

UAE Banking Sector

May 20, 2018

Bank	Rating
Emirates NBD	BUY
Abu Dhabi Commercial Bank (ADCB)	Accumulate

- Credit growth to pick up to mid-single digit over 2018-2021e on the back of increased economic output as well as increased liquidity
- Net interest margins are already showing signs of improvement on improving yields on re-priced assets; rising cost of funding continues to dampen yield improvement
- Limited growth seen in other operating income on highly competitive environment in an over-banked market
- Cost of risk to remain low; NPLs continue to normalize

We reiterate our **BUY** rating on Emirates NBD (ENBD) and **Accumulate** rating on Abu Dhabi Commercial Bank (ADCB) with price targets of AED 13.5 per share and AED 7.5 per share. Both names are trading at attractive P/E'18e and P/B'18e multiples as compared to their regional peer-group average of 9.7x and 1.5x respectively.

Currently, ENBD's shareholders have approved Foreign Ownership Limit (FOL) increase from 5% to 20%, which is expected to be completed soon. However, the management of the bank has indicated that FOL increase may not materialize if Turkey's Denizbank acquisition (also approved by the shareholders of the bank) does not come through, for which the bank's shareholders have approved an AED 7.4bn rights issue to finance the acquisition. The stock rallied by about 20% in March on anticipation of FOL increase. However, the stock has lost its sheen since the probability of FOL increase has come under speculation. In our view, the bank remains fundamentally sound, however, its value may not unlock if FOL increase does not materialize.

ADCB's stock rallied on Q1'18 result announcement by about 10%; however, most of this gain has been lost as investors moved to other more attractive stocks. We believe the stock offers limited upside at this time despite remaining one of the solid performers within the UAE banking space.

Valuation & Risks

Our forecasts are based on mid-single-digit credit and deposit growth assumption, on the back of an improving macroeconomic landscape. We have assumed spreads to continue to improve on the back of rising interest rates, which together with our assumption of improved cost controls, is expected to result in bottom line improvement. However, deterioration in macroeconomic situation warrants downside risk to our valuation as it will have a direct impact on credit growth & quality. Furthermore, deposit growth constraints might put more pressure on cost of funding, dampening improvement in yields on assets expected to materialize in a rising interest rate environment.

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Name	Mkt Cap (AED mn)	Last Px (AED)	Target Price (AED)	Upside/ (Downside)	P/B '18e	P/E '18e	Div Yield '18e
Emirates NBD	54,466	9.80	13.50	38%	0.95	5.89	4.1%
Abu Dhabi Commercial Bank	34,776	6.69	7.50	12%	1.15	7.71	6.3%

Source: Bloomberg, U Capital Research

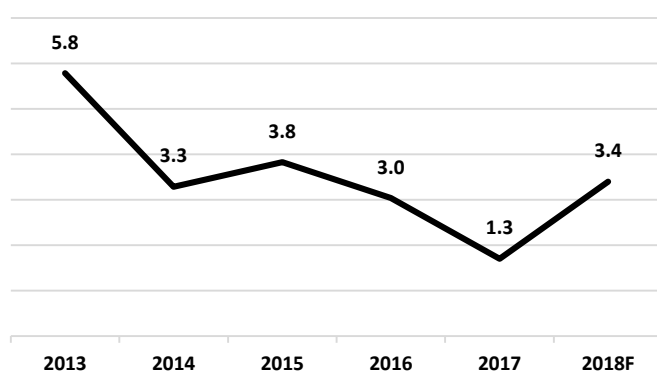
Macro Outlook

An evolving operating landscape

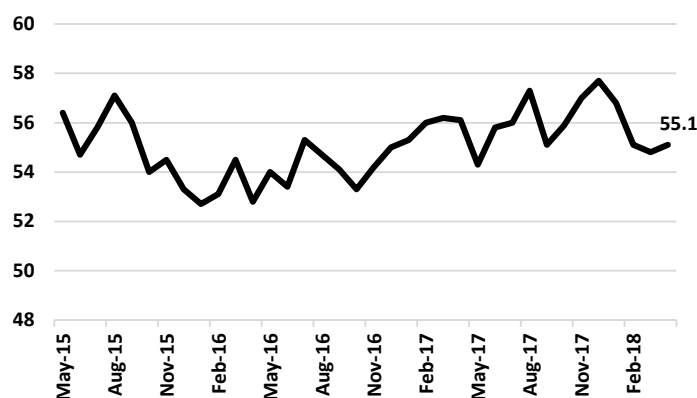
We expect investment expenditure to be the key driver of non-oil GDP growth for the UAE in 2018, as economic activity accelerates ahead of Expo 2020, and as the implementation of hydrocarbon sector projects in Abu Dhabi progresses. A further strengthening of the global economy and trade volumes will also support the UAE's economic activity in 2018.

The International Monetary Fund (IMF) expects UAEs' economic growth to nearly triple next year as Abu Dhabi, benefits from an expected recovery in oil exports. Its gross domestic product will expand by 3.4% in 2018 as compared to 1.3% in 2017, largely on expectations that growth in oil-rich Abu Dhabi will surge to 3.2% from 0.3% in 2017, the IMF forecasts. Dubai's output will accelerate more moderately, to 3.5% from 3.3% in 2017.

