



11 SEPTEMBER 2023

Initiation of coverage

Abu Dhabi Islamic Bank

The people's bank



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Last close, AED	10.54
Fair value, AED	11.45
Upside	8.6%
Stock rating	EQUAL-WEIGHT

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Investment case

Small but mighty

Abu Dhabi Islamic Bank (ADIB) was established in May 1997 as a Public Joint Stock Company. It is currently the sixth-largest bank by assets in the UAE and has 146 branches across the world.

Over the years and with concentrated effort, ADIB managed to build a high-quality franchise. The bank is essentially a solid retail network with a local market share of 15% in retail banking where more than half its clients (55%) are UAE nationals.

ADIB is known to follow an aggressive international expansion strategy. It has a presence in six strategic markets: Egypt, the Kingdom of Saudi Arabia (KSA), the United Kingdom, Sudan, Qatar, and Iraq.

Dynamic expansion strategy

ADIB grew faster than its peers over the past 5 years and now maintains leading margins and impressive return metrics. Its net interest margin (NIM) is the highest among large local banking networks. ADIB also maintains the highest CASA ratio, an essential criterion to limit growth in the cost of funds, especially in a rising interest rate environment.

ADIB clearly outperformed the UAE banking sector in terms of loan growth, with housing and personal loans as the main drivers. In these two segments, the bank commands the biggest national market share among all financial institutions including traditional banks.

The combination of higher NIM and CASA ratio, along with robust loan growth, explains outstanding profitability which outpaces even the toughest competition.

Improving cost efficiency and asset quality

ADIB's cost-to-income ratio is higher than the industry average by c. 80bps. This is primarily due to higher employee costs and a larger branch network compared with peers. The bank's digital strategy is key to its cost efficiency efforts.

ADIB also has a higher NPL ratio than the industry average, probably due to legacy loans and to its exposure to NMC Health. We also note that loan write-offs are prohibited by the Shariah practice, making it harder for Islamic banks to drastically reduce their proportion of NPLs. Improvement in cost metrics and asset quality has been high on management's agenda, and we remain confident that ADIB will be able to improve further over time.

Growth potential factored in

We value the stock according to three blended, equally weighted methods, to arrive at a fair value of AED 11.45 per share, implying a potential upside of 8.6%.

We conclude that the stock is currently fairly valued. We therefore initiate our coverage with an equal-weight rating. The quality fundamentals and promising prospects seem fully priced-in, and we find that there is currently more compelling value elsewhere in the sector.

Stock rating

Current rating	EQUAL-WEIGHT
Fair value	11.45
Former rating	NA
Previous fair value	NA
Target upside	8.6%
Listing location	Abu Dhabi
Sector	Banks
Local exchange	ADIB
Bloomberg	ADIB.UH
Reuters	ADIB.AD

Source: Al Ramz Capital, Refinitiv

Stock statistics

Last close, AED	10.54
Market cap (AED m)	38,281
Avg. daily vol. 3m (m)	6.03
Shares out. (m)	3,632
Free float	53%
YTD change	+15.7%
52w high (AED)	11.54
52w low (AED)	8.86

Source: Al Ramz Capital, Refinitiv

Stock price



Source: Refinitiv

Key ratios

Indicator	2023E
P/E	10.3x
P/B	2.15x
Dividend yield	6.0%
ROTE	21.8%
ROA	2.7%

Source: Al Ramz Capital, Refinitiv, ADX

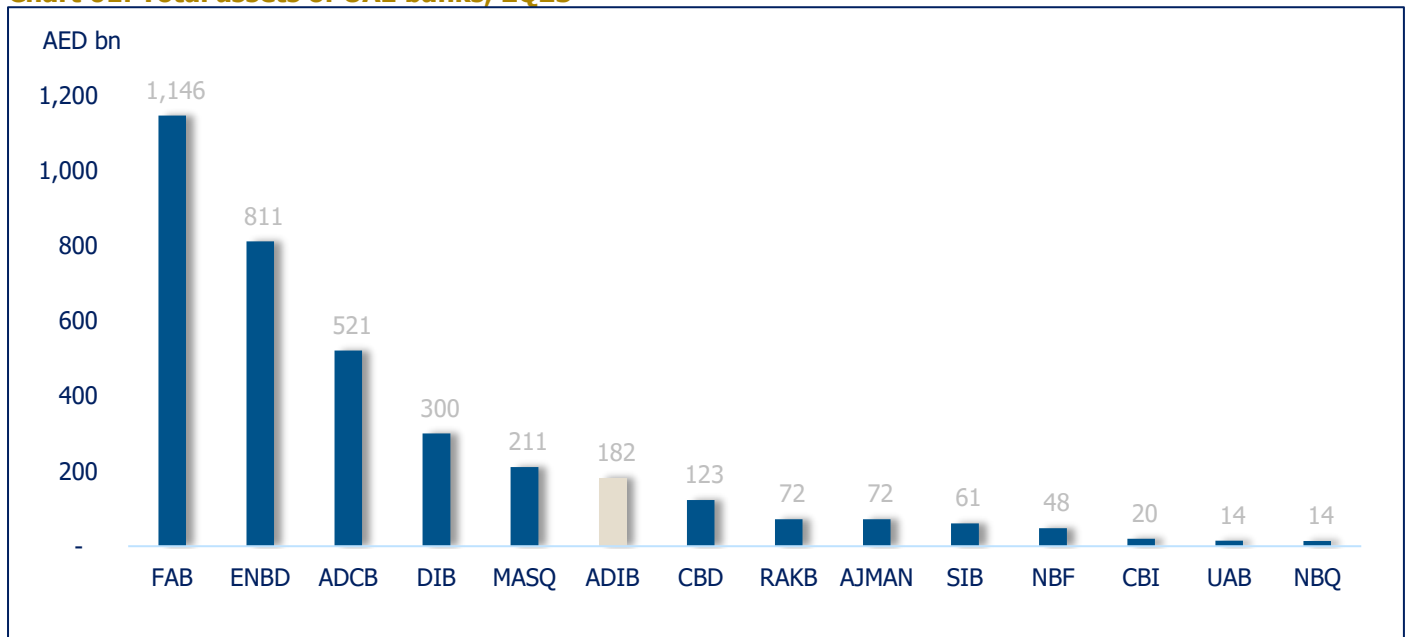
Note: P/B is calculated using tangible equity



Small but mighty

Abu Dhabi Islamic Bank (ADIB) was established in May 1997 as a Public Joint Stock Company through the Amiri Decree No. 9 of 1997. The Bank officially commenced commercial operations in November 1998. It is currently the sixth-largest bank by assets in the UAE and has 146 branches across the world.

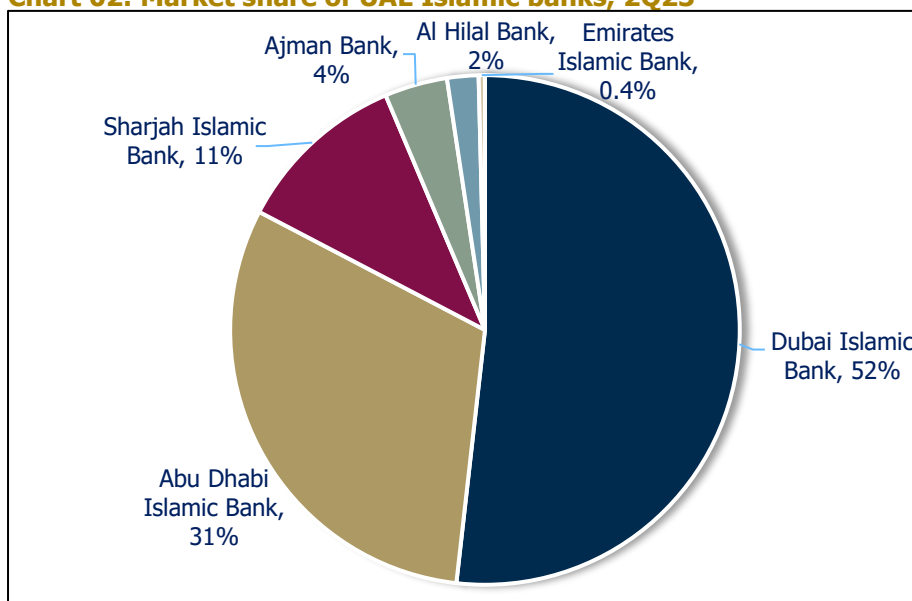
Chart 01: Total assets of UAE banks, 2Q23



Source: Company financials

ADIB is the second-largest Shariah-compliant bank after Dubai Islamic bank (DIB), and all its contracts, operations, and transactions are carried out in accordance with Islamic Shariah principles. In our DIB initiation report titled "A global Islamic Champion" issued on the 11th of May 2023, we highlight the advantages of Shariah-compliant banks, the industry trends, and the outlook for UAE Islamic banking.

Chart 02: Market share of UAE Islamic banks, 2Q23



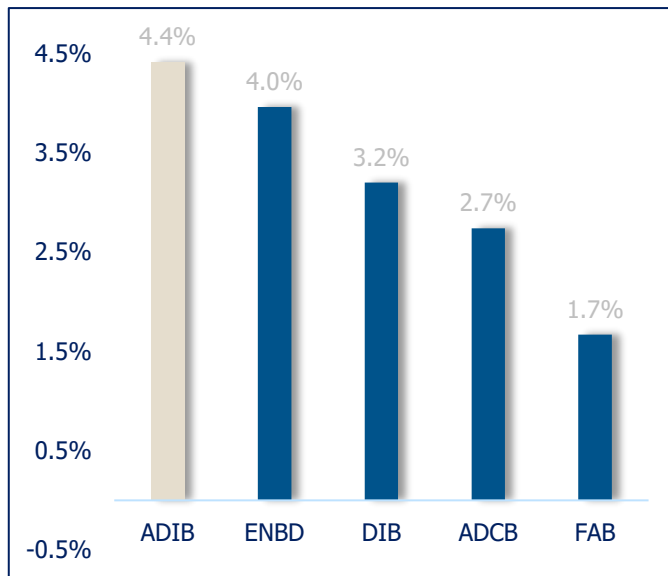
Source: Company financials, Central Bank of the UAE



Much to write home about

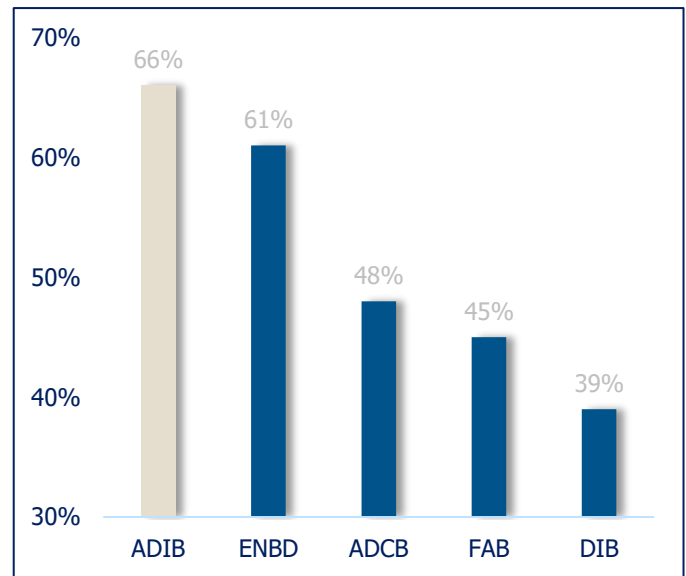
ADIB grew much faster than its peers over the past five years and now maintains leading margins and impressive return metrics. Its NIM is the highest among the local big banks and it maintains the highest CASA ratio, which allows it to keep its cost of funds in check, especially in a rising interest rate environment.

Chart 03: NIM comparison, 2Q23



Source: Company financials

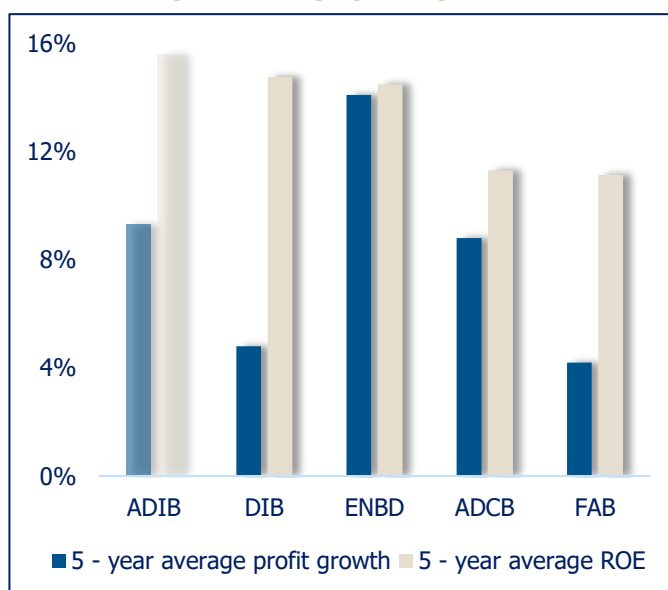
Chart 04: CASA comparison, 2Q23



Source: Company financials

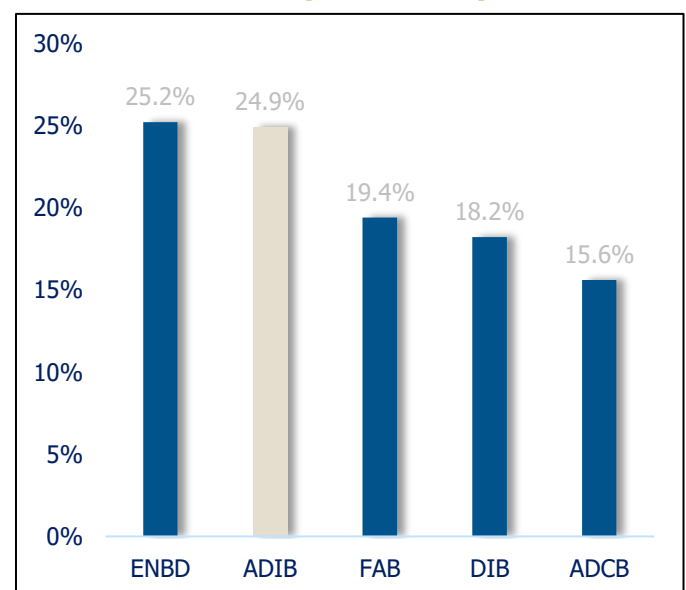
This combination of higher NIM and CASA ratios, along with robust loan growth, may be the primary factor in the bank's profitability outpacing that of competitors. ADIB's average ROE led the sector over the past 5 years (2018-2023). Currently, ENBD and ADIB jointly share return leadership. ADIB's bottom-line expansion over the past 5 years was strong recording the second highest growth in the industry.

