

28 October 2010

Abu Dhabi Comm Bank

Hold

Target price
Dh2.32 (from Dh2.00)

Price
Dh2.49

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	2.20	1.68	2.10
Absolute (%)	13.2	48.2	18.6
Rel market (%)	5.7	34.2	32.9
Rel sector (%)	8.6	31.6	28.2



Market capitalisation
Dh13.93bn (€2.74bn)

Average (12M) daily turnover
Dh3.51m (US\$0.93m)

Sector: ADX Bank & Fin Index
RIC: ADCB.AD, ADCB UH
Priced Dh2.49 at close 27 Oct 2010.
Source: Bloomberg

Analyst

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Looks fully valued

ADCB's share price has risen 64% since the beginning of 3Q10 (vs +12% for the ADX General Index) on the back of its balance-sheet clean-up. With the 3Q results providing little in the way of sustainable positive surprises, in our view, this does not seem justified.

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Reported PTP (Dhm)	1,530	-356	292.2 ▼	1,971 ▼	2,555
Reported net profit (Dhm)	1,237	-559	163.8 ▲	1,899	2,511
Reported EPS (Dh)	0.26	-0.09	0.00	0.30	0.41
Normalised EPS (Dh)	0.26	-0.09	0.00	0.30	0.41
Dividend per share (Dh)	0.10	0.00	0.12	0.12	0.22
Normalised PE (x)	9.43	n/m	535.0	8.25	6.14
Price/book value (x)	0.91	0.93	0.93	0.86	0.80
Dividend yield (%)	4.02	0.00	4.94	5.01	8.71
Return on avg equity (%)	9.43	-3.69	1.09 ▲	12.20	14.90

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
Accounting standard: IFRS
Source: Company data, Rasmala forecasts

year to Dec, fully diluted

Results ahead of our forecasts, but lacking traction

ADCB's headline earnings have struggled back into positive territory on a ytd basis, thanks chiefly to derivative and foreign exchange dealing income. On a quarterly basis, this resulted in 3Q10 headline earnings and attributable income beating our forecasts by 56% and 40%, respectively.

Strong revenues offset by higher costs

The main cause of the earnings beat in 3Q was non-interest income, which benefited from strong, one-off trading-related earnings. In addition, fees & commissions were up 39% qoq and 32% ahead of our forecast, driven by corporate banking fees, which may also not be sustainable. On the other hand, cost inflation of 21% yoy and 7% qoq was disappointing, in spite of the likelihood that some of this relates to investment costs. The cost-to-income ratio, which we calculate at 39.1% ytd, is well above the UAE sector average.

Balance-sheet stabilisation continues

We believe the primary cause of the stock's recent re-rating is the recent quality improvements in the balance sheet, where the numbers were more or less in line with our expectations, although deposit growth beat our estimates by 1ppt. In addition, the loan-to-deposit ratio is continuing to decline and the reliance on wholesale funding is shrinking. With this in mind and the return to profitability on the income statement, we apply a 100bp reduction to our discount rate.

Upgrading our target price, but the stock re-rating has run its course, we believe

In addition to operational adjustments, we also lower our discount rate by 59bp to reflect the recent decline in the US 10-year bond yield. Combined, this results in our target price rising 16% to Dh2.32 from Dh2.00. We maintain our Hold rating on the stock, with 7% downside potential, but consider it to be overvalued relative to its UAE peers in our coverage.

Important disclosures can be found in the Disclosures Appendix.

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Strong results, but sustainable?

Headline and attributable earnings in 3Q10 were ahead of our expectations and, with positive revaluation gains, this also flowed through to the bottom line. The earnings surprise was largely driven by net gains from dealing in derivatives and foreign currencies.

Revenues ahead, but not on high quality

The main positive variances on revenue were in net gains from dealing in derivatives and foreign currencies, which rose fivefold qoq and more than threefold yoy. This was a trend we did not see reflected in balance-sheet volumes and we presume is due not to client flows but to active position-taking – and we expect the trend to reverse in 4Q10. Fees & commissions were also up strongly, thanks to a 79% increase in corporate banking fees, which we regard as probably partially one-off in nature.

