sum of PV of dividends		14,377					
PV of terminal value	+	51,760					
Total equity value	=	66,137					
# of shares outstanding (m)	/	7,320					
Fair value per share (AED)	=	9.03					

Source: Al Ramz Investment Research

Table 8: Sensitivity analysis for DDM Valuation

		Cost of equity						
Growth rate		9.00%	9.50%	10.00%	10.70%	11.00%	11.50%	12.00%
	2.00%	11.17	10.37	9.68	8.84	8.52	8.04	7.61
	2.50%	11.38	10.52	9.78	8.90	8.56	8.06	7.61
	3.00%	11.63	10.69	9.90	8.96	8.61	8.08	7.61
	3.50%	11.92	10.90	10.03	9.03	8.66	8.10	7.61
	4.00%	12.27	11.14	10.19	9.11	8.71	8.12	7.61
	4.50%	12.70	11.42	10.38	9.21	8.78	8.15	7.61
	5.00%	13.23	11.77	10.60	9.32	8.86	8.18	7.61

Source: Al Ramz Investment Research

Residual income: AED 9.01 per share

We value ADCB at AED 9.01 per share based on its residual income, which assumes that the value of the company is the present value of its excess returns (net profit – equity charge). Equity charge is the required rate of return multiplied by shareholder equity.



Table 9: Residual income valuation summary

AED m		2023E	2024E	2025E	2026E	2027E	After 2027
Net profits	(a)	7,109	6,859	6,762	7,466	8,125	
Beginning equity		48,273	53,337	57,610	60,455	63,956	
Cost of equity (COE)		10.7%	10.7%	10.7%	10.7%	10.7%	
Equity charge (Beg. equity * COE)	(b)	5,163	5,705	6,162	6,466	6,840	
Excess equity return	(a-b)	1,946	1,154	600	1,000	1,285	
Discount factor	x	0.97	0.87	0.79	0.71	0.64	
PV of interim excess return	=	1,884	1,009	474	714	829	
Terminal value of excess return							19,768
Sum of PV of excess return		4,911					
PV of Terminal value of excess return	+	12,747					
Beginning equity invested	+	48,273					
Total value of equity	=	65,931					
# of shares outstanding (m)	/	7,320					
Fair value per share (AED)	=	9.01					

Source: Al Ramz Investment Research

Relative valuation: AED 11.06 per share

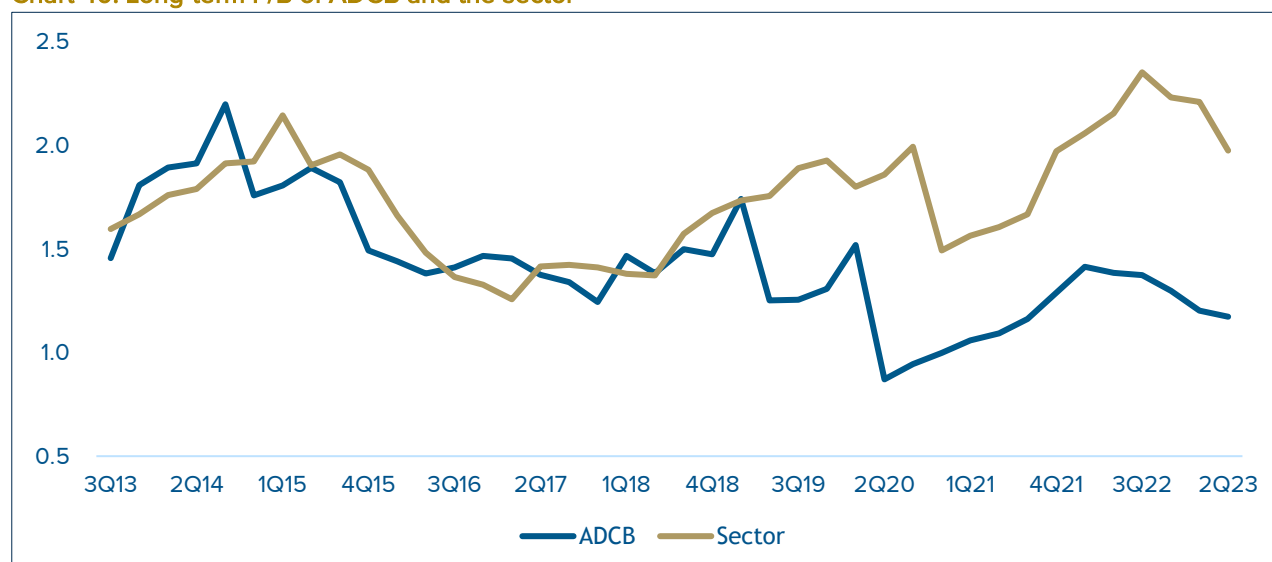
Here, we consider the regional peers of ADCB to assess its relative valuation. Our sample includes the 30 largest GCC-listed banks by total assets. We calculate the 10-year average P/B ratio for ADCB and peers using published book values and closing trading prices at the end of every quarter. We then compare the average long-term multiple of ADCB and peers.