Chart 05: 5-year average profit growth vs. ROE



Source: Bloomberg, company financials

Chart 06: Current tangible ROE, 2Q23



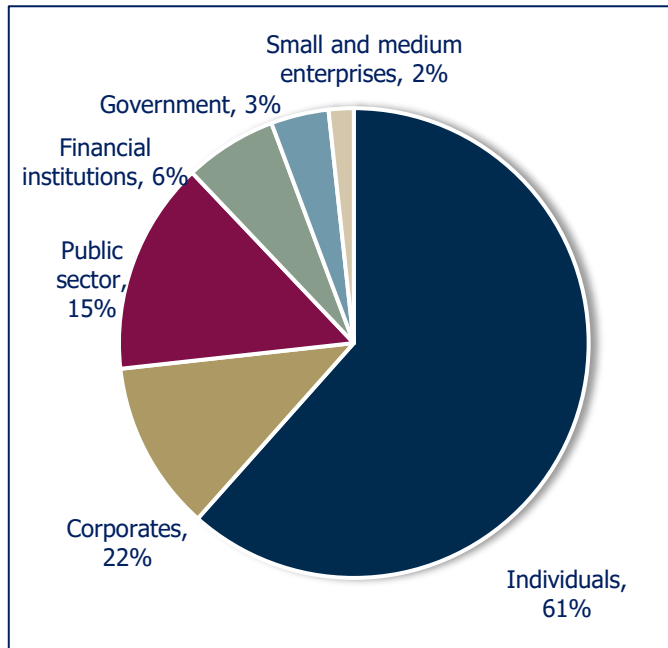
Source: Company financials



A sticky retail client base

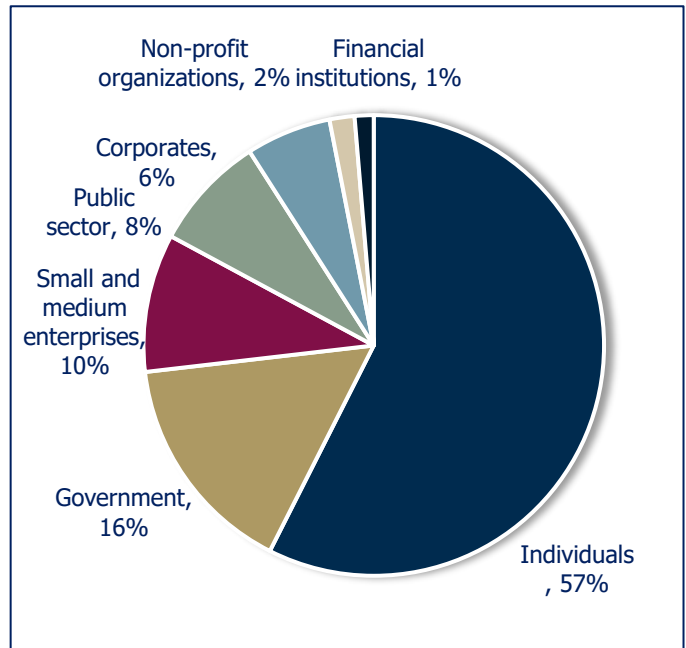
Over the years and with concentrated effort, ADIB managed to build a high-quality franchise. Its client base is skewed towards the retail segment where it captures a 15% market share. Furthermore, 55% of its retail clients are UAE nationals. Management intends to gradually shift its focus to the expat population for fresh growth, and such effort is expected to revolve around affluent Arabs.

Chart 07: Loan book mix, 1H23



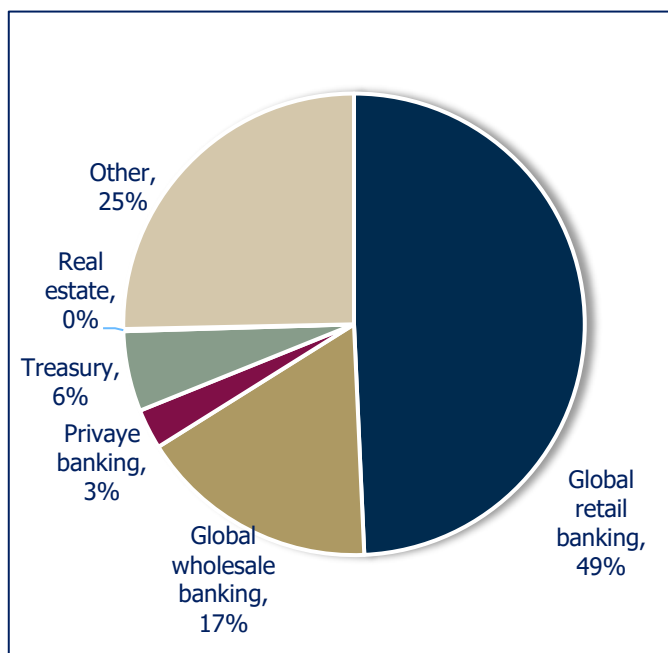
Source: Company financials

Chart 08: Deposit mix, 1H23



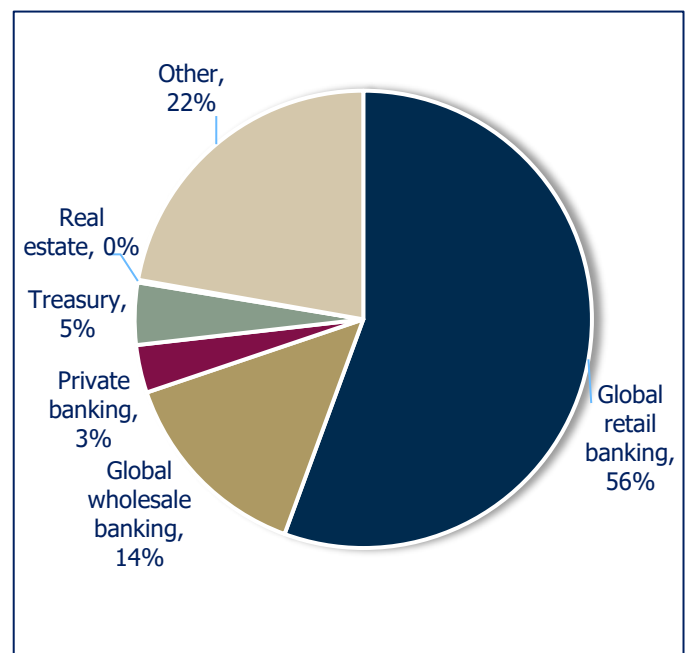
Source: Company financials

Chart 09: Operating profit mix, 1H23



Source: Company financials

Chart 10: Net profit mix, 1H23



Source: Company financials



A strong retail presence has benefits and drawbacks. One clear benefit is the positive margin impact, as individuals typically earn lower rates on deposits and pay more for loans. On the flip side, when borrowing becomes less affordable with rising interest rates, retail customers are the first to curtail borrowing.

Furthermore, the underlying quality of a corporate book is generally greater than that of a retail book, which typically results in a higher probability of default for the latter.

In summary, we believe that the current loan-book mix has served ADIB well in the current cycle. This is evident from the high margin and strong and healthy loan growth.

Rapid international expansion

ADIB is known to follow an aggressive international expansion strategy. It has a presence in six strategic markets: Egypt, where it has 70 branches, KSA, the United Kingdom, Sudan, Qatar, and Iraq.

Chart 11: Current international presence



Source: Company website

An underpenetrated market in Egypt

The bank acquired a 47% stake in Egypt's National Bank of Development (NBD) in 2007. In January 2023, ADIB purchased an additional 9.6m shares, thereby increasing its stake to a controlling 52.6%. This subsidiary is now called ADIB Egypt and is a leading local Islamic lender. Management is optimistic today about its presence in Egypt and expects the contribution from this geography to increase over the coming years, notwithstanding the currently difficult foreign exchange situation.

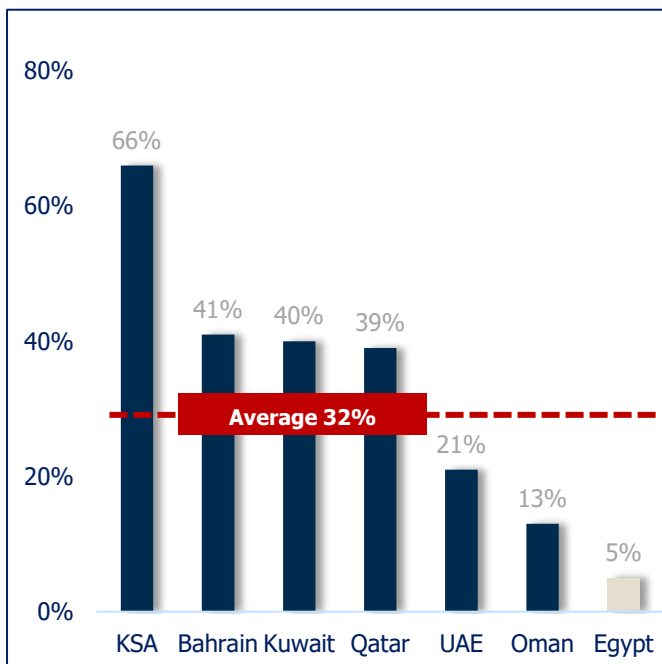


ADIB Egypt operates across three divisions – ADIB Capital, ADIB Lease, ADIB Invest – and offers Shariah-compliant financial services across 70 branches with more than 2,000 employees to the retail, corporate, and SME segments.

The primary reason behind this acquisition was to benefit from the potential growth of the underpenetrated Egyptian Islamic banking market. Islamic banking penetration in Egypt currently hovers around 5%, considerably lower than the GCC average of 32%. This is a surprisingly small percentage, particularly for an Islamic country which is historically perceived as the birthplace of Islamic finance (please see our DIB initiation report as referenced earlier).

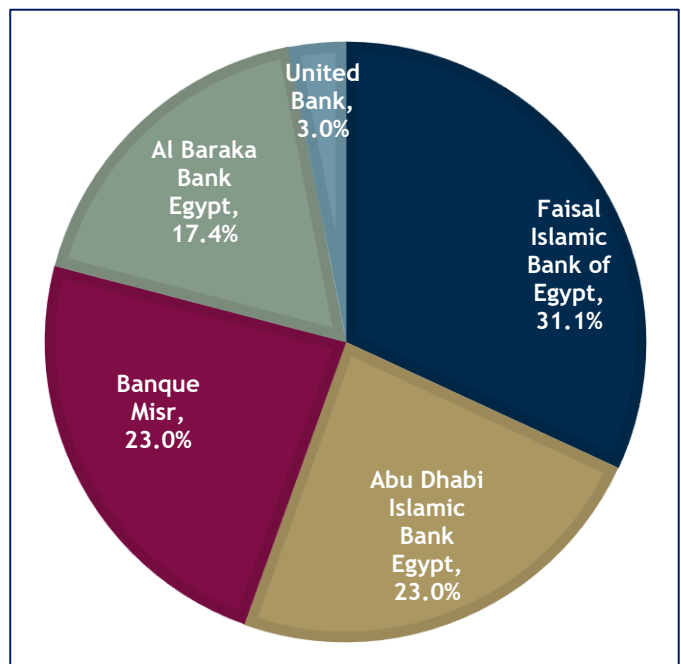
We are seeing a slow but encouraging turnaround in the Islamic banking segment. The Egyptian Islamic Finance Association (EIFA) reported that Islamic banking assets exceeded EGP 600bn in the first half of this year, of which EGP 562bn was provided by banks, and the rest (EGP 60bn) were Sukuk issuances. This marks an increase of EGP 120bn in June 2023, with a growth rate of 27% YoY over June 2022.

Chart 12: Islamic banking penetration



Source: Refinitiv, Zawya

Chart 13: Islamic banking market-share in Egypt



Source: Zawya

Presence in other markets

Contribution from international operations increased from 4% to 17% over the six years from 2017 to 2022, reflecting ADIB's focus on inorganic growth. We believe that ADIB has the firepower to continue to expand inorganically, both locally and internationally.

Kingdom of Saudi Arabia

In September 2011, ADIB acquired a 51% stake in Saudi Finance House. The latter provides a variety of Islamic products and solutions to retail customers, high-net-worth (HNW), and small-to-medium enterprises (SMEs). It specializes in consumer, automotive, and real estate financing.