On the negative side, net interest income was down 2% qoq and missed our expectations by 8%, although to be fair 5ppt of this was the result of moving Dh49m of interest expense from shareholder funds to the income statement. The rest was due to some disappointment in spreads/margins.

Table 1 : 3Q10 results comparison

Dh m	3Q09A	2Q10A	3Q10A	3Q10F	yoy	qoq	vs Est
Balance sheet							
Loans & Islamic financing	116,703	118,757	120,343	119,776	3%	1%	0%
Financial instruments	4,536	7,235	8,311	7,297	83%	15%	14%
Total assets	158,626	166,599	175,867	170,721	11%	6%	3%
Customer deposits & Islamic funding	83,504	96,831	100,623	100,013	21%	4%	1%
Capital market liabilities	37,898	32,414	31,949	32,414	-16%	-1%	-1%
Total liabilities	138,476	147,860	156,611	151,654	13%	6%	3%
Net liquid assets	10,808	12,380	11,257	12,250			
Shareholders' equity	20,151	18,740	19,257	19,067	-4%	3%	1%
Income statement							
Net interest & Islamic returns	861	923	903	982	5%	-2%	-8%
Core non-interest	330	266	480	278	46%	80%	73%
Non-core non-interest	(85)	(247)	(51)	-	-39%	-79%	
Total non-interest Income	245	19	429	278	75%	2156%	54%
Total banking income	1,106	942	1,331	1,260	20%	41%	6%
Total operating expenses	(389)	(439)	(470)	(434)	21%	7%	8%
Provisioning	(708)	(1,098)	(609)	(624)	-14%	-44%	-2%
Profit before tax	83	(508)	351	289	325%	-169%	21%
Tax, minorities & appropriations	(130)	4	(129)	(130)	-1%	-3267%	-1%
Attributable income	(47)	(504)	223	159	-572%	-144%	40%
Headline net income	35	(527)	318	204	814%	-160%	56%
Comprehensive income	203	(435)	454	159	124%	-204%	185%

Source: Company data, Rasmala forecasts

Expenses also generally higher, but plateauing NPLs undershoot our estimates

Expenses have been rising throughout the year, and in 3Q10, staff and other operating costs rose 9% and 5% qoq from already sharply increased numbers. The cost-to-income ratio remained stubbornly high at 35.3%, in spite of one-off revenues. This partly reflects ADCB's greater retail exposure, but another possibility is that it may be building capacity for future growth.

Provisions were down sharply qoq, after the 2Q10 results were impacted by early Dubai World provisioning, beating our expectations by just 2%. More positively, although NPLs rose 5% yoy, they undershot our expectations by 8%, potentially suggesting that ADCB's loan book may peak earlier than the sector average. We believe retail loans account for a high proportion of ADCB's NPL portfolio and, based on comments made by other UAE banks, the retail book looks to be past the worst.

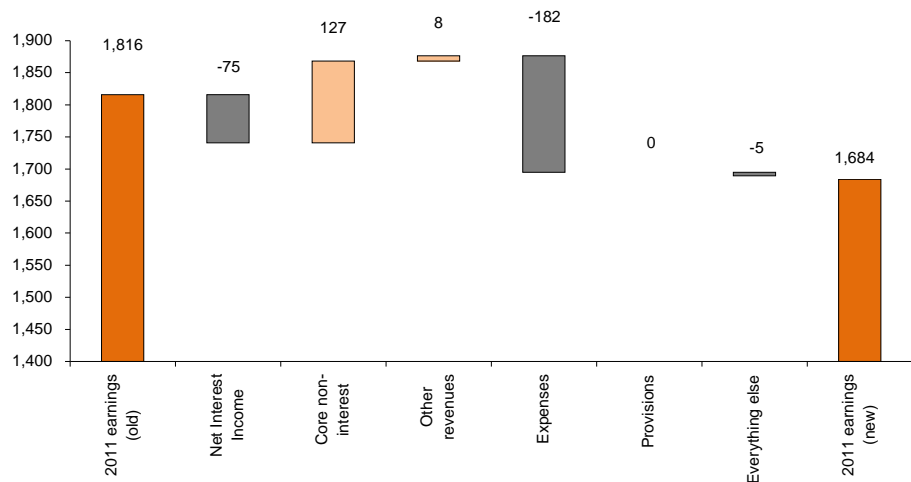
Balance-sheet rebalancing remains on target