We find that ADCB traded in line with the sector until early 2019 – A date coincidental with the start of its acquisition drive. Since then, the stock has earned itself a structural discount of nearly 40% to its listed peers.

On average over the entire period, the discount of ADCB to peers has been 21%, and we choose to retain this number in our relative valuation. We apply this structural discount to the current peer average of 1.82x and use our estimated 23E BVPS of AED 7.67 to arrive at a relative fair value of AED 11.06 per share for ADCB.

The comp table below shows the gap between ADCB and its benchmark group in terms of valuation, returns and dividend yield. It reinforces our belief that the historical valuation discount is substantiated.

Chart 40: Long-term P/B of ADCB and the sector



Source: Al Ramz Investment Research, Refinitiv

Note: Sector average include the top 30 banks in terms of total assets



Table 10: Comparative valuation and return ratios of main GCC banks, listed by decreasing market cap

Banks (USD m)	Total assets	Market cap	P/B	P/E	D/Y	ROTE	ROA
Qatar National Bank	330,081	38,285	1.7	9.5	4.0%	18.3%	1.2%
First Abu Dhabi Bank	312,063	39,529	1.7	10.7	3.9%	16.3%	1.2%
Saudi National Bank	265,764	56,386	1.9	10.8	3.6%	17.7%	2.0%
Emirates NBD Bank	220,860	28,466	1.3	5.3	3.6%	24.9%	2.6%
Al Rajhi Bank	209,300	76,675	3.4	16.9	2.5%	20.7%	2.2%
Kuwait Finance House	120,420	35,604	3.9	19.8	2.3%	21.1%	1.7%
National Bank of Kuwait	117,377	23,363	2.3	13.1	3.7%	18.0%	1.5%
Riyad Bank	103,843	23,474	1.7	11.2	4.3%	16.0%	2.1%
Saudi Awwal Bank	89,351	19,037	1.6	11.7	4.6%	13.7%	1.9%
Dubai Islamic Bank	81,621	10,982	1.2	6.9	5.3%	17.9%	2.0%
Banque Saudi Fransi	65,555	12,208	1.3	11.4	4.8%	11.8%	1.7%
Alinma Bank	60,534	18,929	2.5	17.6	2.9%	14.8%	1.9%
Arab National Bank	57,622	9,958	1.1	9.9	4.9%	11.5%	1.8%
Mashreqbank	57,443	8,194	1.3	5.2	6.0%	26.1%	2.9%
Qatar Islamic Bank	50,349	12,389	1.9	10.9	3.3%	18.2%	2.3%
Abu Dhabi Islamic Bank	49,602	10,187	2.2	8.6	4.7%	25.8%	2.6%
Commercial Bank	44,161	6,138	1.2	7.7	4.5%	15.5%	1.7%
Masraf Al Rayan	44,064	5,415	0.9	18.2	4.7%	5.1%	0.7%
Arab Banking Corporation	40,981	746	0.2	3.6	6.3%	5.5%	0.6%
Bank Albilad	36,124	11,064	2.9	18.7	1.2%	16.3%	1.7%
Bank Muscat	34,717	5,499	1.2	10.5	5.3%	11.3%	1.6%
Commercial Bank of Dubai	33,526	3,820	1.2	6.4	5.2%	12.8%	1.8%
Bank Aljazira	33,200	3,800	1.1	15.2	3.3%	7.9%	0.8%
Saudi Investment Bank	32,973	4,292	1.2	8.9	5.2%	13.6%	1.6%
Boubyan Bank	26,101	7,835	3.0	38.2	0.9%	7.9%	0.8%
Doha Bank	25,550	1,412	0.5	10.4	4.6%	4.9%	0.5%
Al Baraka Group	24,362	342	0.5	2.3	0.0%	18.8%	0.6%
Burgan Bank	23,007	2,171	0.9	16.4	4.0%	5.5%	0.6%
Gulf Bank	22,488	2,690	1.1	12.3	3.8%	9.5%	1.0%
Al Ahli Bank of Kuwait	20,438	1,639	1.0	13.3	3.5%	7.8%	0.6%
Weighted average			1.8	11.1	3.6%	16.8%	1.7%
Abu Dhabi Commercial Bank	141,943	17,061	1.2	9.0	2.0%	14.5%	1.4%
Premium or discount	-	-	-32%	-19%	-44%	-14%	-18%