Qatar, Sudan, and Iraq

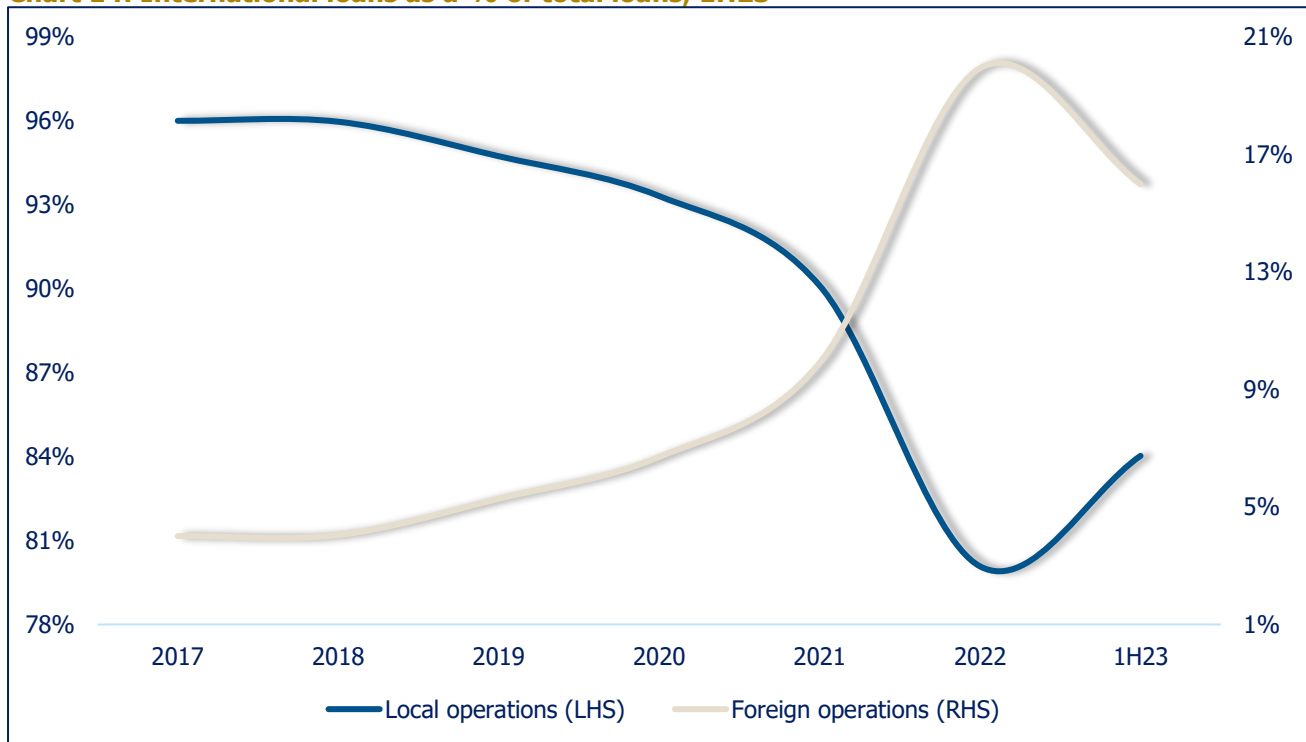
ADIB caters mainly to large corporates in these three countries which collectively account for less than 1% of the total loan-book.



United Kingdom

ADIB operates a private bank which caters to selective and affluent customers looking to finance commercial real-estate in the UK. This portfolio is small, and accounts for 0.4% of total new financing growth in our estimates, but this operation is growing and promising in the eyes of the bank's management. It recorded over GBP 100m in new financing in the first half of this year.

Chart 14: International loans as a % of total loans, 1H23



Source: Company financials



Concentrated ownership but dispersed free float

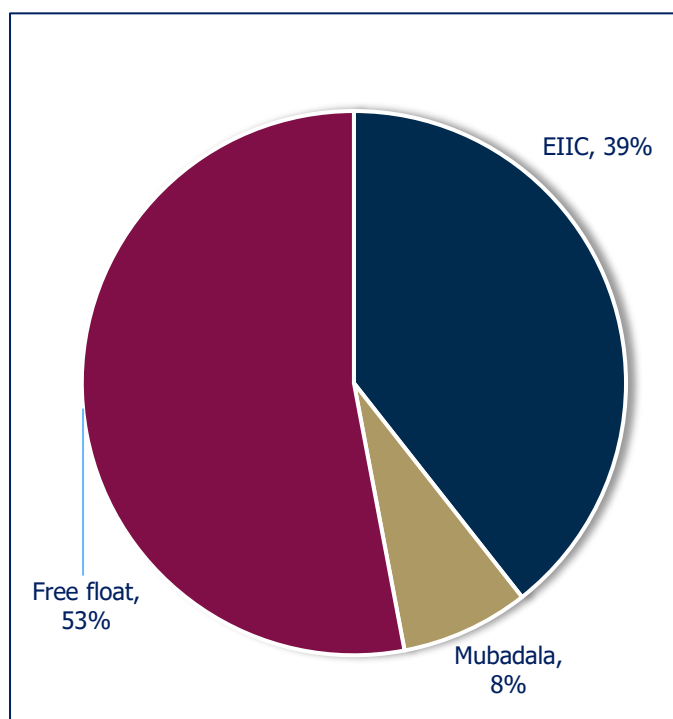
ADIB's principal shareholder is Emirates International Investment Company LLC (EIIC), which directly owns 47% of outstanding shares.

EIIC is the strategic investment arm of Abu Dhabi-based National Holding, and it has a diverse range of interests spanning multiple sectors including banking, real estate, hospitality, fintech, and food & agriculture.

The parent company, National Holding, is a leading private investment holding company with a multi-billion-dollar investment portfolio of companies operating in key growth sectors in the UAE and the MENA region. The ruling family of Abu Dhabi is a major shareholder in National Holding. This means that the government indirectly holds a stake in ADIB, making it a quasi-government entity.

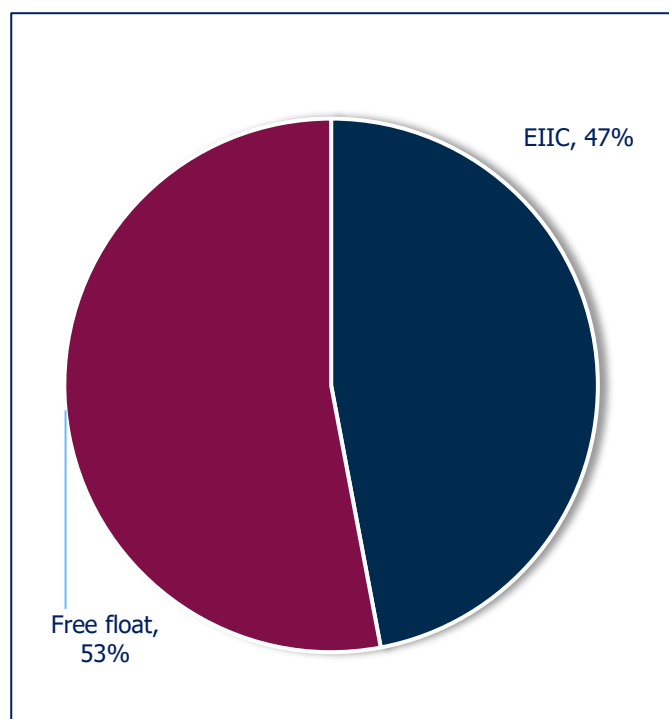
The government indirectly owned a 7.6% stake in ADIB through the Mubadala Investment Company (Mubadala). This stake was acquired by EIIC in early May 2023 for an undisclosed amount. This transaction increased EIIC's total shareholding in ADIB to 47%.

Chart 15: Shareholder structure as at 1Q23



Source: Company website, Refinitiv

Chart 16: Shareholder structure after acquisition



Source: Company website, Refinitiv

The free float represents 52.98% of outstanding shares and is highly diversified, with no single investor directly holding more than 5% outside EIIC. This could be one of the factors behind the stock's liquidity.

Management raised the foreign ownership limit (FOL) from 5% to 40% between September 2019 and July 2020 to diversify the investor base and improve stock liquidity. This development came after the UAE government relaxed its foreign ownership rules to attract international investors. Notwithstanding this change, actual foreign ownership in ADIB still stands at 17.2%.



Table 01: FOL vs. actual ownership of key UAE banks

Bank	Foreign Ownership Limit	Foreign ownership, actual	Free float
Abu Dhabi Commercial Bank (ADCB)	40.0%	17.9%	40%
First Abu Dhabi Bank (FAB)	40.0%	17.4%	62%
Abu Dhabi Islamic Bank (ADIB)	40.0%	17.2%	53%
Dubai Islamic Bank (DIB)	40.0%	16.8%	72%
Emirates NBD (ENBD)	40.0%	13.7%	39%

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

Note: FOL stands for Foreign Ownership Limit

Geared for growth

Figure 01: SWOT analysis

Strengths	Weaknesses	Opportunities	Threats
<ul style="list-style-type: none"> • A large global and local Islamic banking franchise • Comfortable capital position to fund dividend growth and future expansion • Well-structured balance sheet benefits margin expansion 	<ul style="list-style-type: none"> • High NPLs compared with the industry • Exposure to NMC Healthcare scandal • Low cost efficiency 	<ul style="list-style-type: none"> • Unmet Islamic banking potential in the UAE • Potential for global expansion, especially in Egypt 	<ul style="list-style-type: none"> • Changes in banking regulations • A potential economic slowdown impacting sector growth

Source: Al Ramz Capital



Dynamic expansion strategy

In this section, we go over the financial performance of ADIB in the context of its rapid expansion and superior return metrics.

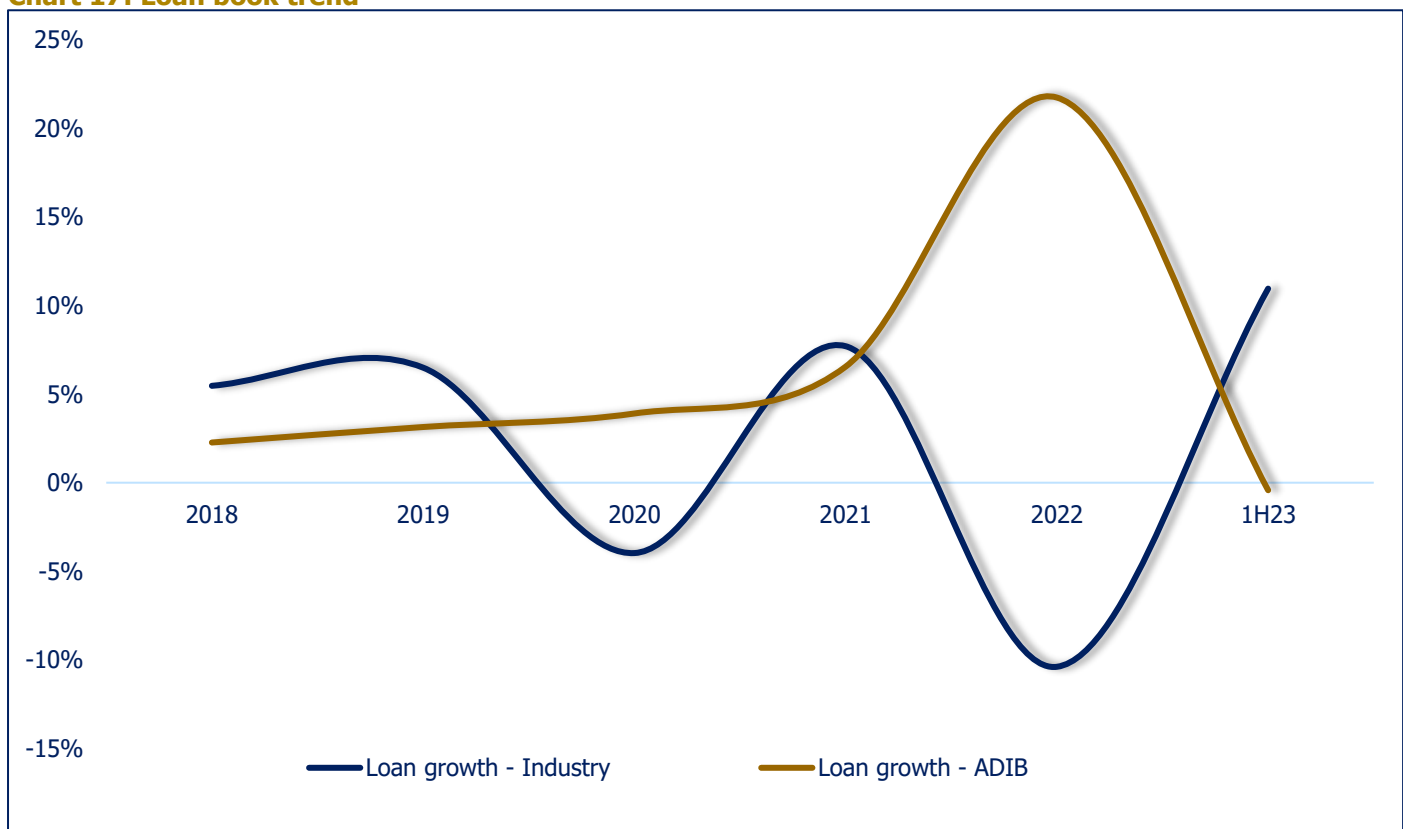
Loans growing faster than the industry

Loan growth at ADIB recently outperformed the average of the UAE banking sector, with a CAGR of 6.6% since 2017 representing more than twice the average sector growth of 2.4%.