UAE GDP YoY



UAE Purchasing Managers' Index (PMI)



Source: IMF, Bloomberg

The introduction of VAT from 1st Jan, 2018 is likely to raise taxes of around 1.5% of GDP in its first full year, realizing a balanced fiscal position in 2018 with higher government revenue despite a pick-up in government spending. However, one caveat of this tax is that it might result in dampening of consumer spending and a rise in inflation. Some corporates might have to initially absorb part of the VAT given the impact on demand.

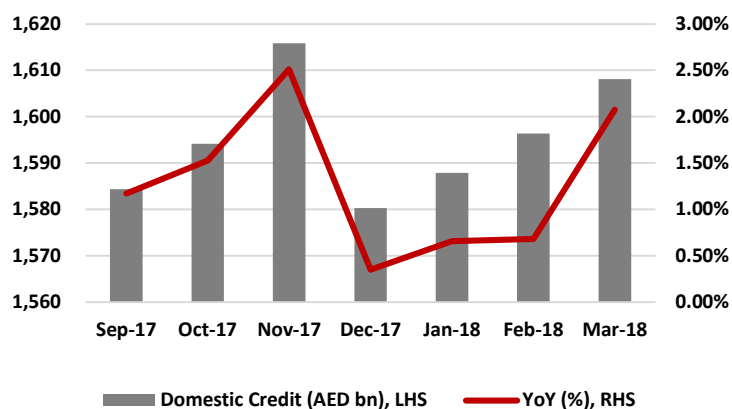
The removal of subsidies and introduction of new taxes are fundamentally altering the economy, while new regulations are strengthening the banking sector. Furthermore, digitization is transforming the banking industry. Therefore, it is evident that the bank which can continuously innovate and adapt digitization will be able to preserve shareholder returns.

Liquidity levels have improved as deposit growth continues to outpace credit growth.

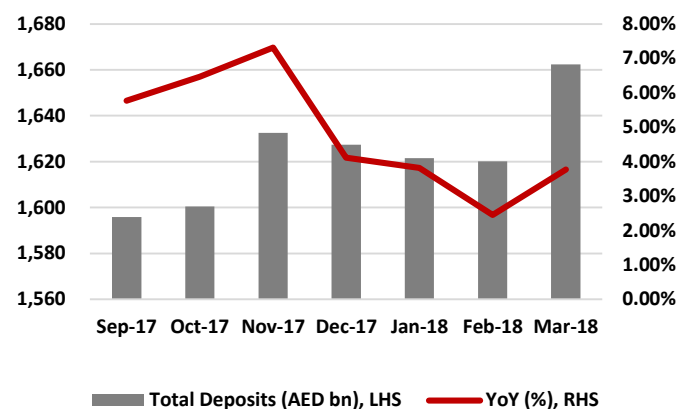
In March'18, total domestic credit of UAE reached AED 1.608 trillion, up by +0.74%MoM and +0.68%YoY. Total deposits including non-resident deposits reached AED 1.662trillion, up by +2.6%MoM and +3.8%YoY, bringing loan-to-deposit ratio down to 88.6% from 90.4% a month ago. On YTD basis, in the first three months of 2018, total credit has increased by 1.8% vs. almost flat for first three months of 2017, and deposits have grown at a somewhat similar pace (+2.2% YTD'18 vs. +2.5% YTD'17).

During the month of March'18, within sectors, credit to non-residents grew by 8.5%YoY, other financial institutions grew by 3.6%YoY Government grew by 2.4%YoY and private sector grew by 1.9%YoY. Deposits raised from corporates and individuals (share ~60%), the largest contributor to total deposits, rose by 0.9%YoY whereas Government deposits grew by 20%YoY. Deposits from Non-banking finance companies grew by 7%YoY, GRES grew by 5%YoY, and non-residents grew by 0.3%YoY.

UAE Banking Sector Credit



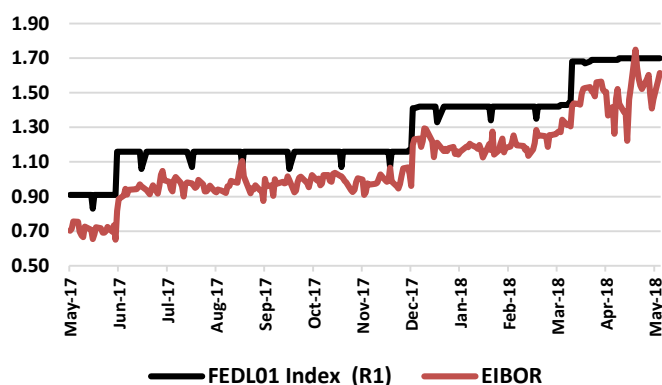
UAE Banking Sector Deposits



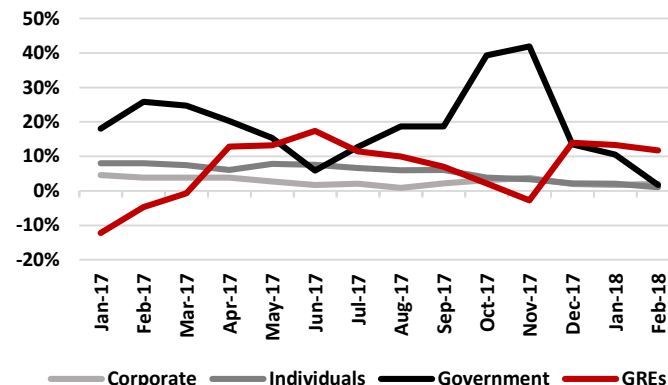
Source: CBUAE, U Capital Research

The easing in banking sector liquidity conditions was also reflected in the narrowing in spreads between UAE and US benchmark rates. While the overall data continues to highlight the weak credit demand environment, the main drivers of deposit growth in 2017 were the government and the GRE (Government Related Entities) sectors. We expect liquidity to remain comfortable in 2018 on the back of a higher oil price, further international debt issuance and a contained credit growth.