Source: Al Ramz Investment Research, Refinitiv Note: The dividend yield of ADCB is calculated using only cash portion of dividends



Investment risks

There are several upside and downside risks that could cause the share price to deviate from our fair value. These include:

Upside risks

Potential recoveries from NMC Healthcare NPLs: To maintain a conservative approach, we have not incorporated the potential recoveries from the sale of NMC business into our forecast. However, successful monetization of NMC could result in provision reversals, lowering the cost of risk and potentially leading to higher-than-expected earnings.

Continuation of monetary tightening or stable rates for longer: Our forecasts account for the reversal of interest rates from early next year and continuing onward. We expect 3M SOFR (Secured Overnight Financing Rate) to decrease to 4.2% by the end of the next year from its current level of 5.4%. However, if there is a further increase in interest rates or if rates remain unchanged for an extended period, this could result in higher NIMs. This in turn could lead to earnings exceeding our current projections.

Downside risks

Higher corporate tax: The tax authority of the UAE introduced a corporate taxation scheme on January 31, 2022, with a proposed standard rate of 9% to be implemented from the beginning of 2024. This is expected to be a transitory rate towards the globally harmonized minimum of 15%.

However, there is still uncertainty regarding the final tax number, including whether it will ultimately be 9% or the globally harmonized minimum of 15%. While our central scenario assumes a 9% tax rate, **commencing at the outset of 2024 and spanning our entire forecast horizon**, it is prudent to consider a sensitivity scale in case the ultimate number is higher. Nevertheless, our assessment indicates that a tax rate at the higher end of the range would have a 7% reduction impact on our valuation.

Table 11: Sensitivity of potential corporate tax on ADCB's EPS and fair value

Tax rate sensitivity	9%	10%	11%	12%	13%	14%	15%
EPS in 2024E, AED	0.94	0.93	0.92	0.91	0.89	0.88	0.87
Fair value, AED	9.70	9.63	9.56	9.48	9.41	9.34	9.27

Source: Al Ramz Investment Research

Lower oil prices: ADCB's operations are UAE-centric. This concentration makes the bank vulnerable to UAE economic conditions which are heavily dependent on energy prices. A significant decline in oil prices would materially impact the growth of the UAE economy and could potentially impact the future earnings of ADCB.



Summary Financials

Summary income statement, AED m	2020	2021	2022	2023E	2024E	2025E
Interest income	14,065	11,121	16,417	26,327	25,953	24,136
Interest expense	(4,282)	(2,258)	(6,223)	(14,586)	(13,756)	(11,734)
Net interest income	9,783	8,864	10,194	11,741	12,196	12,402
Non-interest income	2,688	3,396	4,131	4,326	4,298	4,393
Total income	12,471	12,259	14,325	16,067	16,494	16,795
Operating expense	(4,526)	(4,257)	(4,888)	(5,339)	(5,697)	(5,962)
Provision expense	(3,993)	(2,646)	(2,779)	(3,153)	(3,060)	(3,203)
Profit before tax	3,970	5,363	6,649	7,576	7,737	7,630
Taxes	(120)	(100)	(135)	(196)	(696)	(687)
Net profit	3,806	5,241	6,416	7,381	7,041	6,944
Tier 1 interest payments	(277)	(174)	(182)	(272)	(182)	(182)
Net profit after Tier 1 payments	3,529	5,067	6,234	7,109	6,859	6,762