Retail customers are mostly driving this growth, with Housing and Personal loans representing the bulk of the expansion – This is where ADIB has the biggest market share among UAE banks.

The exceptional loan-book growth of 22% in 2022 was mainly due to the consolidation of ADIB Egypt. Like-for-like growth of c. 12% is still remarkable.

Chart 17: Loan book trend



Source: Company financials

We look at the ratio of loans to deposits to assess the liquidity of ADIB and its potential to grow its loan book further. At the current LDR ratio of 77%, this is 500bps below the 7-year historical average of 82% for ADIB, and in line with the current sector average.

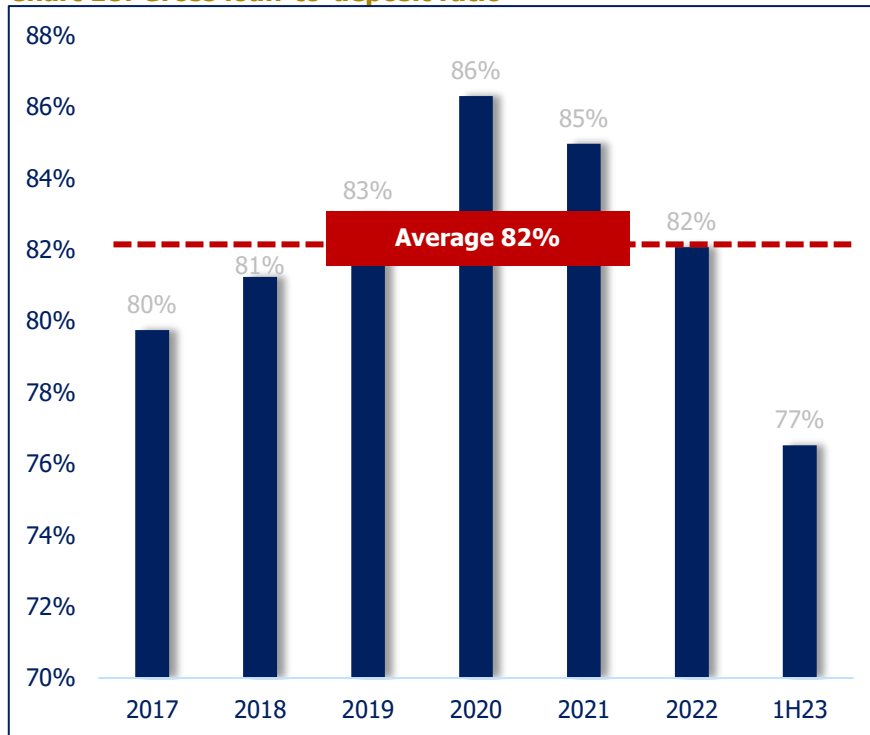
In other words, the loan book is still under-sized compared to current deposits, and the bank could aggressively grow its franchise from here without running into any critical balance-sheet mismatch.

The relatively small loan-book comes on the back of the rapid recent expansion of deposits. It is also a legacy from pandemic times, when customers were consumption-shy, and when the bank was lending less aggressively to improve its liquidity. This is particularly understandable for a franchise so heavily tilted towards the retail-end of the market.



As growth picks up and loan growth follows, the LDR should also mechanically expand to 78% in 2023E and 80% in 2024E. Given the lower relative LDR base, ADIB should be able to expand its lending business more safely and more rapidly than the sector in the coming quarters.

Chart 18: Gross loan-to-deposit ratio



Source: Company financials

Stable outlook for 2023E, uplift thereafter

Looking at the granularity of the loan book, we expect retail to slow down going forward due to its high interest-rate sensitivity. We consequently expect a drop in growth to mid-single-digit in 2023E.

Demand from the corporate segment and government-related entities (GREs) could also weaken, given that significant repayments are expected to continue through 2023E.

Home Finance represents a meaningful c. 20% of ADIB's total loan book. Property development has been on a significant up-swing locally since the end of the pandemic, with sales volumes at healthy levels and prices trending towards the previous cycle-high.

This is a segment where the bank enjoys market leadership, including tie-ups with some of the biggest developers in Abu Dhabi and the rest of the UAE. ADIB should consequently see some loan growth coming from its real estate portfolio.

All in all, we expect that loan growth this year will come in at 5.5% ex. ADIB Egypt, in line with management guidance.

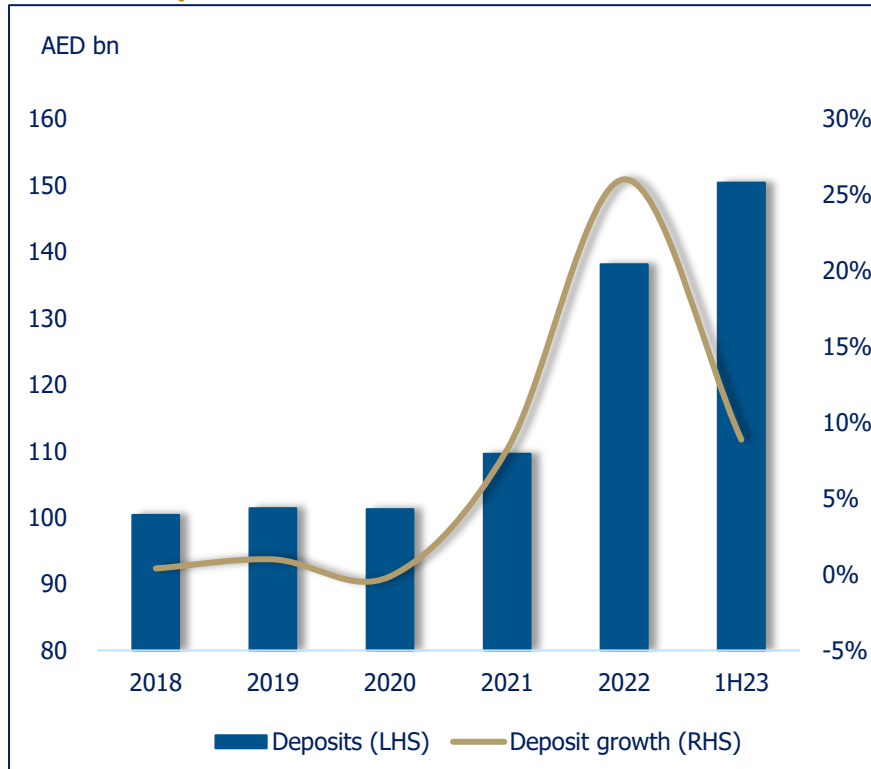
Funding and liquidity on track

ADIB recorded strong deposit growth in 2022 and the first half of 2023, while most other lenders struggled to grow their deposit books. The sluggish growth came from banks shedding costly funds amid higher interest rates, and from corporates optimizing their balance sheets by repaying costly loans using liquidity placed in deposit accounts.



We think that the strong deposit growth at ADIB is due to two main reasons. Firstly, the bank primarily enjoys retail deposits, which cost less to maintain compared to corporate deposits. This should allow ADIB to better preserve margins than other, less retail-centric lenders.

Chart 19: Deposit trend



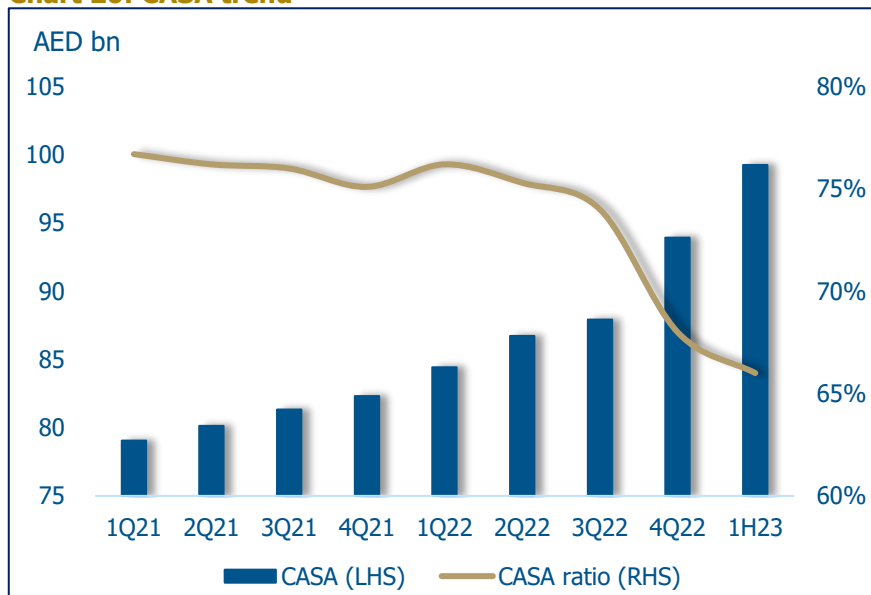
Source: Company financials

Secondly, ADIB has a high proportion of CASA (66%) which are low/no-cost deposits and are largely unimpacted by rising rates. Increasing exposure to low-cost deposits such as CASA is one of the most effective ways for a bank to protect its margins, which ADIB has successfully achieved as it reached the highest CASA ratio in the industry at 66%. This number includes the recently consolidated Egyptian subsidiary and would be even higher without it, at 71%. We note that the CASA ratio declined marginally in 2022 and 2023 while the nominal CASA base continued to widen, an impressive feat in the current macro environment.

This CASA penetration at ADIB bucks the industry trend of decline since 2021, as higher rates have progressively shifted deposits away from CASA and into term deposits.



Chart 20: CASA trend



Source: Company financials

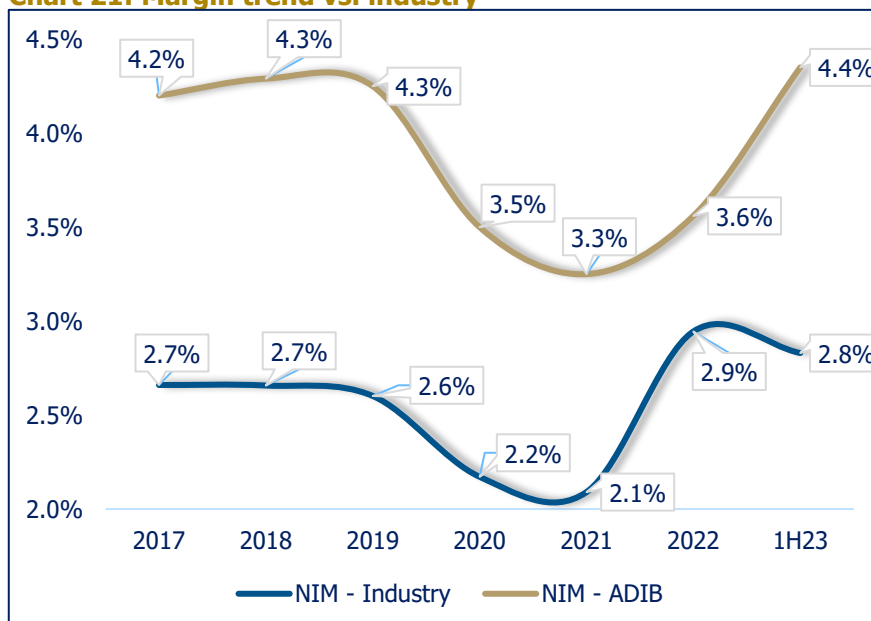
Management is confident about future CASA growth. ADIB claims to attract one of the highest numbers of salary transfers in the UAE, particularly among UAE nationals. These ultimately come with CASA balances. We conservatively expect a steady CASA ratio at 68% going forward.

Margin outlook compelling

ADIB boasts the highest NIM among the five largest UAE lenders at 4.31% and leads with a c. 152bps spread over industry average. This could be explained by the bank's asset-liability mix, and faster repricing.

67% of the loan book consists of mortgage-type variable loans, which adjust to changing benchmark rates. This is as opposed to fixed-rate loans, which are typically applicable to vehicle financing and do not adjust in line with rates. This is especially positive in times of increasing interest rates, such as currently.

Chart 21: Margin trend vs. industry



Source: Company financials

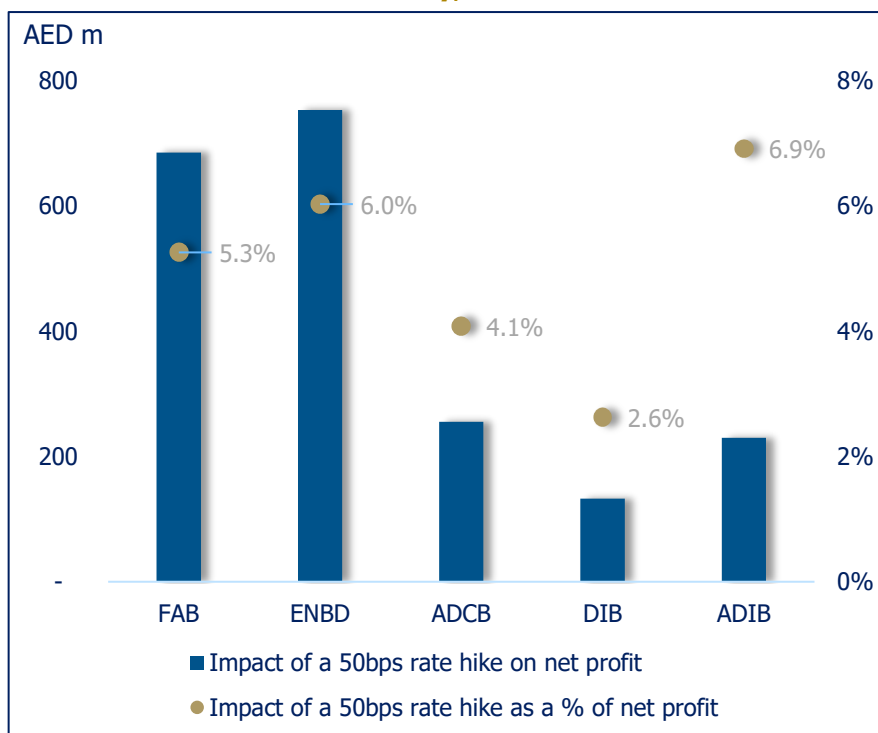


Interest rate kicker

Rising rates typically have a positive impact on bank P&Ls. As we assess this sensitivity, we find that ADIB has the most responsive bottom line to potential rate hikes among the five largest UAE banks – A 50bps increase in interest rates should inflate net profit by +6.9% as estimated by the bank. This is higher than the +5.0% average positive impact estimated for the “club of five” as demonstrated in the chart below.

