



UAE Banking Pulse

Quarter 3, 2019

FOREWORD

Alvarez & Marsal Middle East Limited (A&M) is delighted to publish the Q3'19 edition of the UAE Banking Pulse (“The Pulse”). In this quarterly series, we share results from our research examining the top ten largest listed UAE banks by assets, and highlight key performance indicators of the UAE banking industry. The Pulse aims to help banking executives and board members stay current on industry trends.

All the data used in this report has been obtained from publicly available sources and the methodology for the calculations is discussed in the glossary. Calculation of several metrics has been changed from the previous version to accommodate available information.

We hope that you will find the Pulse useful and informative.

Disclaimer:

The information contained in this document is of a general nature and has been obtained from publicly available information plus market insights. The information is not intended to address the specific circumstances of an individual or institution. There is no guarantee that the information is accurate at the date received by the recipient or that it will be accurate in the future. All parties should seek appropriate professional advice to analyze their particular situation before acting on any of the information contained herein



Authors



Dr. Saeeda Jaffar

Lead Author, Managing Director

- 18+ years of international experience in management consulting and industry
- Focuses on strategic and performance-related matters in financial institutions, sovereign wealth funds, family businesses, real estate, private equity and private investments
- Emirati National, frequent speaker and moderator in Banking & Finance events
- Board member of the Bahrain Fintech Bay



Asad Ahmed

Co-Author, Managing Director

- 30+ years of experience in banking
- Focuses on performance improvement, turn-around, credit management, and formulating and managing strategic and operational changes in financial institutions
- Expertise in Financial Inclusion and creation of digital wholesale and retail banks
- Former CEO of banks in the UAE & Kenya
- Served on the governing council of the Kenyan Bankers' Association



Neil Hayward

Co-Author, Managing Director

- 18+ years experience in turnaround and restructuring in the Middle East, Europe as well as the U.S.
- Focuses on financial services and is an expert in restructuring both conventional finance and Islamic finance facilities
- Advises financially distressed companies including playing a major role as a board member

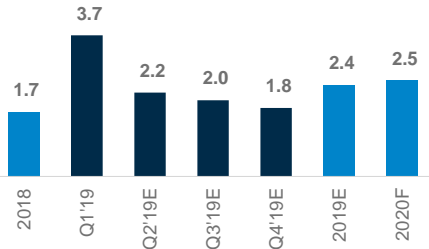
**CONTACT
DETAILS**

financialservices-me@alvarezandmarsal.com
Phone: +97145671065

UAE Macro & Sector Overview

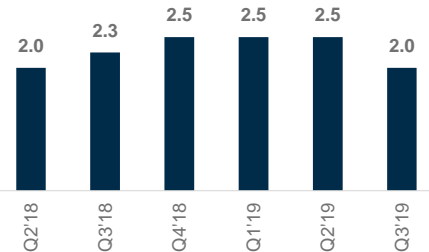
Macro overview

UAE GDP Growth Rate¹, %



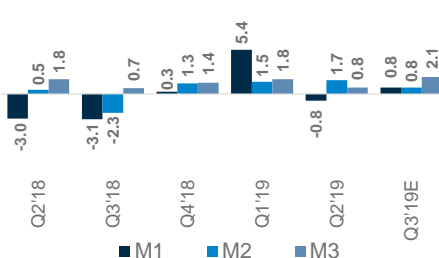
- In Q3'19E GDP is expected to marginally decelerate to 2.0% YoY as oil production growth softened in the quarter although non-oil sector remained in growth territory, which was up by 1.8% YoY
- GDP is projected to grow by 2.4% in FY19 primarily driven by robust government spending and higher investment anticipated for Expo 2020
- The average Q3'19 Emirates NBD Purchasing Managers' Index (PMI) recorded low growth as private sector momentum slowed to nine year low in September'19

US Fed Funds Rate², %



- The US Federal Reserve reduced its funds rate by 25.0 bps in Oct'19, the third cut in 2019 following nine hikes since Dec'15
- The Fed reduced its benchmark interest rate by 50.0 bps to 2.0% in Sept'19
- The move was likely driven by fears of global economic slowdown, intensifying US-China trade tensions, and muted inflation

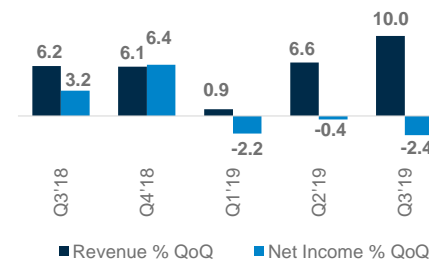
UAE Money Supply³ (% Quarterly)