Fed Funds Rate & Emirates Interbank Overnight Rate



Deposit Growth YoY



Source: Bloomberg, CBUAE

Investment climate has improved

Investment activity across the UAE gained solid traction during 2017 and is expected to play an even stronger role in the non-oil sector this year. Infrastructure projects related to Expo 2020, direct and indirect, alongside construction, power and transportation, featured heavily in Dubai in 2017. In 2017, more than AED 10bn direct Expo-related projects were awarded. There was also a surge of project awards in Abu Dhabi, particularly towards the year end. Plans to increase oil, petrochemical and gas capacity are behind the major projects.

While there is much to be positive about, some economic headwinds persist. Weak regional demand, the still relatively strong dollar and continuing concerns about job security have all played a part in dampening consumer appetite. This resulted in many corporates, particularly in hospitality and retail, cutting prices to bolster demand, thereby impacting their margins. Consequently, private sector credit growth remained soft in both the corporate and consumer sectors.

However, Government initiatives like relaxation of visa requirement for certain nationalities resulted in a rising number of tourist visits that supported external growth and tourism-related sectors providing a welcome revenue boost. The significant rise was triggered by a relaxation in visa regulations for Chinese and Russian tourists, and for Indians with US or Eurozone visas.

Emirates NBD

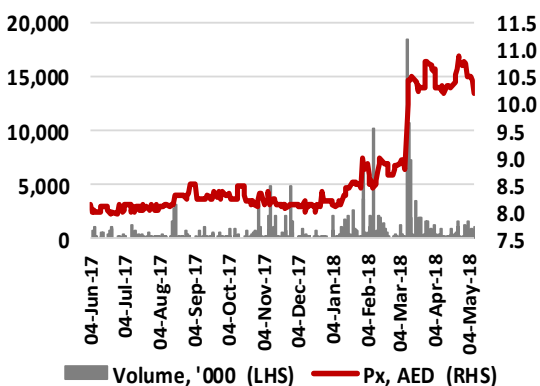
TP: AED 13.5/share
Upside: 37.8%

Recommendation
BUY

Bloomberg Ticker	EMIRATES UH
CMP (AED) as of 20/05/2018	9.80
52wk High / Low (AED)	11.00/7.95
12m Average Vol. (000)	817.6
Mkt. Cap. (USD/AED bn)	14.83/54.47
Shares Outstanding (bn)	5.56
Free Float (%)	39%
3m Avg Daily Turnover (AED mn)	12.1
6m Avg Daily Turnover (AED mn)	10.6
PE 2018e (x)	5.9
PBv 2018e (x)	0.9
Dividend Yield '18e (%)	4.1%

Price Performance:

1 month (%)	(5.31)
3 month (%)	10.11
12 month (%)	18.21

Source: Bloomberg
Price Performance

Source: Bloomberg

- Superior ROE of ~18% vs. regional peer group average of 14.4%
- 17.6% market share in UAE banking assets, 19.5% in loans and 20.5% in deposits and has a branch/rep office presence in India, China, Saudi Arabia, Singapore and UK.
- A sizeable presence outside UAE in Egypt (over 60 branches) via the acquisition of BNP Paribas Egypt
- Asset quality improvement, NIM expansion and healthy fee income growth are the fundamental strengths
- Our rating does not take into account the lack of liquidity on the stock and the current foreign ownership limit (FOL) of just 5%. However, ENBD investors have approved FOL increase to 20% in Mar 2018; expected to be executed within the next 1-2 months.
- Dividend yield is lesser for 2018, as the stock has risen by ~24% during the last 12M.

We upgrade the bank to a **BUY** rating on recent financial performance and fundamental strength of the balance sheet. The stock has already witnessed a price run in March of this year on announcement of shareholder approval to increase foreign ownership limit (FOL) of the stock to 20% from the current 5%. We believe the stock has potential to re-rate to its fair value once liquidity of shares improves with FOL increase on superior profitability metrics as well as sound capitalization. One caveat is the potential rights issue of up to AED 7.3bn which has been approved by the shareholders of the bank that might result in dilution of earnings per share. However, the rights issue proceeds are expected to fund the acquisition of Turkey's Denizbank which will boost earnings in the future.

Valuation & Outlook

We expect the bank to increase its loan-book at a 6% CAGR over 2018-2022F as the macroeconomic situation begins to show signs of improvement. The bank's capital ratios are expected to remain firm and above some of the regional peers, as the bank continues to shed legacy problem loans and improves NPL coverage ratio. We expect the bank to maintain dividend at AED 0.40 per share throughout the forecast period. Our weighted average fair value is based on a cost of equity of 12.5% with a normalized ROE of 14.5% and growth rate of 3% for the terminal value.

In our view, the potential dilution of EPS upon rights issue will be more than offset by the completion of acquisition of Denizbank. The management of the bank has already indicated that the rights issue will not be required if acquisition does not continue.