This sensitivity is an estimate which corresponds to current macro conditions and is likely to change as the economic backdrop or yield curve shifts, such as would be the case in times of slowdown or recession.

Chart 22: Interest rate sensitivity, 2022

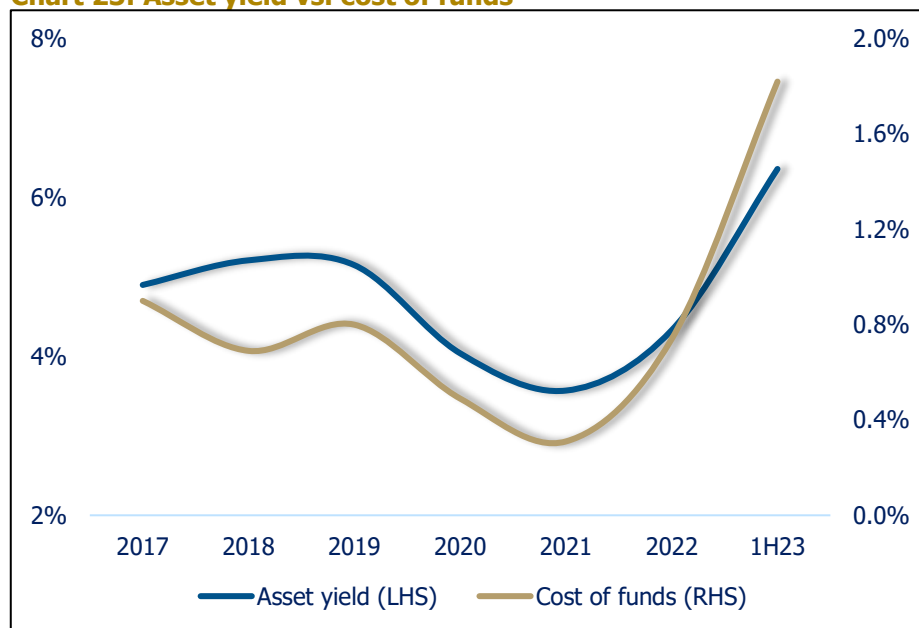


Source: Company financials

ADIB mobilized additional time-deposits and other non-CASA deposits in 2023. Accordingly, its cost of funds increased sharply, reducing the spread between the asset yield and cost of funds. We therefore anticipate a potential slowdown in margin expansion in the upcoming quarters.

We expect the margin to increase to 4.5% by December 2023E. Management expects the NIM to normalize and contract only in the second to third quarter of 2024E.

Chart 23: Asset yield vs. cost of funds



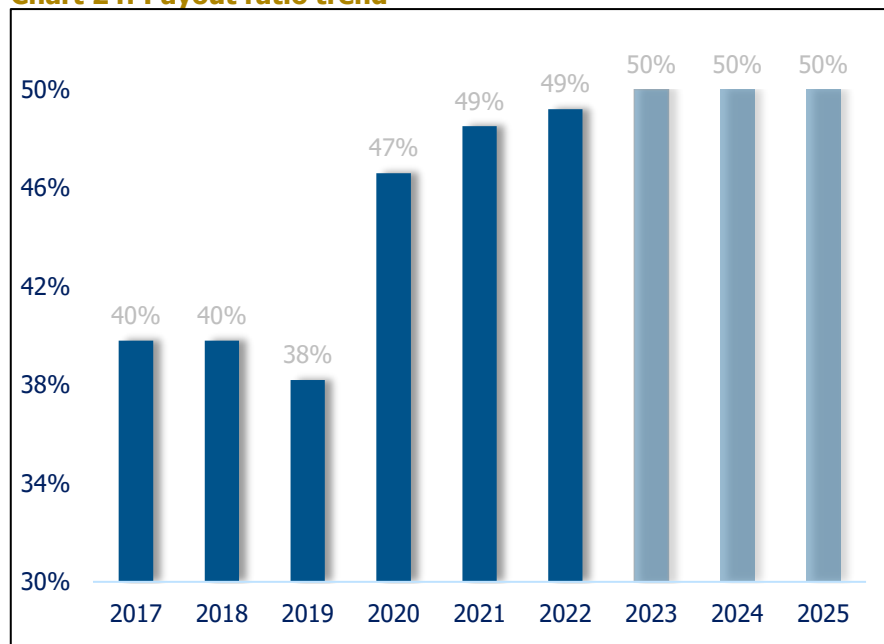
Source: Company financials

Generous payout

The bank proposed a dividend of 49 Fils per share for 2022, 58% higher than the preceding year. This translates into a dividend yield of 4.7% with a reference price of AED 10.54. We find this quite attractive, especially in the context of the 3.7% average sector yield.

Payout has been rising since 2018, commensurate with steady earnings growth. We expect the payout ratio to stabilize at 50% going forward, leaving some room for expansion while ensuring a compelling dividend yield of 6.0% in 2023E.

Chart 24: Payout ratio trend

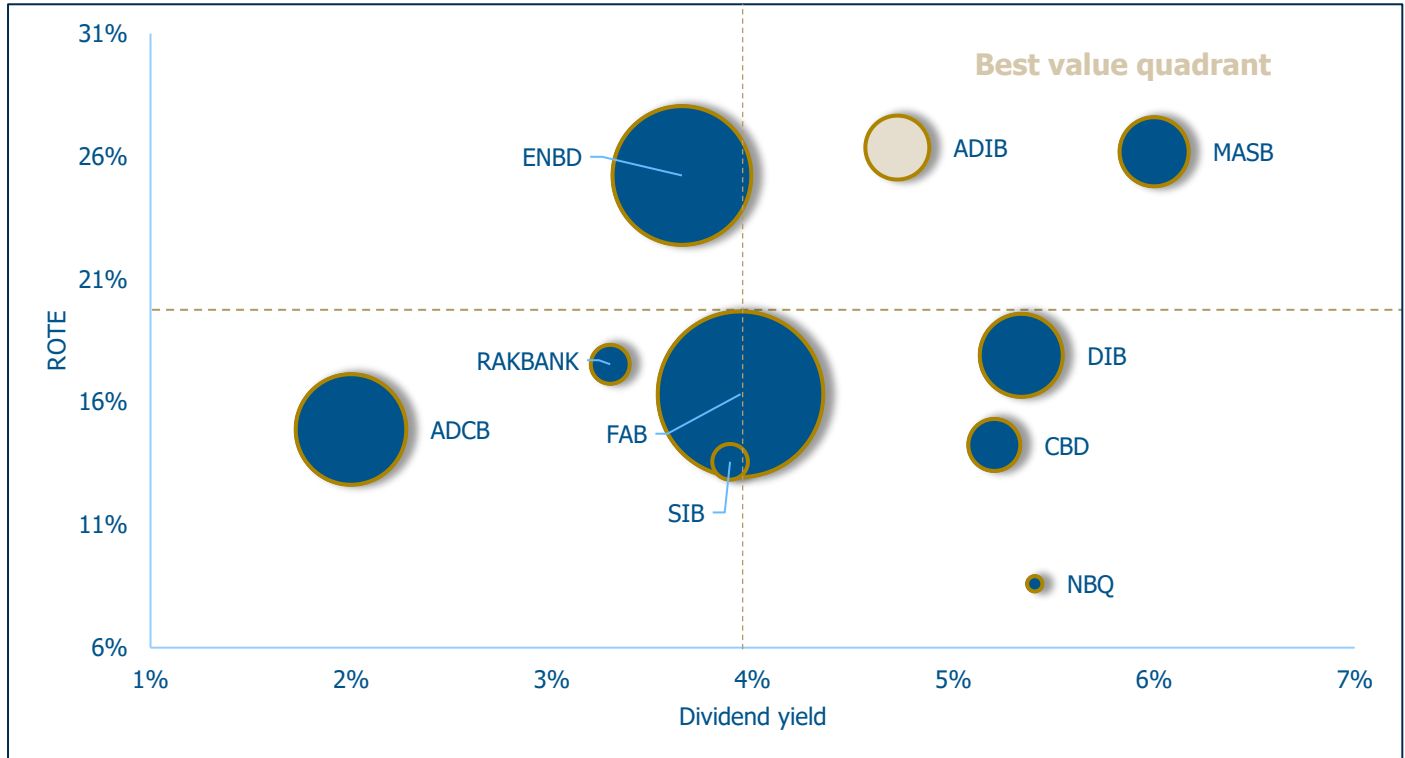


Source: Company financials, Refinitiv

With a combination of high ROE and high dividend yield, ADIB finds itself in the most desirable quadrant of the ROE-Yield matrix, ahead of many larger UAE lenders.



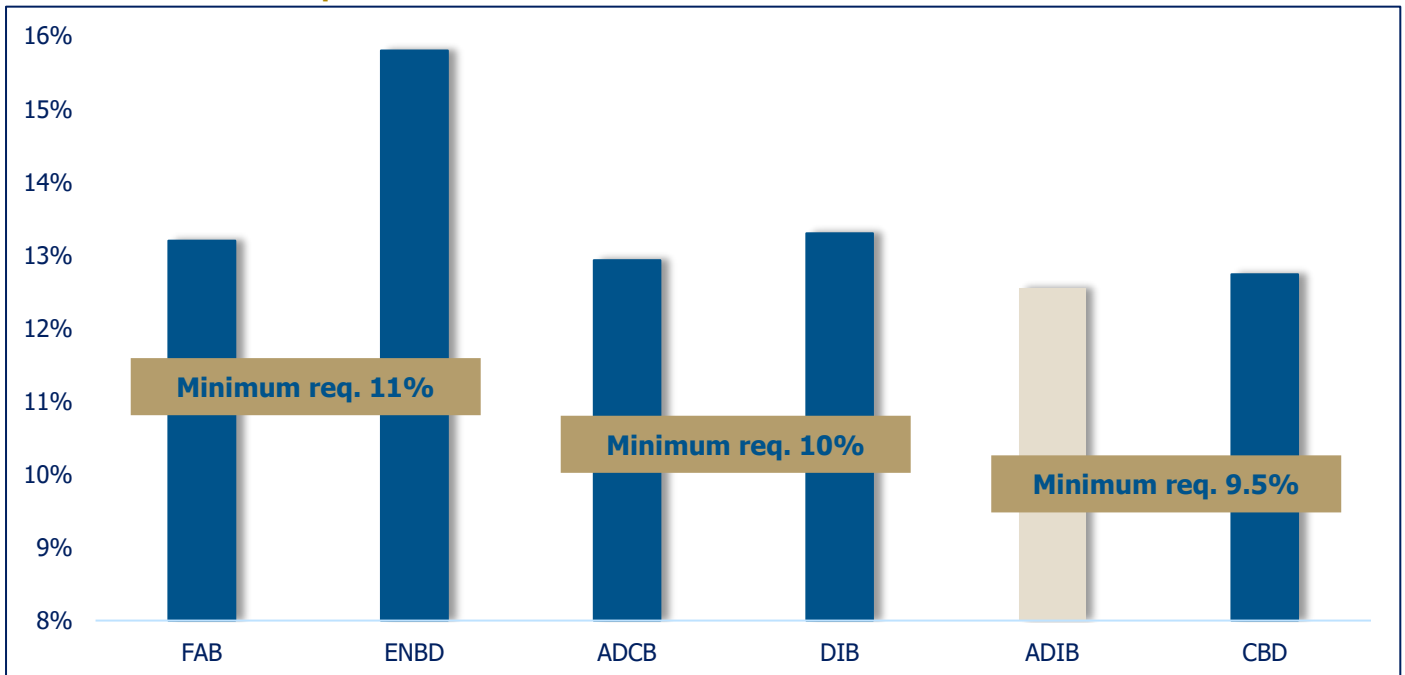
Chart 25: Dividend yield vs. ROE



Source: Company financials, Refinitiv, Prices as at 8th September 2023

Furthermore, the CET1 ratio of 12.8% sits comfortably above the central bank's reinstated floor of 9.5%, even though it remains below local peers. A further improvement in capital generation is key to funding expansion organically or via M&A to sustain the current cash distribution.

Chart 26: CET1 ratio of peers



Source: Company financials



Lower costs with better asset quality

ADIB boasts strong top-line growth and has relatively underperformed when it comes to cost control and asset quality. Management is seemingly hard at work to improve both.