- M2 registered an increase of 0.8% QoQ and 5.4% YoY in Q3'19
- The increase in M2 was primarily due to quarterly increase in non-government resident deposits by 0.9% YoY to AED 1,284.7bn
- M1 improved by 0.8% QoQ in Q3'19. On annual basis, M1 increased by 5.7% to AED 511.9bn

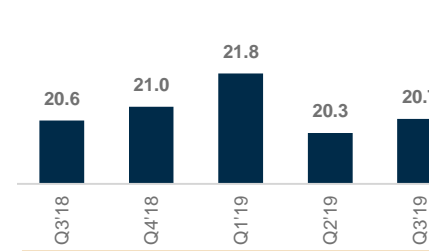
Banking overview Q3'19

UAE Bank's Profitability⁴, %



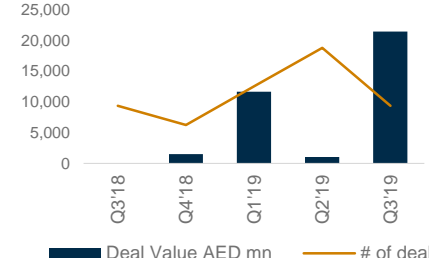
- The top ten UAE banks by assets reported a combined 25.5% YoY increase in top line during Q3'19
- The bottom-line was impacted adversely due to significant impairments reported by Emirates NBD (which was in turn due to the acquisition of DenizBank) and ADIB
- For rest of 2019, margins are likely to stay under pressure due to rate cut in Sept'19 and Oct'19
- Overall banking profitability was influenced by lower gross yields and higher net impairment charges during the quarter

Real Estate & Construction as % of Total Loans⁵



- The UAE banks' exposure to the real estate sector increased by ~40 bps in Q3'19, presenting a concentration risk
- The real estate sector continues to remain under pressure due to oversupply and weaker investment appetite amid muted oil economy and this may have lead to higher delinquencies for banks
- Government measures to boost demand in sector includes stimulus packages and proposed new initiative to allow foreigners to own freehold property in Abu Dhabi

UAE Banking M&A Deals⁶



- Only three M&A deals were proposed or completed during the quarter
- However, increasing move towards digitalization in order to gain market share and competition in building low-cost deposits may uptick the trend in M&A activity
- During Q3'19, Emirates NBD completed acquisition of Turkey's DenizBank to become the #2 bank in the country with AED 672bn worth of assets

¹ UAE Central Bank and IMF forecast, ² US Board of Federal Reserve, ³ UAE Central Bank, ⁴ Company filings, ENBD net income adjusted for one time gain of AED 2.0bn and AED 2.5bn from disposal of stake in jointly controlled entity during Q2'19 and Q3'19, ⁵ Bloomberg & A&M Analysis, ⁶ Bloomberg and A&M Analysis; * Data of top 10 UAE banks shortlisted on the basis of asset size as of September 30,2019

Pulse: Decrease in RoE and RoA as Pressure on Profitability Margins builds due to Interest Rate Cuts

→ Improved ← Stable → Worsened

	Metric	Q2'19	Q3'19	Q3'18	Q4'18	Q1'19	Q2'19	Q3'19	Key Trends of Q3'19
Size	Loans and Advances (L&A) Growth (QoQ)	7.5%	7.8%						1 The growth in L&A during Q3'19 was primarily driven due to consolidation of DenizBank with Emirates NBD
	Deposits Growth (QoQ)	8.5%	7.5%						
Liquidity	Loan-to-Deposit Ratio (LDR)	87.6%	87.9%						2 Excluding Emirates NBD impact, QoQ growth in L&A and Deposits are 1.6% and 1.5%, respectively
Income & Operating Efficiency	Operating Income Growth (QoQ)	4.4%	6.5%						3 The increase in operating income was mainly driven by Emirates NBD (+25.5%) as a result of the consolidation with DenizBank
	Operating Income / Assets	3.6%	3.5%						
	Non-Interest Income(NII) / Operating Income	31.4%	30.3%						
	Yield on Credit (YoC)	7.2%	7.4%						4 NIM improved marginally during the quarter
	Cost of Funds (CoF)	2.2%	2.3%						5 The C/I ratio worsened marginally by 72.1 bps due to lower operating income of coverage universe which was partially offset by Emirates NBD's consolidation with DenizBank
Net Interest Margin (NIM)	2.4%	2.5%							
Risk	Cost-to-Income Ratio (C/I)	32.8%	33.6%						6 The increase in CoR was driven by increase in allowance for impairments for Emirates NBD by 2.3x due to consolidation impact
	Coverage Ratio	113.2%	111.1%						
Profitability	Cost of Risk (CoR)	0.9%	1.0%						7 The RoE during Q3'19 declined by 1.2% as the net income margins were impacted due to two rounds of interest rate cuts
	Return on Equity (RoE)	14.7%	13.5%						
	Return on Assets (RoA)	1.9%	1.7%						
Capital	Return on Risk-Weighted Assets (RoRWA)	2.6%	2.4%						8 RoA declined by 16.5 bps due to lower profit margins. The CAR declined due to increase in risk weighted assets
	Capital Adequacy Ratio (CAR)	17.6%	17.2%						