Key Risks to Valuation

Key downside risks arise primarily from lower than expected asset growth and NIMs, in addition to a higher than currently estimated asset quality deterioration. Regulatory, geopolitical risks in organic and inorganic international expansion need to be closely watched.

Increase in foreign ownership limit could offer upside risks to our view on the stock, as would the favorable direction of economic growth and monetary/fiscal policy compared to our expectations. On the other hand, the stock could continue to trade below its fair value should the FOL action (pending regulatory approval) not occur.

Key Indicators

Year	2016	2017	2018e	2019e	2020e	2021e
Total Net Loans (AED bn)	290	304	328	350	374	402
Total Customer Deposits (AED bn)	327	345	368	393	423	456
Operating Income (AED mn)	14,883	15,527	17,486	19,711	21,793	24,202
Net Profit (AED mn)	7,239	8,345	9,255	10,398	11,405	12,569
EPS (AED)	1.30	1.50	1.67	1.87	2.05	2.26
BVPS(AED)	7.98	8.97	10.35	11.71	13.25	15.00
P/E(x)	6.5	5.5	5.9	5.2	4.8	4.3
P/BVPS(x)	1.1	0.9	0.9	0.8	0.7	0.7
Dividend yield (%)	4.7%	4.9%	4.1%	4.1%	4.1%	4.1%

Source: Company Financials, U Capital Research
**excluding the effect of forthcoming AED 7.3bn rights issue*
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Rights issue impact amid potential Denizbank acquisition; ENBD's shareholders have approved FOL increase

ENBD could see a surge in its number of shares once the shareholder approved rights issue (worth AED 7.3bn) is completed. However, it is difficult to analyze at this moment what the increase in shares will be like, depending on the offer price. The proceeds of the rights issue will be utilized towards acquisition of Turkey's Denizbank. The bank said in Jan'18 that it had started initial strategic talks with Russia's Sberbank about a possible purchase of its stake in Denizbank.

The shareholders of the bank have also approved the foreign ownership limit (FOL) increase from 5% to 20%. We saw ENBD shares jump from the likes of AED 8.5 – 9.0 per share in anticipation of FOL increase to above AED 10 per share near the AGM date, reaching a high of AED 10.9 per share on April 25, 2018.

We believe that once the regulatory approvals for FOL increase are in place then the stock has potential to unlock shareholder value further, partially diluting the negative impact of rights issue. As per chatter around the timeline on FOL regulatory approval, it is expected to be completed by mid-June 2018. Looking at the example of other UAE banks that approved FOL increases (e.g. DIB & DIC), the process of regulatory approval and implementation can take around 3 months; however, in case of ENBD, the process could be expedited.

Net Interest Margins are improving; Cost of Risk under control

We have revised our projections for the bank on the recent performance in FY17 and Q1'18. Now we expect the bank's net profit to reach AED 8.9bn instead of our earlier estimate of AED 8.0bn, despite slower credit offtake than assumed in our earlier estimates.

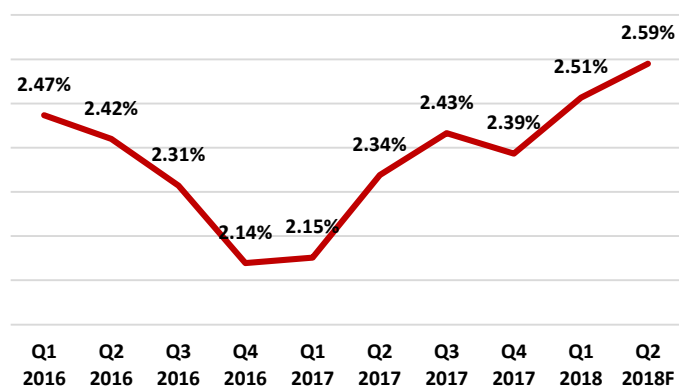
We believe that the bank's NIMs will continue to improve as rate rises flow through to the loan book and funding costs remain stable due to healthy liquidity conditions. The bank has a unique advantage that more than half of its customer deposits are CASA (57% of total deposits).

AED bn	Previous FY'18e	Current FY'18e	Var %
Gross Loans & Financings	366.9	345.8	-6%
Loan Loss Reserve	(31.8)	(29.7)	-7%
Net Loans & Financings	335.1	316.0	-6%
Deposits from Customers	356.1	341.3	-4%
LTD, %	94.1%	92.6%	-2%
Total Operating Income	16.3	16.8	3%
Impairment Charges	(2.7)	(2.5)	-9%
Operating Expenses	(5.3)	(5.3)	-2%
Attributable Net Profit	8.0	8.9	11%

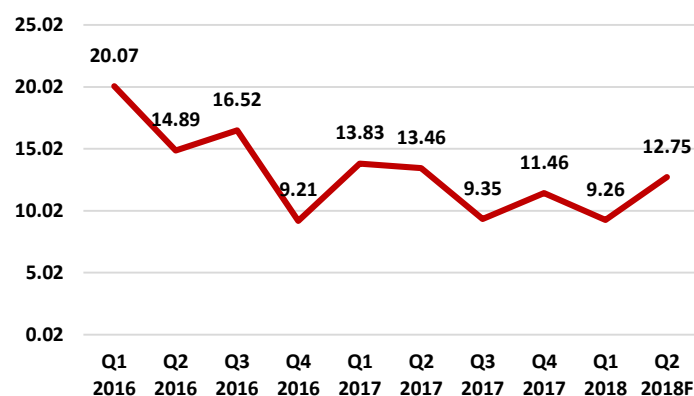
Source: U Capital Research

Additionally, we believe that the bank will continue to normalize its NPA ratio (currently at 6.0%) as it sheds problem legacy loans as well as careful monitoring of new exposures.

