

# Abu Dhabi Islamic Bank – 3Q17 Review

**TP: AED 4.20 / share**

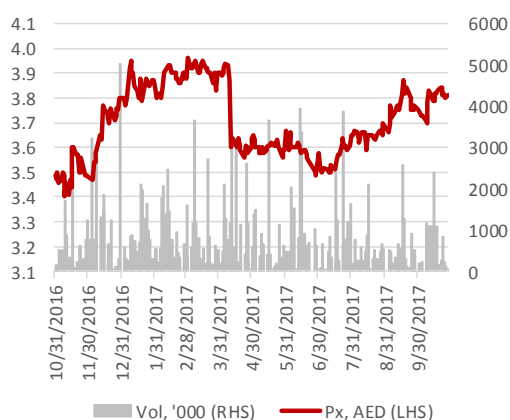
Recommendation	Accumulate
Bloomberg Ticker	ADIB UH
Current Market Price (AED)	3.77
52wk High / Low (AED)	4.1/3.4
12m Average Vol. (000)	749
Mkt. Cap. (USD/AED mn)	3,252/11,943
Shares Outstanding (mn)	3,168.0
Free Float (%)	60%
3m Avg Daily Turnover (000)	1,974
6m Avg Daily Turnover (000)	2,347
PE 2018e (x)	6.3
PBv 2018e (x)	0.9
Dividend Yield (%)	6.3%

## Price Performance:

1 month (%)	0.53
3 month (%)	3.29
12 month (%)	8.65

Source: Bloomberg

## Price-Volume Performance



Source: Bloomberg

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Rating upgraded to **Accumulate**, with Blended Target Price (TP) increased to AED 4.20 per share from the previous TP of AED 3.80, as the bank reduces its cost of risk and pursues balance sheet optimization. Our target price represents an 11.4% upside to the latest closing price, with an implied PE'18e of 6.97x and PB'18e of 1.10x.

## Non-Financing income jumps 34%YoY in 9M'17; Provision expense declined by 13%

Net profit attributable to shareholders reached AED 1.69bn in 9M'17, up by 13%YoY on a 34%YoY increase in other operating income and a 13%YoY decrease in provision expense. Operating profit of AED 2.32bn before impairment allowances was up 5%YoY, benefiting from a controlled cost base. 9M'17 operating expenses were AED 1.86bn, an increase of 3%YoY, which resulted in a further improved cost to income ratio of 44.4% in 9M'17 compared to 45.5% for FY16.

Income statement (AED'000)	9M 2016	9M 2017	YoY 17/16
<b>Net financing income</b>	<b>2,937,658</b>	<b>2,834,588</b>	-4%
<i>Other income</i>	<i>1,006,292</i>	<i>1,348,331</i>	34%
<b>Total income</b>	<b>4,018,430</b>	<b>4,182,919</b>	4%
<i>Operating expense</i>	<i>1,813,125</i>	<i>1,864,757</i>	3%
<b>Operating Profit</b>	<b>2,205,305</b>	<b>2,318,162</b>	5%
<i>Provisions</i>	<i>717,830</i>	<i>623,446</i>	-13%
<b>Profit before taxes</b>	<b>1,510,379</b>	<b>1,716,201</b>	14%
<i>Taxes &amp; Zakat</i>	<i>11,947</i>	<i>23,245</i>	95%
<b>Profit before minority interest</b>	<b>1,498,432</b>	<b>1,692,956</b>	13%
<i>Minority interest</i>	<i>965</i>	<i>1,092</i>	13%
<b>Net profit</b>	<b>1,497,467</b>	<b>1,691,864</b>	13%

Source: U Capital Research, Company Financials

## Funding structure continues to improve

Despite its fast loan growth in recent years (9% CAGR between 2012 and 2016), ADIB has strengthened its funding structure, with its loan-to-deposit ratio falling to 79.9% as of 9M'17 from 89% in 2011. This compares well with the UAE banking system average of ~91%, owing to a greater increase in granular retail deposits. Supported by a solid retail network, ADIB sourced most of these deposit inflows from the bank's growing retail customer portfolio, which represented around 62.4% of total deposits as of 9M'17. In the current context of low oil prices and tightened liquidity, we expect such a granular deposit base to provide the bank with a resilient funding and liquidity profile, particularly as the bank projects a more moderate loan growth than in the last five years.

## Asset quality metrics not alarming yet need to be watched

With regard to the improvement in asset quality, it is worth noting that ADIB's non-performing loan (NPL) ratio has fallen to 5.1% as of 9M'17 from a peak of 11.5% as of December 2011. However, in 2016, NPL ratio stood at 3.9% of gross financing asset. Additionally, total provision coverage on impaired loans fell from 114.5% in 9M'16 to 82% in 9M'17, with specific provision coverage falling from 42.2% in 2016 to 37.5% in 9M'17.