Note 1: QoQ stand for quarter over quarter

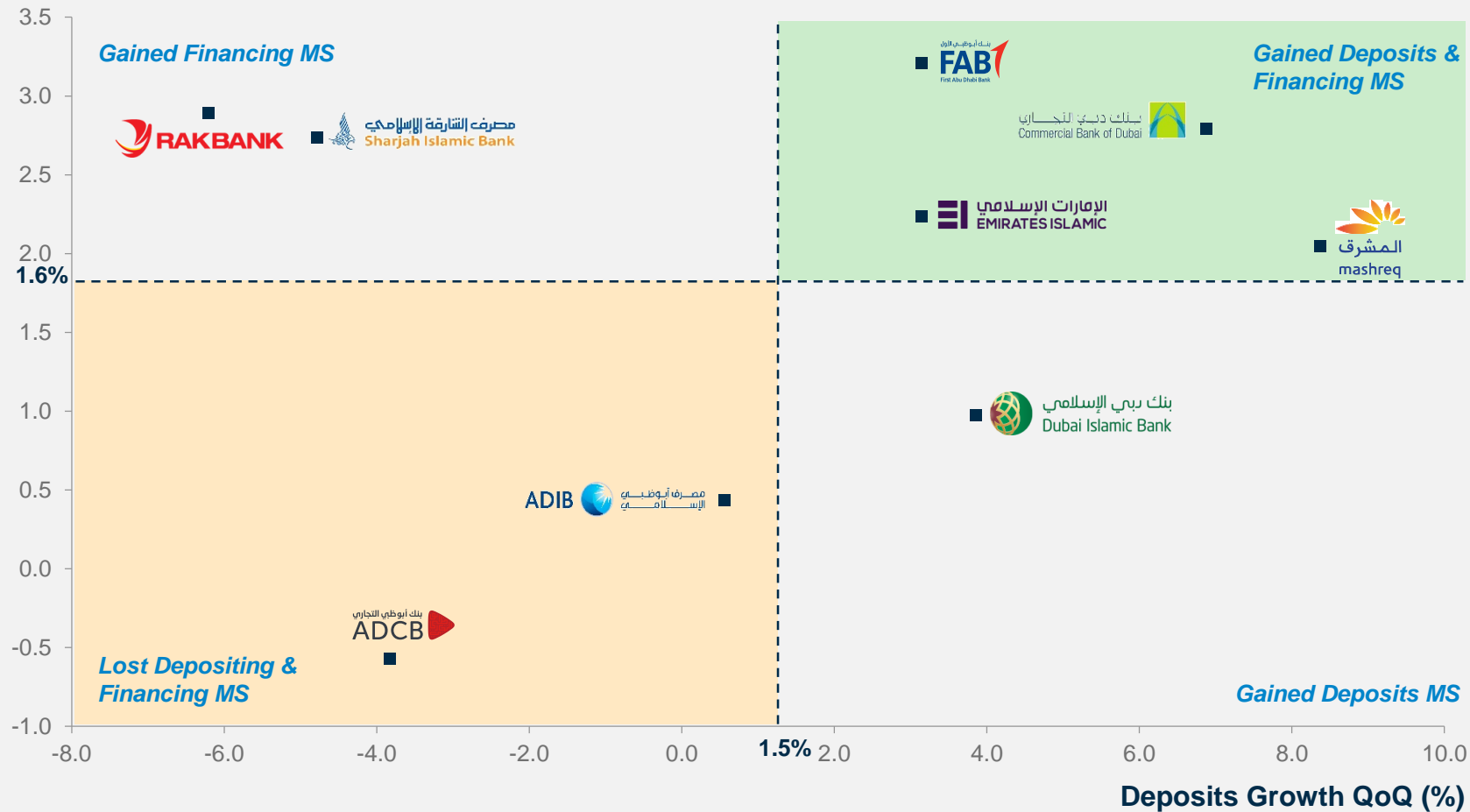
Note 2: Growth in loans & advances and deposits were presented QoQ instead of YoY

Note 3: Quarterly income was used in the calculation of operating income growth

Source: Financial statements, Investor presentations, A&M analysis

Overall Deposits Growth Declines Due to Increase in Competition

L&A Growth QoQ (%)