Significant improvement in cost efficiency

In the first half of 2023, expenses increased by 25% YoY to AED 1.5bn, largely on the back of the consolidation of Egypt and staff compensation readjustment. Despite higher costs, ADIB managed to reduce its cost-to-income ratio to 32% by the end of 1H23 from 46% at the end of 2020, which points to faster topline than opex growth.

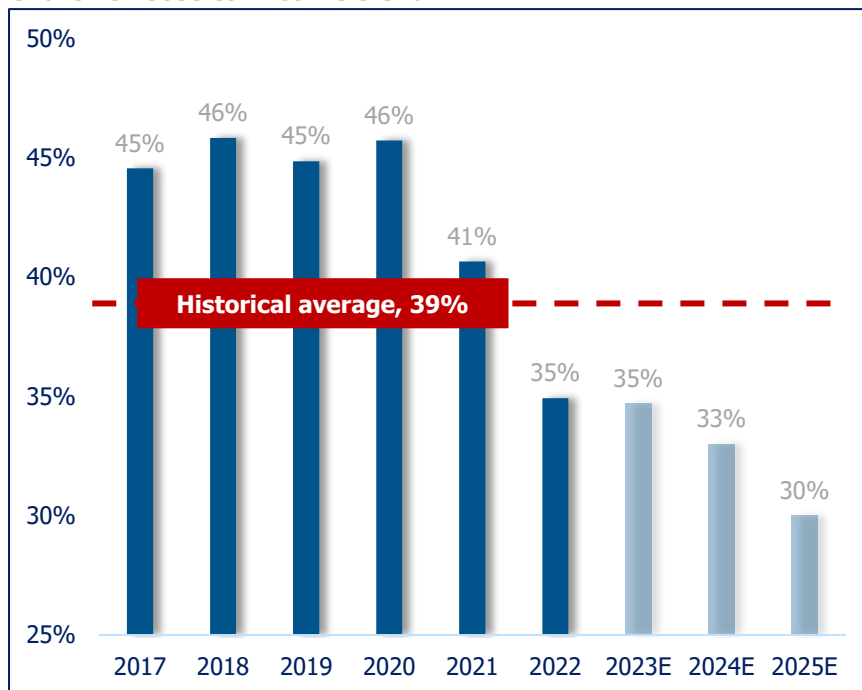
Chart 27: Cost-to-income comparison



Source: Company financials

At its current C/I of 32%, ADIB sits 80bps above the industry average. We expect the cost ratio to increase to 35% this year, as topline growth subsides in the second half. Management guides towards a better cost position in 2024E and 2025E due to further expected cost improvements and we target 30% in two years as per the chart below.



Chart 28: Cost-to-income trend

Source: Company financials

ADIB's strategic retail positioning, and pro-active efforts to grow its market share, rest on a solid and expansive branch network. This has an impact on costs and could explain the higher cost positioning compared to peers.

Digital is key

Digitalization is key to cost efficiency, according to ADIB. This is a standard theme in the industry, one which we have heard from other lenders. By numbers and as per management, it appears that the estimated cost of conventional customer acquisition is AED 4,000 as compared with only AED 400 for a digitally acquired client.

Management further claims the most efficient digital onboarding of any UAE bank, via a dedicated mobile app, and further illustrates by providing a 40% statistic for the proportion of digitally opened accounts. This sounds impressive and ties in with the progressive improvement of the C/I ratio, but does not yet entirely compensate for other cost inefficiencies, in our view.

Asset quality near pre-pandemic levels

ADIB reported a non-performing loan (NPL) ratio of 7.5% in 1H23A, surpassing the industry average by 100 bps. This elevated number can be attributed to two key factors. Firstly, the non-performing loan book includes legacy corporate loans in the real estate and construction segments, which have existed in the portfolio since 2012 with no possibility of writing them off. Secondly, the bank was negatively impacted by its exposure to the NMC default.

NMC went into administration in April 2020 following months of turmoil over its finances, after mis-reporting the value of its assets, profits, cash balances, and debts. It disclosed more than \$ 4bn in hidden debt leaving many lenders exposed to large write-offs.

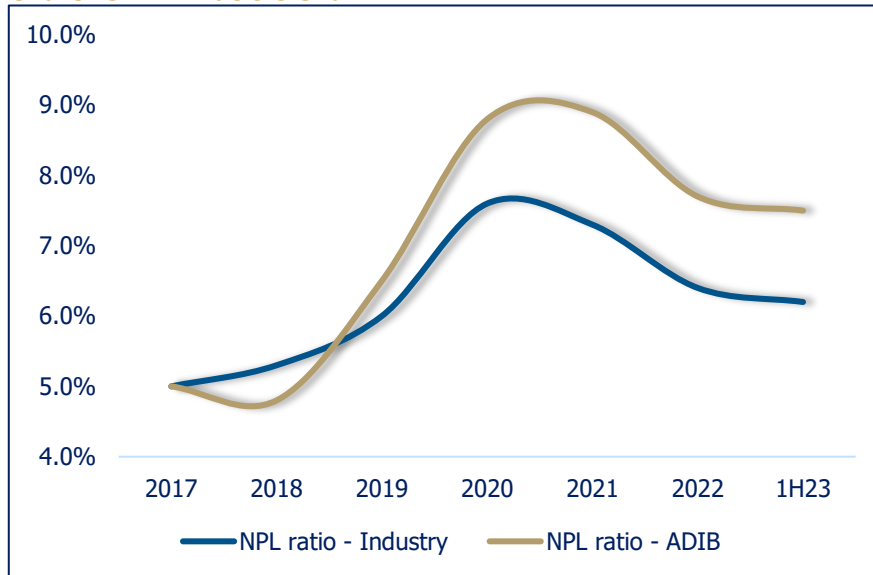
ADIB's loan exposure to NMC totaled USD 291.4m or AED 1,069m, which constituted c. 0.7% of total assets at the time. The bank had additional exposure of USD 31m (AED 113.77m) to Islamic bonds issued by NMC



Health. We believe ADIB has higher provision coverage to its NMC Health loans compared to DIB (78%) and ADCB (38%).

The bank's NPL ratio should reach its pre-pandemic level of about 6.5% once NMC Health makes the due repayment of AED 1bn, the timing of which remains uncertain. We expect the NPL ratio to remain between 7.0% and 7.5% in 2023E.

Chart 29: NPL ratio trend



Source: Company financials, Central Bank of the UAE

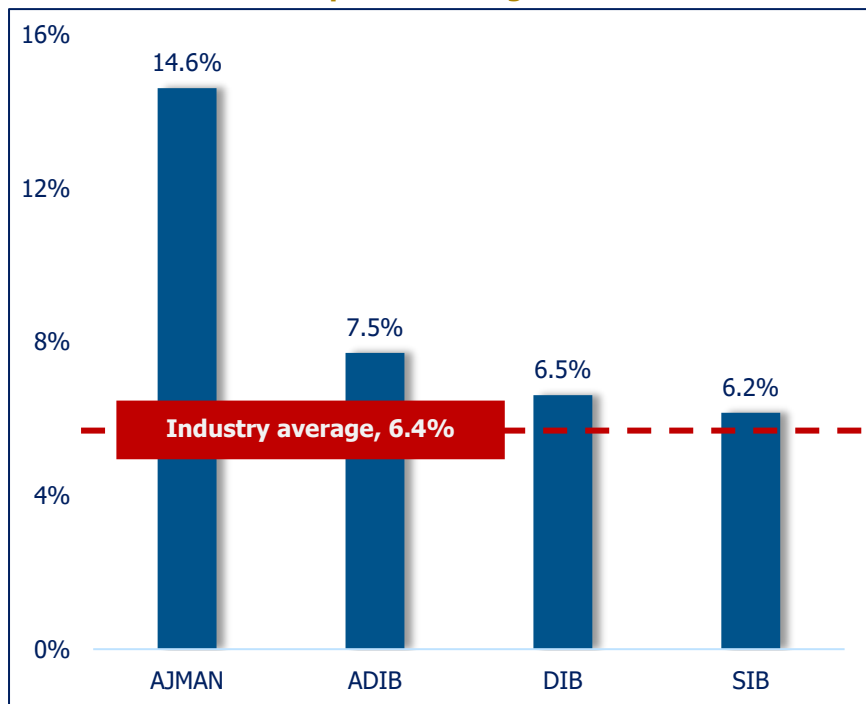
Murabaha's and write-offs

Murabaha is an Islamic financing mechanism where the buyer and seller jointly set the asset cost and markup, replacing the interest which is non-compliant with Shariah principles.

Defaults in Murabaha agreements are challenging for Islamic institutions who are not authorized to write off bad loans under the Sharia law, and who are left with inflated NPLs when Murabaha agreements are not honored.

ADIB indicates that some such loans have been deemed irrecoverable since 2012. Excluding those, the lender's NPL ratio would have been significantly lower at 5.7%.

Chart 30: NPL ratio comparison of largest UAE Islamic banks



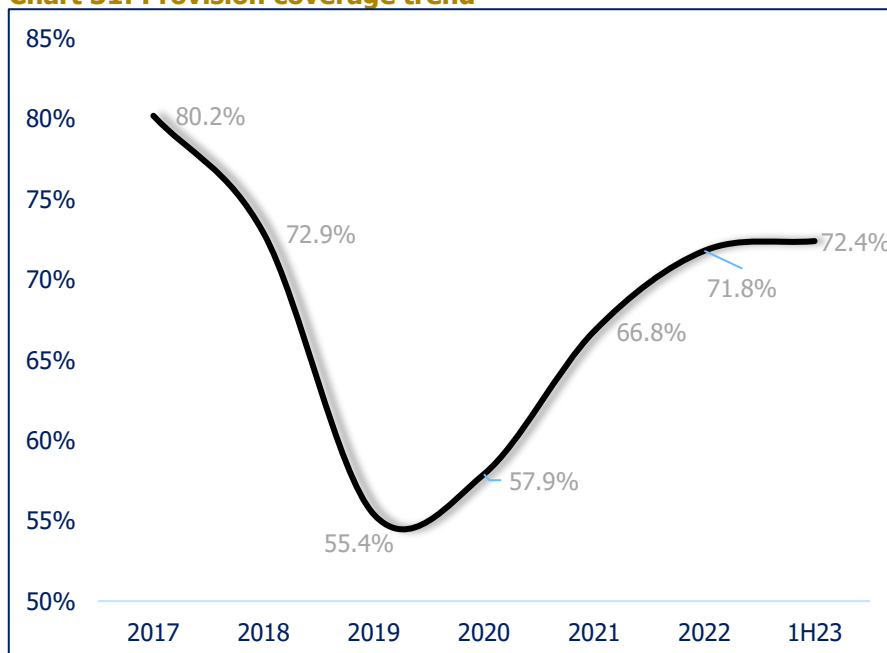
Source: Company financials

Loan coverage declined to 55.4% in 2020 following the NMC blowup. However, the pickup since 2020 has been notable and reached 72.4% at the end of 1H23.

ADIB's coverage ratio is comparatively lower than the industry average of 102%. This could be due to some legacy loans that have been in the books for a long time which, given their Islamic nature, cannot be written off.

Management appears unconcerned about the relatively lower coverage, since most Islamic loans are secured by high-quality collateral. Impairments including collateral are at 128%. We include a flat coverage ratio of around 72% in our forecasts.

Chart 31: Provision coverage trend



Source: Company financials

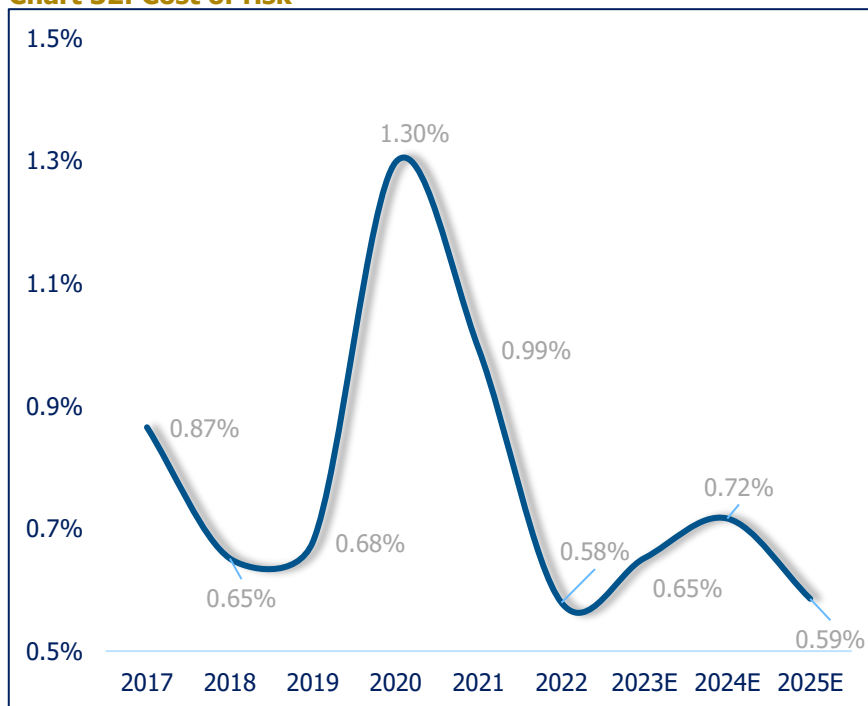


Cost of risk likely to increase

The cost of risk (CoR) rose from a low point of 65bps in 2018 to a peak of 130bps in 2020, after which it reversed. It currently hovers around 48bps, below its historical average of 86bps.