Source: Al Ramz Investment Research, Company data

Summary balance sheet, AED m	2020	2021	2022	2023E	2024E	2025E
Cash and balances with central banks	29,602	33,746	39,429	37,873	40,517	42,428
Customer loans	238,976	244,282	258,493	278,539	296,089	313,791
Investment securities	88,206	96,513	112,011	121,548	129,198	137,126
Total assets	411,156	440,278	497,842	532,735	566,800	600,522
Customer deposits	251,395	265,052	308,931	328,509	349,183	370,610
Total shareholder equity	56,602	59,370	61,426	66,893	71,641	74,979

Source: Al Ramz Investment Research, Company data



Key consolidated ratios

Ratios	2020	2021	2022	2023E	2024E	2025E
EPS (AED)	0.48	0.69	0.85	0.97	0.94	0.92
DPS (AED)	0.27	0.37	0.18	0.47	0.47	0.47
Tangible BVPS (AED)	6.21	6.62	6.94	7.67	8.28	8.69
Yield on earning assets	4.0%	3.1%	4.1%	6.0%	5.6%	4.9%
Cost of funds	1.3%	0.7%	1.7%	3.5%	3.1%	2.5%
Net interest spread	2.6%	2.4%	2.4%	2.5%	2.5%	2.4%
Net interest margin (NIM)	2.8%	2.4%	2.5%	2.7%	2.6%	2.5%
Return on equity (ROE)	8.2%	11.0%	12.9%	13.3%	11.9%	11.2%
Return on assets (ROA)	0.9%	1.2%	1.3%	1.3%	1.2%	1.1%
Net advance-to-deposit ratio (ADR)	99.6%	96.2%	87.5%	89.3%	89.9%	90.3%
Investment-to-deposit ratio (IDR)	35.1%	36.4%	36.3%	37.0%	37.0%	37.0%
CASA ratio	50.7%	57.7%	49.5%	47.6%	50.0%	52.0%
NPL ratio	8.0%	7.4%	6.7%	6.3%	6.4%	6.4%
NPL coverage ratio	57.1%	57.1%	65.3%	79.7%	88.3%	98.0%
Cost-to-income ratio	36.3%	34.7%	34.1%	33.2%	34.5%	35.5%
Cost of risk	1.7%	1.0%	1.0%	1.1%	1.0%	0.9%
Common Equity Tier 1 (CET1) ratio	13.3%	12.9%	13.0%	12.6%	12.9%	12.8%
Tier-1 ratio	15.3%	14.7%	14.6%	14.1%	14.3%	14.2%
CAR	16.6%	16.0%	15.8%	15.5%	15.9%	15.9%

Source: Al Ramz Investment Research, Company data Note: 2022 DPS includes only the cash component of the dividend

Growth	2020	2021	2022	2023E	2024E	2025E
Net loans	-3.6%	2.2%	5.8%	7.8%	6.3%	6.0%
Total assets	1.5%	7.1%	13.1%	7.0%	6.4%	5.9%
Customer deposits	-4.1%	5.4%	16.6%	6.3%	6.3%	6.1%
Net interest income	5.9%	-9.4%	15.0%	15.2%	3.9%	1.7%
Total income	6.4%	-1.7%	16.9%	12.2%	2.7%	1.8%
Operating expenses	0.2%	-5.9%	14.8%	9.2%	6.7%	4.6%
Net profit	-20.3%	36.7%	23.8%	13.3%	-4.6%	-1.4%

Source: Al Ramz Investment Research, Company data



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A stock is rated “over-weight” when Al Ramz Investment Research believes that its fair value lies 15% above the current market price and the stock is likely to reach such fair value within the next 12 months.

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A stock is rated “equal-weight” when Al Ramz Investment Research believes that its fair value lies between -15% and +15% of the current market price and the stock is likely to remain within this range during the next 12 months.

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