Loan growth and deposit growth were both in positive territory and fractionally ahead of our expectations, the latter by 1ppt. Balance-sheet rebalancing continues, with deposit growth exceeding loan growth, allowing the loan-to-deposit ratio to fall to 120% from 123% in 2Q10. The total amount of capital market liabilities remains high at 18% of the balance sheet, but this is now within the norms for the sector and down from 24% as at year-end 2009. We continue to expect ADCB's focus to be on raising deposits, if necessary high-cost deposits, to ease the wholesale funding squeeze and bring the loan-to-deposit ratio further into balance.

Adjusting forecasts downwards

We adjust our forecasts generally downwards following the 3Q10 results, with the key changes being lower net interest income (we now believe we were giving ADCB too much credit for the conversion of the mandatory convertible securities) and higher costs, particularly in the near term. Offsetting this we raise our non-interest income expectations.

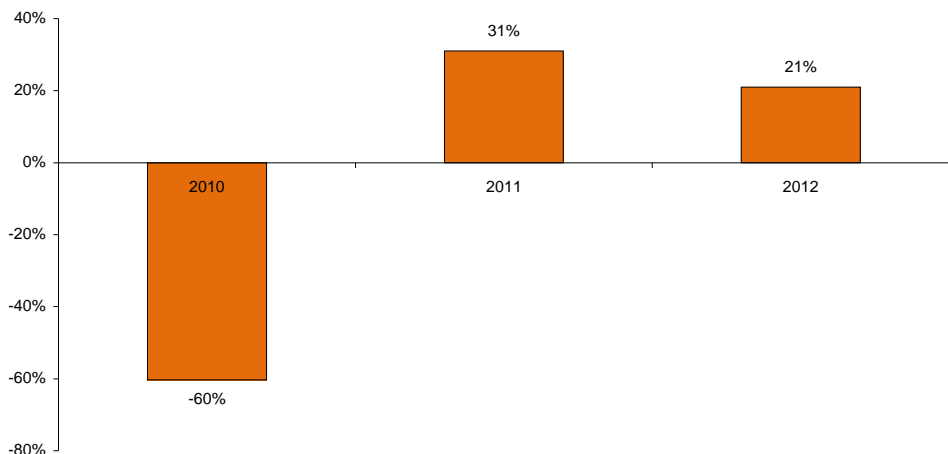
Chart 1 : Forecast revisions for attributable income, ADCB, 2011F (Dhm)



Source: Rasmala forecasts

Our forecasts for ADCB's headline net profit continue to stand at a premium to the Zawya consensus, with both being largely unchanged over the last month. For headline net profit, our downward revision has been considerably smaller than for adjusted attributable income, due to the technicalities of accounting for the conversion of the mandatory convertible securities on 1 April 2011.

Chart 2 : Rasmala forecasts versus Zawya consensus



Source: Zawya, Rasmala forecasts

Downgrading forecasts and raising target price

Our forecast downgrades are significantly aimed at more accurately reflecting the dilution of the upcoming conversion of the mandatory convertible securities. They also reflect the likelihood that if the higher costs are maintained, this will unquestionably weigh on net profit.

Nevertheless, we believe ADCB has done a good job of cleaning up its balance sheet. Although provisions for CDSs continue, we expect these to be of diminishing significance going forward. In addition, our concerns over the bank's Malaysian associate RHB Capital Berhad have eased. As a result of this, we have lowered our stock risk premium from 4.5% to 3.5%, slightly above the sector average. We believe further declines in our discount rate will be contingent on increased clarity on earnings recovery and improved communication policies. We also trim our discount rate to reflect declines in the US 10-year bond yield.

However, we continue to believe that ADCB's share price has risen too far and too fast. The stock has now risen 64% since the beginning of 3Q10 (vs +12% for the ADX General Index), which we believe is largely based on the bank's decision to aggressively clean up its balance sheet. Nevertheless, we believe ADCB has an erratic communication policy, which makes reliable long-term earnings projections challenging, and we see little evidence so far that the bank can maintain a premium return on equity.