Impairments increased by 29% YoY in 1H23 but declined 65% sequentially, a common trend across the industry. This translates into a CoR of 0.29%. However, management expects a pickup in the CoR to 0.55-0.65% in 2023E. Should NMC Health make a recovery payment, overall impairment costs would decline mechanically and commensurately by the recovered amount, in the form of an impairment reversal.

Chart 32: Cost of risk



Source: Company financials

Growth potential factored in

We use three methodologies to value the bank: dividend discount model (DDM), residual income model (RIM), and relative valuation to the sector. We arrive at a blended, equally weighted fair value of **AED 11.45 per share**. This implies an **upside of 8.6%** to the last closing price. We conclude that the stock is currently fairly valued, and we therefore initiate our coverage with an **EQUAL-WEIGHT** rating.

Table 02: Blended valuation summary

Valuation method	Weight	Fair value
Dividend discount model	33.3%	9.90
Residual income model	33.3%	15.20
Relative valuation	33.3%	9.23
Blended fair value		11.45
Last closing price		10.54
Upside		8.6%

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 (DFM) over the past three years. Daily prices are sourced from Factset.
- **Equity risk premium (ERP):** Based on the long-term historical average return for the UAE equity market return and risk-free rate, we calculate an ERP of 5.50%.
- **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 ADIB's earnings will 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 the UAE's real GDP growth from 1980 to 2021.
- **Sustainable ROE:** Our sustainable ROE is derived from our financial model and forecasts.

Table 03: Valuation assumptions

Valuation parameter	Assumed rate
Risk-free rate	4.2%
Market risk premium	5.5%
Beta	1.04
Cost of equity	9.92%
Terminal growth rate (g)	3.3%
Tangible sustainable average ROTE	23.7%

Source: Al Ramz Investment Research, Bloomberg



Dividend discount model: AED 9.90 per share

We value ADIB at AED 9.90 per share based on a two-stage Gordon growth valuation model, which is made up of future dividend distributions for the forecasting period and a terminal dividend payment.

Table 04: Dividend discount valuation summary

AED m		2023E	2024E	2025E	2026E	2027E	Terminal value
Net profit		3,895	4,169	5,002	5,002	5,140	
Dividend payout ratio	x	50.0%	50.0%	50.0%	50.0%	50.0%	
Dividends	=	1,948	2,084	2,501	2,501	2,570	40,101
Discount factor	x	0.97	0.88	0.80	0.73	0.66	0.66
Present value (PV) of dividends	=	1,891	1,841	2,009	1,828	1,709	26,663
Total equity value		35,940					
# of shares outstanding (m)	/	3,632					
Fair value per share (AED)	=	9.90					

Source: Al Ramz Investment Research

Table 05: Sensitivity analysis for DDM valuation

		Cost of equity						
		8.00%	8.50%	9.00%	9.92%	10.00%	10.50%	11.00%
Growth rate	2.0%	11.29	10.44	9.71	8.61	8.53	8.04	7.61
	2.5%	12.12	11.13	10.30	9.05	8.96	8.42	7.94
	3.0%	13.12	11.95	10.98	9.56	9.45	8.84	8.31
	3.3%	13.82	12.52	11.44	9.90	9.78	9.12	8.55
	4.0%	15.86	14.13	12.75	10.82	10.68	9.88	9.20
	4.5%	17.82	15.63	13.93	11.62	11.46	10.53	9.75
	5.0%	20.43	17.56	15.41	12.59	12.40	11.30	10.39

Source: Al Ramz Investment Research



Residual income: AED 15.20 per share

We value ADIB at AED 15.20 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 cost of equity multiplied by shareholder equity.

Table 06: Residual income valuation summary

AED m		2023E	2024E	2025E	2026E	2027E	Terminal value
Beginning value of tangible book value		17,920	17,822	20,143	22,882	25,620	
Net profit		3,895	4,169	5,002	5,002	5,140	
Equity charge (Beg. value x Cost of equity)	-	1,778	1,768	1,998	2,270	2,542	
Excess equity return	=	2,118	2,401	3,004	2,733	2,598	40,543
PV factor	x	0.97	0.88	0.80	0.73	0.66	0.66
PV of excess return	=	2,056	2,120	2,413	1,997	1,728	26,957
Sum of PV of excess return		37,271					
Beginning equity invested	+	17,920					
Total value	=	55,191					
No. of shares	/	3,632					
Fair value	=	15.20					

Source: Al Ramz Investment Research

Table 07: Sensitivity analysis for residual income valuation

		Cost of equity						
		8.00%	8.50%	9.00%	9.92%	10.00%	10.50%	11.00%
Growth rate	2.0%	18.72	17.19	15.88	13.90	13.75	12.87	12.09
	2.5%	19.72	17.99	16.53	14.34	14.18	13.23	12.38
	3.0%	20.92	18.93	17.28	14.85	14.67	13.63	12.72
	3.3%	21.76	19.59	17.79	15.20	15.00	13.90	12.94
	4.0%	24.22	21.45	19.23	16.13	15.90	14.62	13.52
	4.5%	26.57	23.18	20.53	16.94	16.69	15.24	14.02
	5.0%	29.71	25.40	22.16	17.92	17.63	15.98	14.60

Source: Al Ramz Investment Research



Sector relative valuation: AED 9.23 per share

For valuation purposes, we find that ADIB is most comparable to GCC Islamic banks from the perspective of size, business activity, franchise positioning, sources of revenues, and geographic location.

Relative valuation using book-value multiples: AED 7.08 per share

We consider the long-term historical P/B valuation of both ADIB and the sector. We find that the latter has traded at an average P/B of 2.69x since September 2018, while ADIB traded at 1.18x over the same period. This suggests a structural discount to the sector of 43.2%.

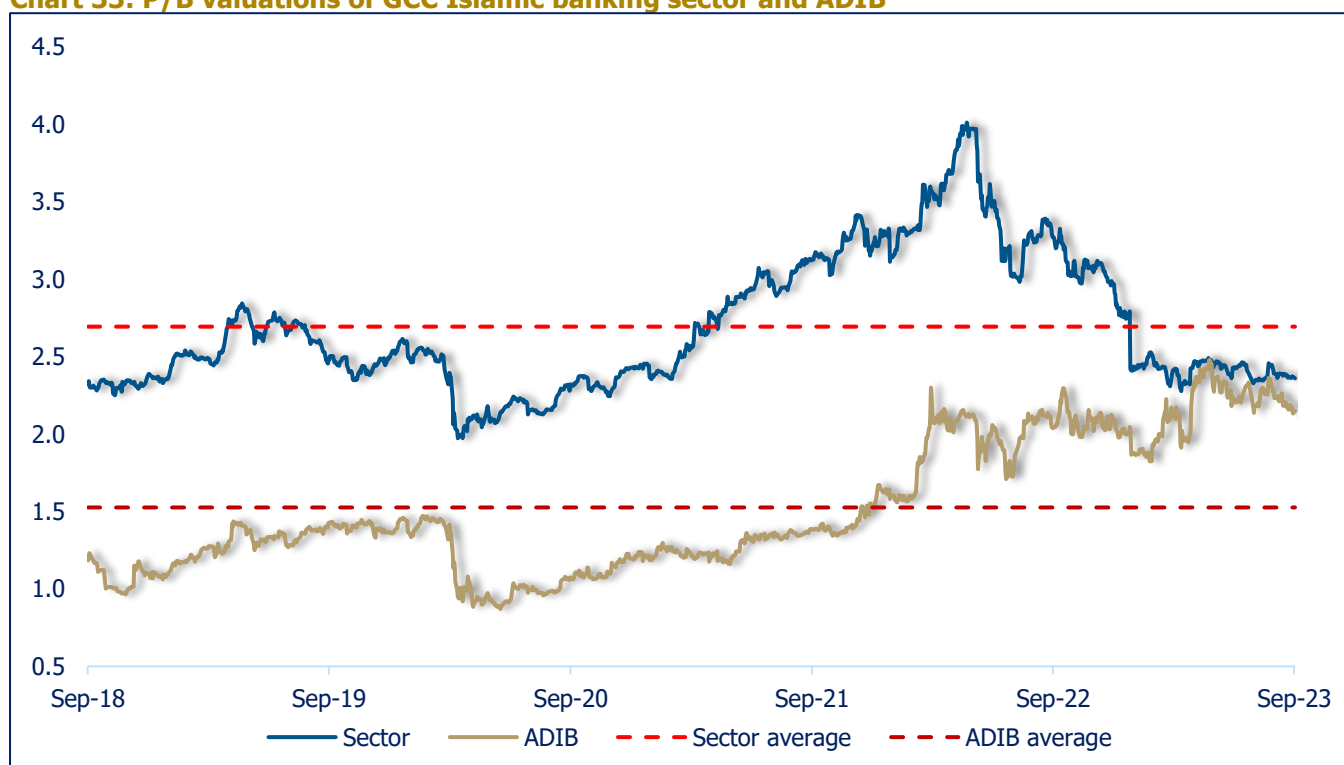
Furthermore, we note that the sector discount of ADIB started subsiding progressively since mid-2022 and all but vanished this year, leaving it trading in line with peers, after a positive combination for ADIB which saw its shares re-rate while the sector de-rated.

We find ourselves today in a situation where ADIB trades at a 40% premium to its own average historical valuation, while the sector trades at a 15% discount. Not knowing if this is the new norm, we prefer to be cautious and to assume that the sector should progressively re-rate towards its own historical value, while ADIB should reclaim most, but not all, its historical discount to the sector.

We assume a sector multiple of 2.7x, which is positively skewed by the covid era, and a discount for ADIB of 40%. This yields a target multiple of 1.6x for ADIB. At the estimated FY23E BVPS of AED 4.90, we arrive at a target value of AED 7.85 per share for ADIB.

If we conservatively keep the sector multiple where it currently is, and apply the 40% discount of ADIB, we end up with a target multiple of 1.3x for ADIB, which translates into a target price of AED 6.30 at the low end of the relative P/B valuation. In summary, we retain a blended P/B valuation of AED 7.08 per share.

Chart 33: P/B valuations of GCC Islamic banking sector and ADIB



Source: Al Ramz Investment Research, Bloomberg



Relative valuation using earnings multiples: AED 11.42 per share

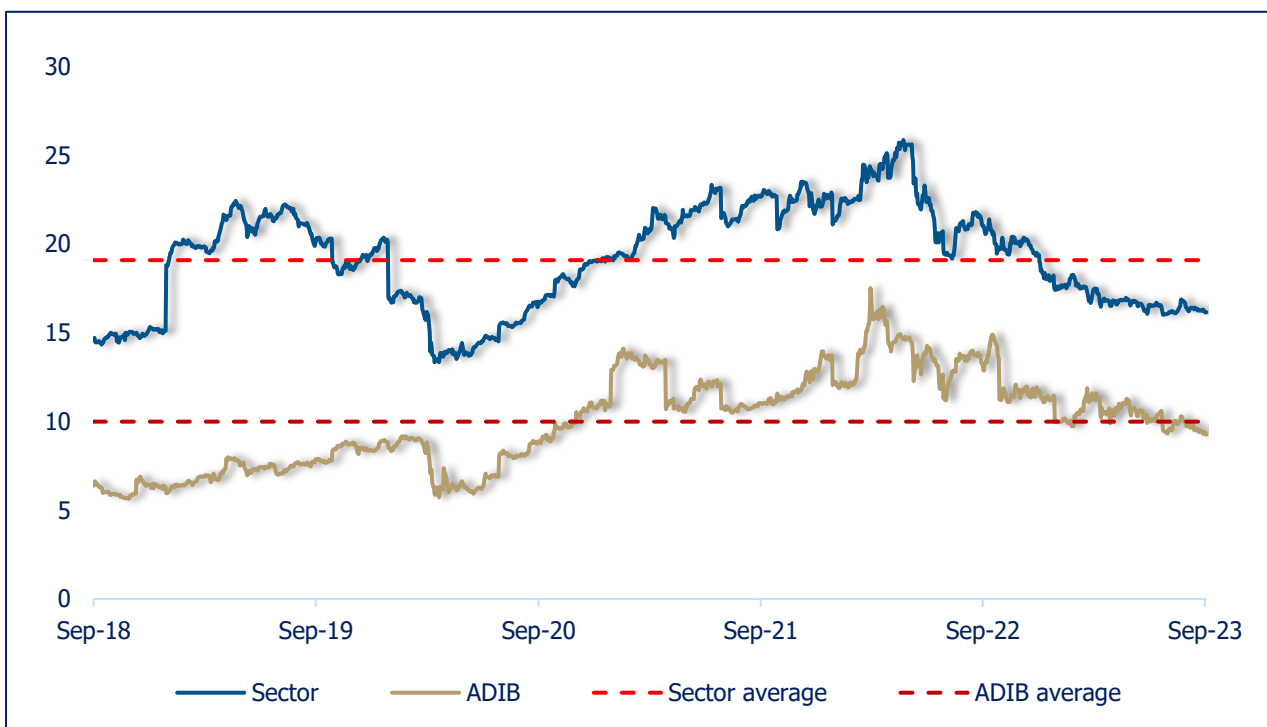
Applying the same reasoning as above to the earnings multiple (P/E ratio), we find a 5-year historical multiple of 19.10x for the sector and 10.00x for ADIB, which yields a historical discount of 48% for our local lender.

At the current sector multiple of 16.20x and with the same discount, and assuming FY23E EPS of AED 1.21 for ADIB, we arrive at a benchmark valuation of AED 10.15 per share.

In a best-case-scenario where the sector reclaims its historical average, and where ADIB loses some of its discount due to its improved earnings power, we assume that ADIB's shares could be worth AED 12.7 per share, derived as follows: Sector multiple of 19.10 x discount of 45% x EPS of AED 1.21 = AED 12.70 per share.