ENBD: Quarterly NIMs (bps)



ENBD: Cost of Risk (bps)



Source: Company Financials, U Capital Research

We believe that operating costs will remain under control going forward, and hence the bank's net profit will grow at a CAGR of 11.7% over 2018-2022F on strong operating income growth together with controlled costs.

Huge IT transition in process

Emirates NBD is investing over AED1bn in its IT transition. Over a four-year period, the bank plans to invest in its IT infrastructure, operating model and platform upgrades, in order to accelerate its technology transformation.

Key Financials

Income Statement (AED mn)	2015	2016	2017	2018e	2019e	2020e
Income Statement						
Interest/Financing Income	13,275	14,945	16,206	18,247	20,830	23,391
Interest Expense/Payment to Depositor	(3,034)	(4,834)	(5,420)	(6,074)	(6,818)	(7,684)
Net Interest/Financing Income	10,241	10,111	10,786	12,173	14,013	15,707
Fee & Commission Income	2,793	2,861	2,957	3,314	3,554	3,796
Other Income	2,279	1,745	1,641	1,839	1,973	2,107
Total Non-Interest/Financing Income	5,073	4,607	4,598	5,153	5,527	5,903
Total Operating Income	15,314	14,718	15,384	17,326	19,539	21,610
Provisions expense	(3,406)	(2,608)	(2,229)	(2,689)	(3,105)	(3,570)
Operating Expenses	(4,719)	(4,888)	(4,844)	(5,421)	(6,071)	(6,669)
Profit Before Taxation	7,188	7,222	8,312	9,216	10,363	11,371
Net Profit Attributable to Parent	7,043	7,074	8,202	9,095	10,226	11,221
Balance Sheet (AED mn)						
Cash Balances	34,088	32,584	35,607	28,337	30,244	32,713
Deposits with Banks & FIs	39,837	57,082	49,726	53,601	57,216	61,151
Investment Securities	15,927	13,574	15,493	16,700	17,827	19,053
Gross Loans & Financings	296,353	317,433	332,021	357,265	381,357	407,587
Loan Loss Reserve	(25,772)	(27,036)	(27,928)	(29,473)	(31,461)	(33,625)
Net Loans & Financings	270,581	290,396	304,093	327,792	349,896	373,962
Other Assets	46,128	54,368	65,453	69,229	73,333	77,793
Total Assets	406,560	448,004	470,372	495,660	528,516	564,672
Deposits from Banks & FIs	18,823	18,857	21,311	22,487	24,003	25,654
Deposits from Customers	287,232	310,752	326,528	344,545	367,779	393,075
Other Borrowings	44,685	55,587	54,793	52,374	51,792	51,210
Other Liabilities	14,549	18,424	17,856	18,736	19,865	21,093
Paid-up Capital	5,558	5,558	5,558	5,558	5,558	5,558
Retained Earnings	17,567	21,939	27,404	33,817	41,374	49,937
Other Reserves	18,141	16,880	16,915	18,134	18,134	18,134
Shareholders' Equity	41,266	44,377	49,876	57,509	65,066	73,629
Minority Interest	6	7	8	9	10	11
Total Equity & Liability	406,560	448,004	470,372	495,660	528,516	564,672
Cash Flow Statement (AED mn)						
Cash from operations	6,531.4	(5,739)	13,068	3,580	11,819	12,506
Cash from investing activities	(1,843.3)	(2,742)	(6,451)	(6,809)	(6,488)	(6,613)
Cash from financing	1,451.0	6,977	(3,594)	(4,041)	(3,424)	(3,424)
Net changes in cash	6,139.1	(1,504)	3,023	(7,270)	1,907	2,470
Cash at the end of period	34,088	32,584	35,607	28,337	30,244	32,713
Key Ratios						
Return on Average Assets	1.9%	1.7%	1.8%	1.9%	2.0%	2.1%
Return on Average Equity	18.1%	16.9%	17.7%	17.2%	17.0%	16.4%
Recurring Income/Operating Income	85.1%	88.1%	89.3%	89.4%	89.9%	90.2%
Cost of Funds	1.0%	1.3%	1.4%	1.5%	1.6%	1.7%
Net Spread	2.9%	2.5%	2.4%	2.6%	2.8%	2.9%
Cost to Income Ratio	30.7%	32.8%	31.2%	31.0%	30.8%	30.6%
Net Loans to Customer Deposits	94.2%	93.4%	93.1%	95.1%	95.1%	95.1%
NPLs to Gross Loans (LHS)	7.0%	6.4%	6.1%	5.9%	5.8%	5.8%
NPL Coverage (RHS)	123.7%	133.4%	137.5%	139.4%	141.4%	143.4%
Cost of Risk (bps)	117.1	85.0	68.6	80.4	84.1	90.5
Equity to Gross Loans	13.9%	14.0%	15.0%	16.1%	17.1%	18.1%
Equity to Total Assets	10.1%	9.9%	10.6%	11.6%	12.3%	13.0%
Dividend Payout Ratio	31.2%	30.7%	26.6%	24.0%	21.4%	19.5%
Adjusted EPS (AED)	1.3	1.3	1.5	1.7	1.9	2.1
Adjusted BVPS (AED)	7.4	8.0	9.0	10.3	11.7	13.2
Market Price (AED) *	7.4	8.5	8.2	9.8	9.8	9.8
Dividend Yield	5.4%	4.7%	4.9%	4.1%	4.1%	4.1%
P/E Ratio (x)	5.8	6.5	5.5	5.9	5.2	4.8
P/BV Ratio (x)	1.0	1.1	0.9	0.9	0.8	0.7