We view the stock as remaining overvalued relative to its UAE peers in our coverage, with 7% downside potential to our target price of Dh2.32, and we reiterate our Hold rating on the stock. We believe a higher rating is contingent on improved communication with the market, as well as improved earnings visibility. Our rating assumes an extrapolation of recent positive trends, but should results going forward fall short of these, we would likely revisit our recommendation.

Income statement

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Net interest income	2649	3429	3640	3939	4313
Non-interest income	998.4	498.8	968.1	1474	1678
Total income	3647	3928	4608	5413	5991
Operating costs	-1530	-1539	-1793	-1894	-2097
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
Other costs	0.00	0.00	0.00	0.00	0.00
<u>Pre-prov operating profit</u>	2117	2389	2815	3518	3894
Provisions charges	-758.4	-2968	-2900	-1901	-1711
<u>Post-prov op prof</u>	1359	-579.4	-85.0	1617	2184
Associates (pre-tax)	171.6	223.2	377.2	353.7	371.4
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	1530	-356.3	292.2	1971	2555
Taxation	-8.52	-3.23	-2.73	-18.4	-23.9
Minority interests	-121.9	-46.6	-20.1	-20.1	-20.1
Preference dividends	0.00	-120.0	-243.3	-243.3	-243.3
Other post-tax items	-163.4	-33.3	137.8	210.0	243.3
Reported net profit	1237	-559.4	163.8	1899	2511
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised PTP	1530	-356.3	292.2	1971	2555
Normalised net profit	1237	-559.4	163.8	1899	2511

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Net loans to customers	108813	116610	120622	129775	142815
Other int earn assets	20951	22722	27436	26942	29649
Goodwill	0.00	0.00	0.00	0.00	0.00
Oth non-int earn assets	13421	16188	22928	22970	27043
Total assets	147728	160209	176465	185546	205905
Total customer deposits	84361	86300	102529	114202	129962
Oth int-bearing liabs	37640	42389	36600	32042	33596
Non int-bearing liab	10293	12430	18227	18983	20722
Total liabilities	132294	141119	157355	165227	184280
Share capital	15327	15021	15021	16223	17521
Reserves	0.00	0.00	0.00	0.00	0.00
Total equity (excl min)	15327	19021	19021	20223	21521
Minority interests	107.6	69.1	89.3	96.4	104.1
Total liab & sh equity	147728	160209	176465	185546	205905
Risk weighted assets	130552	143476	0.00	0.00	0.00
Est non-perf loans	n/a	n/a	n/a	n/a	n/a
Specific provisions	-2258	-4232	-6108	-7093	-7740
General provisions	n/a	n/a	n/a	n/a	n/a

Source: Company data, Rasmala forecasts

year ended Dec

Capital

Dhm	FY08A	FY09A	FY10F	FY11F	FY12F
Risk weighted assets	130552	143476	0.00	0.00	0.00
Reported net profit	1237	-559.4	163.8	1899	2511
Opening risk assets	95685	130552	143476	0.00	0.00
Closing risk assets	130552	143476	0.00	0.00	0.00
Change in risk assets	34867	12924	-143476	0.00	0.00
Capital required	3487	1422	-15782	0.00	0.00
Free capital flow	-2250	-1861	16189	2143	2754
Ordinary dividend paid	-481.0	0.00	-591.7	-697.5	-1213
Share buy back/spec div	0.00	0.00	0.00	0.00	0.00
Equity / preference issue	4608	12.3	21.6	0.00	0.00
Cash flow from financing	4127	12.3	-570.0	-697.5	-1213
Net capital flow	1877	-1849	15619	1445	1541
Tier 1 capital	14185	17102	15732	16663	17669
Tier 1 capital ratio (%)	10.9	11.9	0.00	0.00	0.00

Source: Company data, Rasmala forecasts

year to Dec

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Abu Dhabi Comm Bank (RIC: ADCB.AD, Rec: Hold, CP: Dh2.49, TP: Dh2.32): We believe the main risk to our GGM-derived target price is increased provisioning as regulations tighten. In addition, we have concerns about ADCB's weak communication policy, which continues to be below the market standard. On the positive side, a swift turnaround of investment income and resolution of its pending exposures to US markets should provide some upside, as would generally increased transparency levels.

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