## Robust Capitalization

Total equity (including Tier 1 capital instruments) was AED 16.1bn for 9M'17. This represents an increase of 3.5% YoY and a 3-Yr CAGR of 6.3%. ADIB's capital adequacy ratio under Basel II principles now stands at 16.28% with the Basel II Tier 1 capital ratio at 15.68% and a common equity tier 1 ratio of 10.06%, well above Central Bank of the UAE's prescribed minimums of 12% for capital adequacy and 8% for Tier 1 under Basel II.

## Key Revisions to Estimates

We have adjusted our estimates for FY17 net loans & deposits, as the recent performance of the bank indicates slower-than-expected growth rates. Net financing assets grew to AED 78.37bn for 9M17, a decline of 2%YTD. Customer deposits increased by 0.3%YTD to AED 99.09bn. UAE's system wide credit growth has slowed to 0.91%YoY as of August'17 vs. 5.35%YoY as of Dec'16.

AED mn	Earlier FY'17e	Current FY17e	Var, %
Gross Loans & Financings	119,164	122,368	3%
Loan Loss Reserve & Reserve Interest	39,098	43,610	12%
Net Loans & Financings	80,066	78,758	-2%
Deposits from Customers	100,138	99,486	-1%
LTD	80%	79%	-1%
Total Operating Income	5,618	5,538	-1%
Provisions expense	-1,018	-871	-14%
Operating Expenses	-2,556	-2,496	-2%
<b>Attributable Net Profit*</b>	<b>1,875</b>	<b>1,971</b>	<b>5%</b>

Source: U Capital Research

\*Post Zakat, Taxes, Profit on Tier 1

## Outlook

We are estimating ADIB's net profit to increase to AED2.18bn in 2017 (2016: AED1.95bn), supported by operating income at AED 3.042bn (2016: AED 2.90). Net financing income is expected to clock in at AED3.75bn (2016: AED 3.92bn). Non-funded income is expected to be at AED 1.78bn (2016: AED 1.43bn). We believe that operating expenses will be maintained at +3.1%, implying a cost/income ratio of 45.1%in 2017, versus 45.5% in 2016. Impairment is decreasing to AED 870mn (2016: AED 970mn).

We believe that the estimated -10%YoY reduction in impairment expense and +18%YoY growth in non-funded income are primarily driving ADIB's net profit growth in 2017. We expect contraction in financing income, and therefore any positive surprise on that front is an upside risk to our valuation. The downside risk to our forecast arises from too optimistic an expectation of cost of risk decline.

The bank has been pursuing international growth opportunities, with the growing acceptance of Islamic banking worldwide; ADIB is increasingly turning its attention to replicating its business model through systematic geographic expansion. ADIB's international expansion began in Egypt with the acquisition via a joint venture structure of National Bank of Development followed by the establishment of Iraq, UK, Saudi Arabia operations and will continue with the new operations in Qatar and Sudan. ADIB is also in the process of applying for banking licenses in a range of other countries.

## TP offers an upside of 11.4% to CMP; Implies PE'18e of 6.97x and PB'17e of 1.10x

Our target price offers an upside of 11.4% compared to the current market price. The bank is trading at 1.09x book value, but we believe that given its improving earnings profile, as indicated by its 9M'17 performance, and cautious growth strategy, the bank is trading at a discount to its fair value. Its strong core operating performance, which warrants sustained dividend payouts over the forecast period, primarily drives the bank's valuation.

Furthermore, market conditions are expected to improve as macroeconomic environment eases with fiscal consolidation, stronger global trade and higher Dubai Expo 2020 investment. The UAE will see non-oil GDP growth hitting 3.3%<sup>1</sup> this year. Real GDP growth is expected to be 1.34% in 2017 and 3.36% in 2018<sup>2</sup>, on improvement in oil prices.