Source: U Capital Research, Company Financials
** Market price for 2018 and subsequent years based on closing price of 20-May-18*

Abu Dhabi Commercial Bank

TP: AED 7.5/ share
Upside: 12%

Recommendation

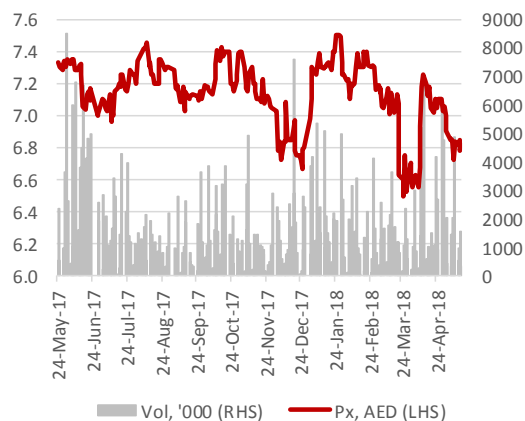
	Accumulate
Bloomberg Ticker	ADCB UH
CMP (AED) as of 20/05/2018	6.69
52wk High / Low (AED)	6.50/7.50
12m Average Vol. (000)	1,701.5
Mkt. Cap. (USD/AED bn)	9.5/34.8
Shares Outstanding (mn)	5,198.2
Free Float (%)	37%
3m Avg Daily Turnover (AED mn)	11.3
6m Avg Daily Turnover (AED mn)	11.7
PE 2018e (x)	7.8
PBv 2018e (x)	1.2
Dividend Yield '18e (%)	6.2%

Price Performance:

1 month (%)	(5.11)
3 month (%)	(9.23)
12 month (%)	(8.48)

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

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- Superior ROE of 16.5% vs. regional peer-group average of 14.4%
- Primarily focused on UAE; 94% loans are in the UAE; Market share of 11% in loans and 10% in deposits
- Deposits form 70% of liabilities and wholesale funding at 19%; CASA forms 43% of total deposits
- Adequately capitalized: CAR of 17.48% and common equity tier 1 (CET1) ratio of 12.37% remained well above the UAE Central Bank minimum capital requirements of 12.75% and 9.25% (including buffers)

We maintain our rating on ADCB at **ACCUMULATE** but slightly reduce our target price to AED 7.5 per share as we adjust our forecasts on recent financial performance of the bank in addition to adjusting the new risk profile for cost of equity calculation. ADCB's stock rallied on Q1'18 result announcement by about 10%; however, most of this gain has been wiped out lately. We believe the stock offers limited upside at this time despite remaining one of the solid performers within the UAE banking space in terms of financial performance and robustness.

Valuation & Outlook

We have a modest loan-book growth outlook in spite of a pickup in deposit growth. Operating performance over 2018-2022e is expected to be modest, growing at a CAGR of 7.5%, as loan book growth constraints weigh down operating income growth, in spite of our expectation of rapidly improving spreads. Operating expenses are expected to be curtailed at current levels, growing only moderately at a CAGR of 6.5% over the forecast period. We conservatively assume cost of risk to continue to rise albeit slowly as has been the trend in the previous years.

Improving key financial metrics

Loan re-pricing continued to benefit the Bank in 1Q18. NIM, as per our calculation, continued to improve sequentially over the last few quarters to reach 2.84% for Q1'18. ADCB is one of the biggest net lender to other banks and has a good mix (44%-56%) of Consumer and Wholesale Banking portfolios. At the same time, it maintains a similar mix of deposit funding: Time and Islamic at 56%, CASA at 43%. The bank posted a significant improvement in NPL ratio to 2.1% in 2017 from 2.7% in 2016. However, it ticked up again to 2.2% in Q1'18.

Risks to Our Valuation

Key downside risks to our rating and TP largely arise from higher-than-expected asset quality deterioration, competitive and margin pressures beyond current estimates, GDP growth being slower than expected.