At the mid-point of the two scenarios, we arrive at a target P/E valuation of AED 11.42 per share for ADIB.

Chart 34: P/E valuations of GCC Islamic banking sector and ADIB



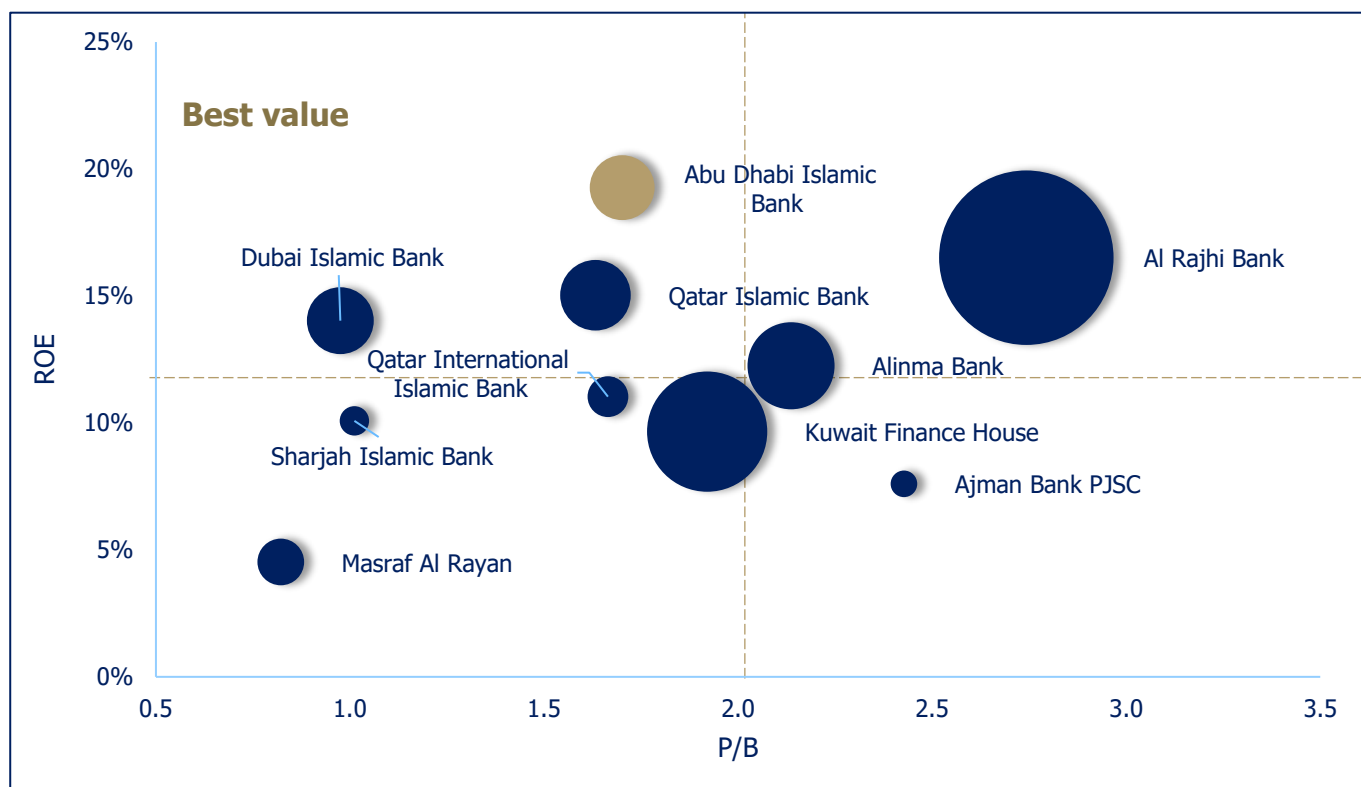
Source: Al Ramz Investment Research, Bloomberg

Relative valuation in perspective

Here, we present a scatter valuation diagram for the sector to identify visually the best value across the GCC. We also summarize in a valuation table the main sector metrics for the GCC Islamic banks.



Chart 35: Relative valuations of GCC Islamic banks



Source: Refinitiv

Note: All financials are as at 2Q23 and prices as at September 08, 2023

Note 2: We use total equity to calculate P/B and ROE as some banks do not disclose tangible equity

Table 08: Comparative valuations and return ratios of GCC Islamic banks

Banks	Market cap, USD m	P/E	P/B	ROE	ROA
Al Rajhi Bank	75,504	16.6	2.7	16.5%	2.2%
Dubai Islamic Bank	11,080	7.0	1.0	14.0%	2.0%
Kuwait Finance House	35,843	19.9	1.9	9.7%	1.5%
Alinma Bank	18,796	17.4	2.1	12.3%	1.8%
Qatar Islamic Bank	12,349	10.9	1.6	15.0%	2.3%
Masraf Al Rayan	5,404	18.2	0.8	4.5%	0.7%
Qatar International Islamic Bank	4,120	15.1	1.7	11.0%	1.7%
Sharjah Islamic Bank	2,141	10.0	1.0	10.1%	1.3%
Ajman Bank PJSC	1,750	31.9	2.4	7.6%	0.9%
Average		16.1	2.1	12.8%	1.8%
Abu Dhabi Islamic Bank	10,423	8.8	1.7	19.3%	2.4%

Source: Refinitiv

Note: All financials are as at 2Q23 and prices as at September 08, 2023

Note 2: We use total equity to calculate the regional bank's P/B and ROE as some banks do not disclose tangible equity



Uncompelling risk profile for the stock

Finally, we look at peak-to-trough valuations to assess the reward-to-risk multiple of an investment in ADIB. Our assumption is that long-term valuations of an asset tend to reflect solid boundaries where the stock can potentially trade again but which are difficult to breach.

In other words, if an asset has traded within specific minimum/maximum valuation boundaries for a decade, only significant structural shifts should allow it to trade outside of such boundaries.

For instance, over the past five years, ADIB traded at a P/B of 0.87x at its lowest and 2.48x at its highest. We assume that it is likely for the stock to recover those values at some point, but unlikely that it will break them without a structural shift in the fundamentals.

If we accept that an asset should mostly be bound by its long-term extreme valuations, we can deduct the distance of travel from the current valuation to these extremes. A greater distance to the peak means greater reward than risk. The higher the reward compared with the risk, the more attractive the asset.

Table 09: Reward to risk

	P/B	P/E
Current multiple	2.15	9.27
Minimum	0.87	5.64
Maximum	2.48	17.52
Distance to minimum	-60%	-39%
Distance to maximum	15%	89%
Maximum to minimum	0.25x	2.28x
Average reward-to-risk ratio	1.27	

Source: Al Ramz Investment Research, Bloomberg

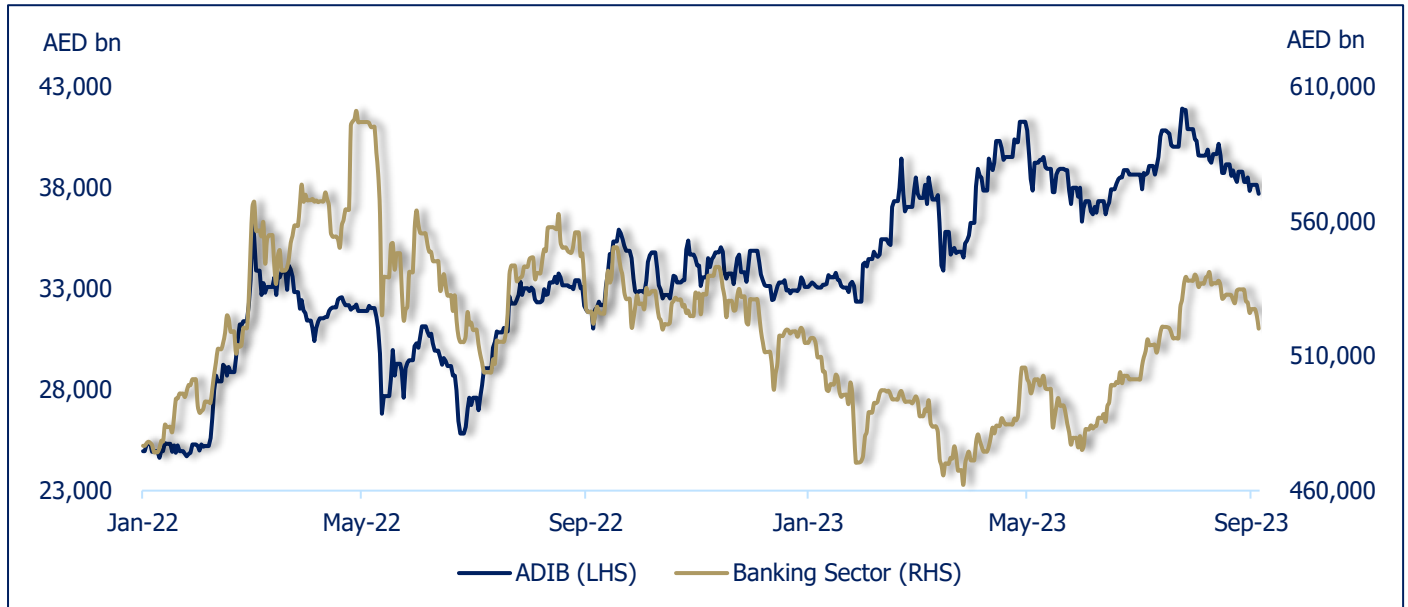
In the case of ADIB and according to the table above, we find an average reward-to-risk ratio of 1.27x. In other words, there is only 1.27x more reward than risk to investing in ADIB stock at the current price. A reward-to-risk ratio inferior to 2.0x is generally not deemed very compelling.

We conclude that ADIB is currently fairly valued, from a fundamental perspective and relative to the rest of the industry, and that the risk profile of the stock at the current level is uncompelling relative to other stocks in the same industry.



Furthermore, we point out that the stock is up 51% since January 2022, outperforming the entire banking sector by 42%. ADIB also outperformed its home index ADX by 37% in the same period.

Chart 36: ADIB market cap performance vs. banking sector



Source: Refinitiv

Chart 37: ADIB market cap performance vs. ADX



Source: Refinitiv



Key risks to our investment theme

We believe the operating environment for the banking sector in the UAE remains promising. This is in view of a combination of healthy macro drivers, including solid macroeconomic growth in the UAE, elevated oil prices, and strong balance sheets in the banking sector overall.

However, we note that this encouraging environment could swing in the opposite direction, depending on global interest rates and the inflation situation. We identify four risks to ADIB's growth scenario.

Table 10: Key risks to our investment thesis

Key risk	Description
Macro outlook reversal	<ul style="list-style-type: none"> Indications of a recession have started to show up in global markets – an inverted yield curve, rising interest rates owing to high inflation, and continuing supply chain disruptions. If a recession were to materialize, the key focus in the context of our thesis would be to assess the contagion effect to the UAE, as this could be detrimental to the growth picture of the country's banking sector.
NIM squeeze from Fed pivot	<ul style="list-style-type: none"> The UAE's banking industry has benefited from the current rising interest rate environment. The benign interest rate scenario could change if the increase in rates were to trigger a recession.
Shock to oil prices	<ul style="list-style-type: none"> The UAE economy is heavily dependent on oil prices, and a reversal in prices would materially impact the growth of the UAE and future earnings of the country's banking sector, including ADIB.

Source: Al Ramz Investment Research



Summary financials

Summary income statement, AED m	2020	2021	2022	2023E	2024E	2025E
Interest income	3,827	3,675	5,042	8,246	8,397	9,031
Interest expense	(502)	(330)	(891)	(2,880)	(2,809)	(2,927)
Net interest income	3,324	3,345	4,151	5,366	5,588	6,105
Non-interest income	2,034	2,215	2,684	2,862	3,420	3,659
Total income	5,358	5,560	6,835	8,228	9,008	9,764
Operating expense	(2,450)	(2,260)	(2,387)	(2,776)	(2,973)	(2,929)
Provision expense	(1,314)	(954)	(769)	(809)	(933)	(816)
Profit before tax	1,594	2,345	3,680	4,643	5,103	6,019
Taxes and others	-	(15)	(60)	(247)	(459)	(542)
Net profit attributable to equity holders	1,311	2,074	3,322	3,895	4,169	5,002

Source: Al Ramz Investment Research, Company data

Note: Net profit attributable to equity holders is after tier 1 payments

Summary balance sheet, AED m	2020	2021	2022	2023E	2024E	2025E
Cash and balances with central banks	19,580	21,699	24,229	20,105	21,291	23,612
Customer loans	87,407	93,129	113,367	119,036	124,928	131,112
Investment in Sukuk	10,350	9,633	14,370	16,684	17,502	19,409
Total assets	127,816	136,868	168,517	170,808	181,960	194,252
Customer deposits	101,276	109,611	138,137	151,674	159,106	176,449
Total shareholder equity	19,151	20,547	22,481	22,371	24,693	27,431

Source: Al Ramz Investment Research, Company data

Key ratios	2020	2021	2022	2023E	2024E	2025E
EPS (AED)	0.36	0.57	0.91	1.07	1.15	1.38
Tangible BVPS (AED)	3.91	4.31	4.93	4.91	5.55	6.30
ROE	8.5%	12.8%	19.0%	21.8%	22.0%	23.3%
ROA	1.1%	1.7%	2.4%	2.7%	2.7%	3.1%

Source: Al Ramz Investment Research, Company data



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