<sup>1</sup> IMF estimates

<sup>2</sup> IMF estimates

## Key Financials

(AED mn)	2014	2015	2016	2017e	2018e	2019e
<b>Income Statement</b>						
Financing Income	4,133	4,388	4,529	4,331	4,332	4,478
Interest Expense/Payment to Depositors	628	617	608	578	637	709
<b>Net Interest/Financing Income</b>	<b>3,505</b>	<b>3,771</b>	<b>3,921</b>	<b>3,753</b>	<b>3,695</b>	<b>3,769</b>
Fee & Commission Income	739	885	840	1,050	1,041	1,067
Other Income	332	458	589	735	729	747
<b>Total Non-Interest/Financing Income</b>	<b>1,071</b>	<b>1,343</b>	<b>1,429</b>	<b>1,785</b>	<b>1,770</b>	<b>1,814</b>
<b>Total Operating Income</b>	<b>4,576</b>	<b>5,114</b>	<b>5,350</b>	<b>5,538</b>	<b>5,465</b>	<b>5,583</b>
Provisions expense	758	820	970	871	904	959
Operating Expenses	2,071	2,374	2,448	2,496	2,459	2,535
<b>Profit Before Taxation</b>	<b>1,754</b>	<b>1,940</b>	<b>1,968</b>	<b>2,206</b>	<b>2,136</b>	<b>2,128</b>
Tax, Minority Interest & Sukuk profit paid	335	307	285	236	228	227
<b>Attributable Net Profit</b>	<b>1,420</b>	<b>1,633</b>	<b>1,682</b>	<b>1,971</b>	<b>1,908</b>	<b>1,901</b>
<b>Balance Sheet</b>						
Cash Balances	18,758	18,629	19,778	25,466	29,383	31,838
Deposits with Banks & FIs	6,270	4,742	4,246	1,805	1,850	1,896
Investment Securities	6,429	8,736	10,460	10,301	10,559	10,823
Gross Loans & Financings	98,058	114,650	118,931	122,368	125,428	128,563
Loan Loss Reserve	25,052	36,246	38,958	43,610	44,701	45,818
Net Loans & Financings	73,006	78,403	79,973	78,758	80,727	82,745
Other Assets	7,441	7,867	7,832	8,105	8,298	8,494
<b>Total Assets</b>	<b>111,904</b>	<b>118,378</b>	<b>122,290</b>	<b>124,436</b>	<b>130,816</b>	<b>135,797</b>
Deposits from Banks & FIs	5,476	3,106	5,154	5,189	5,447	5,635
Deposits from Customers	84,776	94,927	98,814	99,486	104,436	108,036
Other Borrowings	10,234	7,508	5,673	5,673	5,673	5,673
Other Liabilities	3,374	3,433	2,863	3,137	3,215	3,296
Paid-up Capital	3,000	3,168	3,168	3,168	3,168	3,168
Retained Earnings	1,245	1,859	2,487	3,426	4,334	5,238
Other Reserves	3,799	4,376	4,131	4,357	4,543	4,751
Shareholders' Equity	8,044	9,403	9,786	10,950	12,045	13,157
<b>Total Equity &amp; Liability</b>	<b>111,904</b>	<b>118,378</b>	<b>122,290</b>	<b>124,436</b>	<b>130,816</b>	<b>135,797</b>
<b>Cash Flow Statement</b>						
Cash from operations	(2,175.4)	5,291.8	7,099.5	6,530.8	5,111.0	3,634.1
Cash from investing activities	481.0	2,421.3	2,815.2	36.8	380.3	389.8
Cash from financing	(806.7)	(2,998.8)	(3,135.3)	(806.3)	(813.8)	(788.8)
Net changes in cash	(3,463.2)	(128.2)	1,149.0	5,687.7	3,916.9	2,455.4
Cash at the end of period	18,758	18,629	19,778	25,466	29,383	31,838
<b>Key Ratios</b>						
Return on Average Assets	1.3%	1.4%	1.4%	1.6%	1.5%	1.4%
Return on Average Equity	18.3%	18.7%	17.5%	19.0%	16.6%	15.1%
Recurring Income/Operating Income	92.7%	91.0%	89.0%	86.7%	86.7%	86.6%
Yield on Financing Assets	4.12%	4.95%	4.86%	4.67%	4.71%	4.75%
Cost of Funds	0.67%	0.63%	0.60%	0.55%	0.59%	0.63%
Net Spread	3.45%	4.33%	4.26%	4.11%	4.11%	4.11%
Cost to Income Ratio	45.3%	46.4%	45.8%	45.1%	45.0%	45.4%
Net Loans to Customer Deposits	86.1%	82.6%	80.9%	79.2%	77.3%	76.6%
Non Performing Loans (AED mn)	757	1,289	1,732	1,782	1,826	1,872
Loan Loss Reserve	2,753	2,995	3,733	4,499	5,291	6,109
NPLs to Gross Loans	0.8%	1.8%	2.3%	2.3%	1.5%	1.5%
NPL Coverage	363.7%	232.3%	186.1%	175.6%	175.6%	175.6%
Cost of Risk (bps)	83.3	92.6	104.1	93.9	98.3	101.7
Equity to Gross Loans	8.2%	8.2%	8.2%	8.9%	9.6%	10.2%
Equity to Total Assets	7.2%	7.9%	8.0%	8.8%	9.2%	9.7%
Dividend Payout Ratio	46.7%	47.1%	46.2%	39.8%	39.8%	39.8%
Adjusted EPS (AED)	0.47	0.52	0.53	0.62	0.60	0.60
Adjusted BVPS (AED)	2.68	2.97	3.09	3.46	3.80	4.15
Market Price (AED) *	5.57	3.94	3.80	3.77	3.77	3.77
Dividend Yield	4.0%	6.2%	6.5%	6.6%	6.4%	6.3%
P/E Ratio (x)	11.8	7.6	7.2	6.1	6.3	6.3
P/BV Ratio (x)	2.1	1.3	1.2	1.1	1.0	0.9

Source: U Capital Research, Company Financials

\* Market price for 2017 and subsequent years based on closing price of Nov 01, 2017

## Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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