Key Indicators

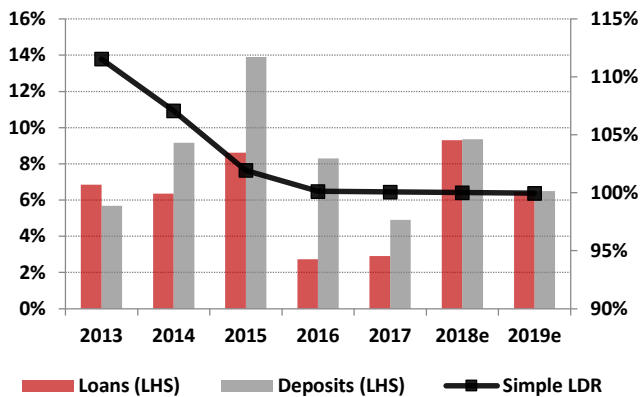
Year	2015	2016	2017	2018F	2019F	2020F
Total Net Loans (AED bn)	153.7	158.5	163.3	178.5	190.0	203.2
Total Customer Deposits (AED bn)	163.1	178.4	189.9	203.2	218.5	0.0
Operating Income (AED mn)	8,261.8	8,503.3	8,905.2	9,556.6	10,560.2	11,527.0
Net Profit (AED mn)	4,924.2	4,148.7	4,277.6	4,508.7	5,046.2	5,562.1
Diluted EPS (AED)	0.88	0.74	0.76	0.81	0.90	0.99
Diluted BVPS(AED)	4.42	5.07	5.47	5.81	6.27	6.78
P/E(x)	7.5	8.6	8.3	7.7	6.9	6.3
P/BVPS(x)	1.5	1.4	1.2	1.2	1.1	1.0
Dividend yield (%)	6.1%	7.0%	5.9%	6.3%	7.1%	7.8%

Source: Company Financials, U Capital Research

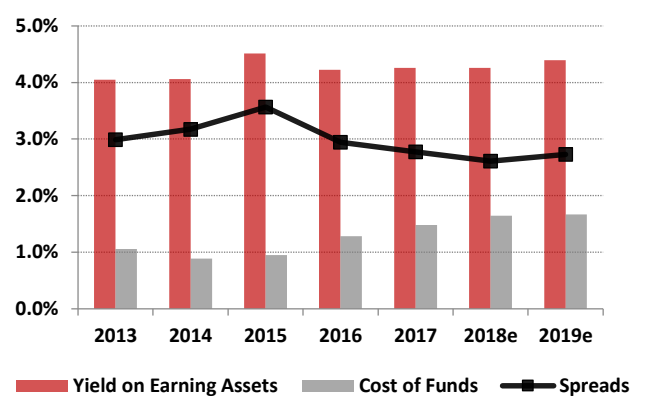
Spreads expected to improve on the back of asset re-pricing

ADCB's spreads are expected to improve from here onwards, albeit slowly, as improvement in yield on assets is expected to outpace cost of funding. In spite of the expected spread improvement outlined above, we have estimated a modest growth in the bottom line of the bank, as operating costs are expected to grow at a CAGR of 6.5% over the forecast period in addition to rising cost of risk (CAGR: 7.5% over 2018-2021e). Income growth is expected to be supported by loan and deposit growth, where we expect the bank to grow its loans by a CAGR of 7.6% over the forecast period, and deposits to grow hand in hand as LTD is expected to remain stable at FY17 levels.

ADCB: Loans & Deposits Growth



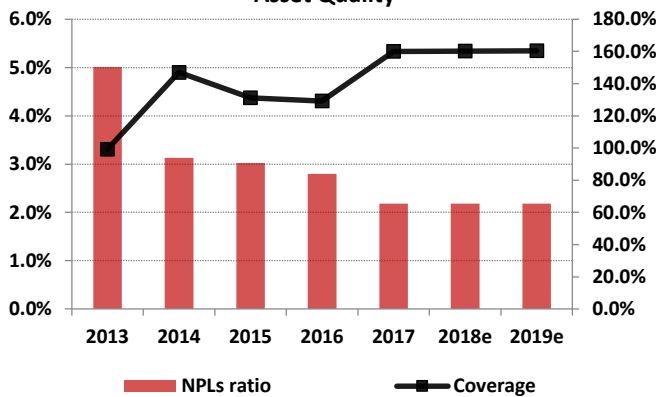
ADCB: Spreads



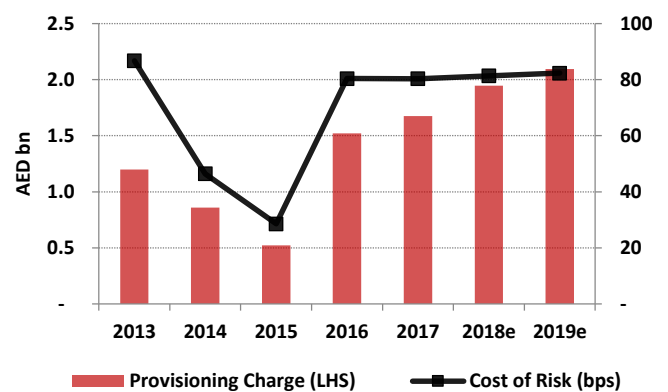
Non-performing loans contained; provisioning is adequate and above GCC peer group average

ADCB's non-performing loans (NPLs) are down by 20%YoY in FY17, with NPL ratio declining from 2.8% in FY16 to 2.2% in FY17. In Q1'18, the bank posted non-performing loans and provision coverage ratios of 2.2% and 179.7%. The bank has made consistent progress in bringing down the NPL ratio over the years, and has successfully shed some legacy loans. Its provision coverage is adequate and above regional peer-group average of 135%.

Asset Quality



Provisioning Requirements



Source: Company Financials, U Capital Research

Adequately capitalized; Economic sector credit concentrations exist

ADCB has a capital adequacy ratio of 17.48% and common equity tier 1 (CET1) ratio of 12.37% that remained well above the UAE Central Bank minimum capital requirements of 12.75% and 9.25% (including buffers), post dividend pay-out of AED 2.2 bn and IFRS 9 adjustment of AED 1.36 bn. As of Q1'18, the bank has a large (c36%) exposure to real estate investment & hospitality sectors. The next largest exposures are retail and government & GREs at 22% and 20% respectively.

