EQUITY RESEARCH

BANKS

STRUCTURAL STORY APPEARS RESILIENT TO MACROECONOMIC CHALLENGES | **Banks | UAE | 8 December 2015**

This report reflects the views of ADCB Securities and not those of Abu Dhabi Commercial Bank PJSC. Please refer to the detailed disclaimers at the end of the report.

Equity Research Team

Nikhil Poddar, CFA
+971 2 417 1642
nikhil.poddar@adcb.com

We initiate coverage on Dubai Islamic Bank (DIB), Emirates National Bank of Dubai (ENBD) and First Gulf Bank (FGB) with Buy ratings and National Bank of Abu Dhabi (NBAD) with a Hold rating. For ENBD, we estimate the earnings growth to be robust supported by strong liability franchise and improvement in credit costs. DIB has the best growth outlook. FGB is justifiably viewed as a low-risk investment option in uncertain times. For NBAD, we believe any significant upside is constrained by its weak profitability.

Within the region, UAE finds itself in a relatively strong position

Lower oil prices have been negative for the UAE's fiscal and external surpluses, but the country continues to benefit from its perceived safe haven status and relatively large fiscal buffers, accumulated over the last decades. Given its openness and ease of doing business, UAE has over time been able to build up its non-oil sector. Dubai makes up half of the UAE's non-oil economy and has acquired a solid reputation as a hub for transport, trade and logistics. In anticipation of prolonged subdued oil revenues, the government has initiated fiscal consolidation measures by reducing its subsidies. These measures will dampen growth over the next years. In the long term, however, progress in economic diversification and prudent fiscal policies will promote growth and thus limit the negative impact from lower oil prices.

Credit growth to slowly moderate

Bank loan growth has been stable at 7.0% YoY up to Sept. 2015. In addition to international markets, growth was strong in the government and manufacturing sectors. Going forward, we expect the slowdown in economic growth, reduced government deposits and the resulting tightening of liquidity likely to act as a constraint for loan growth. However, the slowdown in credit growth is likely to be moderate on account of continued public sector spending and robust growth in the non-oil sector.

Credit costs likely to increase from cyclical lows

UAE banks have been experiencing lower credit costs on the back of improvement in asset quality from its historically high levels. Going forward, we expect it to increase marginally on account of slowdown in economic growth. We expect the formation of fresh NPLs to be moderate due to tighter credit standards. Further, unlike the previous credit crisis (2008-2009), real estate has not experienced a credit boom, and in our view, is unlikely to experience a bust. However, real estate is often used as collateral and the fall in prices will require additional provisions.

Premium valuation to its regional peers to continue

UAE banks trade at 1.4x P/BV 2016E at a premium to MENA banks at 1.2x P/BV 2016E. We expect UAE banks to continue to command premium valuations for its a) large exposure to the UAE economy, which has a relatively more robust and diversified economic base b) better profitability, c) attractive dividend yields. Key downside risks: A prolonged oil price decline is likely to have a negative impact on growth and profitability of the banks. Also concentration risks may negatively impact asset quality.

TABLE OF CONTENTS

Fig. 1. Valuation comparables

Banks	Ticker	Rating	Price (AED) Current	Target	Implied (%) Upside/downside	Mkt cap US$mn	P/E (x) 2015E	2016E	EPS growth 2015E	2016E	P/B (x) 2015E	2016E	RoE (%) 2015E	2016E	Dividend Yield (%) 2015E	2016E
Dubai Islamic	DIB UH	Buy	5.9	7.8	32	6,351	7.4	6.9	28.7	7.6	2.0	1.8	25.0	24.3	7.6	8.5
Emirates NBD	Emirates UH	Buy	8.0	10.3	28	12,090	7.5	6.6	27.1	13.3	1.4	1.2	15.2	15.7	5.6	6.3
First Gulf	FGB UH	Buy	12.1	14.4	20	14,764	9.7	9.4	-11.4	3.6	1.7	1.6	18.0	17.7	7.9	8.3
Nat. Bnk Abu Dhabi	NBAD UH	Hold	8.3	9.2	12	11,702	8.0	7.3	-10.0	10.5	1.2	1.0	15.0	15.0	4.8	5.2

Source: Bloomberg, ADCB Securities Equity Research Estimates.

Note: Prices as of market close 7 December 2015.

Fig. 2. Investment thesis

	Rating	Investment thesis	Upside case	Downside case
DIB	Buy, TP AED7.8	- Strong growth outlook. - Unique business model with balanced mix of corporate and high yield book. - Well positioned to capitalize on Dubai's vision of becoming the global capital of Islamic economy.	- Higher than expected loan book growth (with credit costs maintained at current levels). - Sustained asset quality improvements.	- Risk of prolonged oil price decline may dampen the bank's growth objective. - Margin compression due to intensified competition, particularly in retail loans, which is one of its key focus area.
ENBD	Buy, TP AED10.3	- Emerging from a period where its profitability was below potential. - Earnings growth to be healthy aided by strong liability franchise and improving asset quality. - Continued to maintain sustainable position in capital markets and asset management businesses.	- Sharper moderation in credit cycle. - Material reduction in concentration risks. - NIM upside given its high proportion of CASA ratio.	- Lower than expected book growth as it run off its exposure to the government of Dubai. - Higher than expected credit losses, particularly in the event of failure of Dubai megaprojects.
FGB	Buy, TP AED14.4	- Track record of consistent performance supported by strong board and management team. - Strong asset franchise with dominant position in both Abu Dhabi corporate and retail segments that has proven to be less risky. - Strongest pre-provision profitability among our coverage banks, providing it a strong loss absorbing cushion.	- Higher than expected book growth led by a more positive macro or growth environment.	- Given its proximity to Abu Dhabi, lower oil price may have a negative impact on growth and profitability. - Given its wholesale funding profile, margins compression can be higher in a rising interest rate environment.
NBAD	Hold, TP AED9.2	- Bank's valuation multiple is constrained by its weak profitability. - Its pre-provisioning profitability is the lowest among its peers. - Earnings to remain subdued as we expect pressure on both revenue and cost to continue.	- Pick-up in fee income growth. Bank has been investing in this area. - Faster growth in retail book - an area which has been of less focus in the past.	- Income growth not keeping up pace with cost growth as it builds up its franchise due to slower than expected economic growth.

Source: ADCB Securities Equity Research.

For full report, please contact the author of the report.

Thank you!