Financial Statements

(AED mn)	2015	2016	2017	2018e	2019e	2020e
Income Statement						
Interest/Financing Income	7,797	8,751	9,854	10,916	12,135	13,335
Interest Expense/Payment to Depositor	(1,591)	(2,550)	(3,153)	(3,705)	(4,039)	(4,359)
Net Interest/Financing Income	6,206	6,201	6,701	7,211	8,095	8,977
Fee & Commission Income	1,438	1,472	1,507	1,543	1,579	1,616
Other Income	618	830	697	803	886	934
Total Non-Interest/Financing Income	2,056	2,302	2,204	2,346	2,465	2,550
Total Operating Income	8,262	8,503	8,905	9,557	10,560	11,527
Provisions expense	(502)	(1,521)	(1,674)	(1,945)	(2,095)	(2,268)
Operating Expenses	(2,827)	(2,796)	(2,948)	(3,096)	(3,411)	(3,689)
Profit Before Taxation	4,933	4,187	4,284	4,515	5,054	5,570
Taxation & Minority Interest	(9)	(38)	(6)	(7)	(8)	(8)
Net Profit Attributable to Parent	4,924	4,149	4,278	4,509	5,046	5,562
Balance Sheet						
Cash Balances	10,669	19,262	19,997	21,966	22,476	24,501
Deposits with Banks & FIs	24,466	24,664	11,452	12,518	13,322	14,254
Gross Loans & Financings	160,022	164,400	169,189	184,945	196,871	210,550
Loan Loss Reserve	(6,345)	(5,942)	(5,907)	(6,465)	(6,890)	(7,378)
Net Loans & Financings	153,677	158,458	163,282	178,480	189,981	203,172
Other Assets	39,454	55,906	70,272	74,941	81,341	86,596
Total Assets	228,267	258,289	265,003	287,904	307,119	328,523
Deposits from Banks & FIs	1,692	3,843	5,177	5,036	5,696	5,917
Deposits from Customers	143,526	155,442	163,078	178,351	189,944	203,240
Other Borrowings	43,172	50,744	47,465	51,536	54,625	58,169
Other Liabilities	15,144	21,910	20,838	22,789	24,271	25,970
Paid-up Capital	5,596	5,198	5,198	5,198	5,198	5,198
Retained Earnings	9,627	11,295	13,342	15,090	17,480	20,125
Other Reserves	9,505	9,857	9,905	9,905	9,905	9,905
Shareholders' Equity	24,728	26,351	28,445	30,193	32,583	35,228
Minority Interest	5	-	-	-	-	-
Total Equity & Liability	228,267	258,289	265,003	287,904	307,119	328,523
Cash Flow Statement						
Cash from operations	(754)	15,613	22,995	3,520	4,946	4,841
Cash from investing activities	2,990	18,827	15,726	4,813	6,351	5,142
Cash from financing	4,206	11,807	(6,534)	3,262	1,915	2,326
Net changes in cash	461	8,593	735	1,969	510	2,025
Cash at the end of period	10,669	19,262	19,997	21,966	22,476	24,501
Key Ratios						
Return on Average Assets	2.3%	1.7%	1.6%	1.6%	1.7%	1.8%
Return on Average Equity	20.9%	16.2%	15.6%	15.4%	16.1%	16.4%
Fee Income Yield	0.9%	0.9%	0.9%	0.9%	0.8%	0.8%
Recurring Income/Operating Income	92.5%	90.2%	92.2%	91.6%	91.6%	91.9%
Interest Earning/Financing Assets Yield	4.5%	4.2%	4.3%	4.3%	4.4%	4.5%
Cost of Funds	0.9%	1.3%	1.5%	1.6%	1.7%	1.7%
Net Spread	3.6%	2.9%	2.8%	2.6%	2.7%	2.8%
Cost to Income Ratio	34.2%	32.9%	33.1%	32.4%	32.3%	32.0%
Net Loans to Customer Deposits	107.1%	101.9%	100.1%	100.1%	100.0%	100.0%
NPLs to Gross Loans	3.0%	2.8%	2.2%	2.2%	2.2%	2.2%
NPL Coverage	131.3%	129.2%	160.0%	160.2%	160.4%	160.6%
Cost of Risk (bps)	28.6	80.4	80.3	81.3	82.3	83.3
Equity to Gross Loans	15.5%	16.0%	16.8%	16.3%	16.6%	16.7%
Equity to Total Assets	10.8%	10.2%	10.7%	10.5%	10.6%	10.7%
Dividend Payout Ratio	45.5%	60.7%	48.6%	48.4%	49.0%	49.0%
Adjusted EPS (AED)	0.88	0.74	0.76	0.81	0.90	0.99
Adjusted BVPS (AED)	4.42	4.71	5.08	5.40	5.82	6.30
Market Price (AED)	6.59	6.90	6.80	6.69	6.69	6.69
Dividend Yield	6.1%	7.0%	5.9%	6.3%	7.1%	7.8%
P/E Ratio (x)	7.5	8.6	8.3	7.7	6.9	6.3
P/BV Ratio (x)	1.5	1.4	1.2	1.2	1.1	1.0

Source: Company Financials, U Capital Research

* Market price for 2018 and subsequent years based on closing price of 20-May-18

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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