KEY TAKEAWAYS**

- Excluding Emirates NBD merger impact, banks QoQ growth in terms of L&A is 1.5% and deposits is 1.6%
- Mashreq Bank reported the highest deposits growth of 8.4%, while its L&A growth was 2.0% during the quarter
- RAK, SIB and ADCB deposit growth declined by 6.2%, 4.8%, and 3.8%, respectively. However, L&A growth increased for FAB, RAK and CBD by 3.2%, 2.9%, and 2.8%, respectively

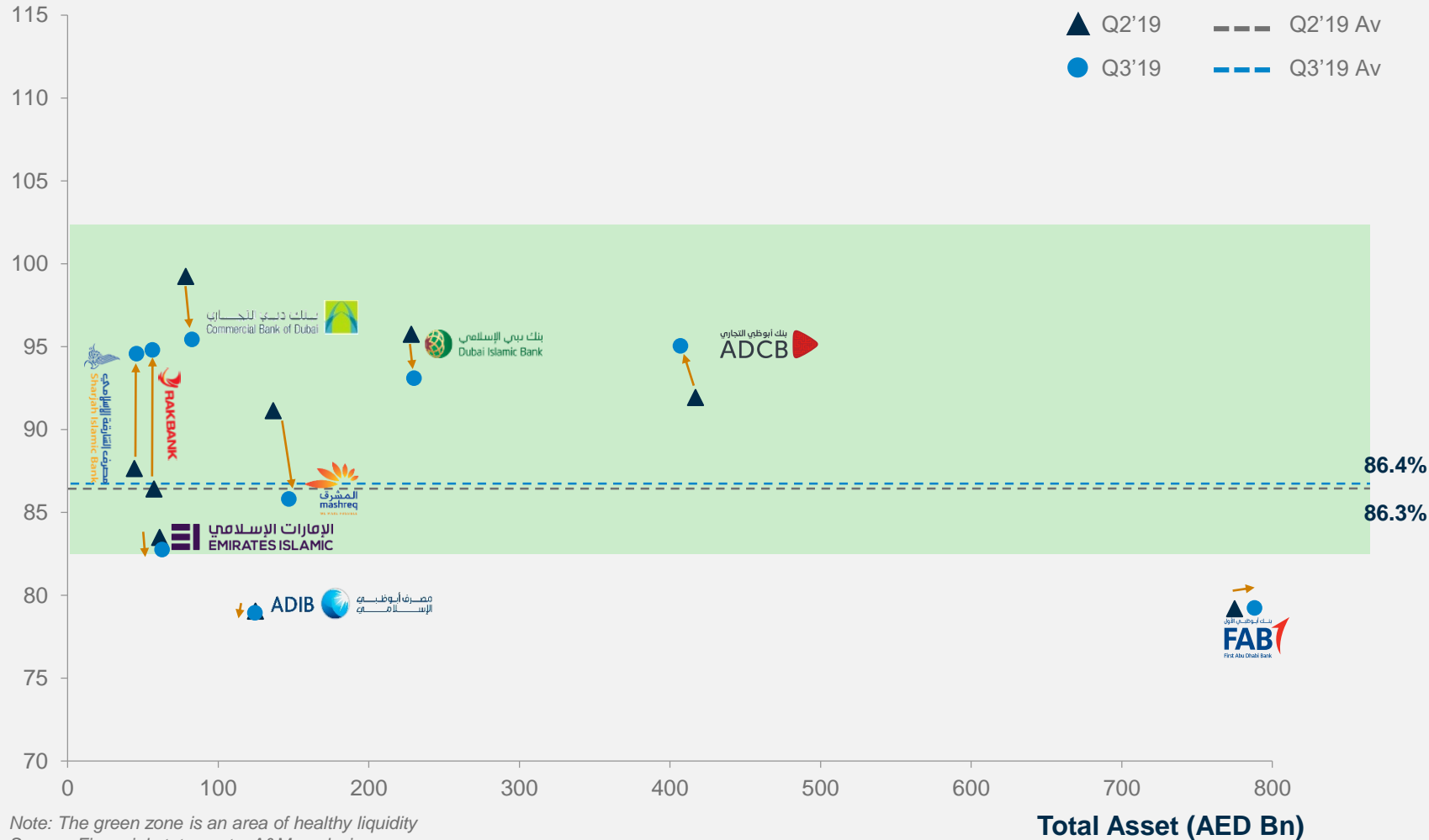
Note: MS stands for market share

Source: Financial statements, Investor presentations, A&M analysis

** Excluded Emirates NBD due to higher ratios driven by consolidation of Denizbank

LDR Stabilizes as Lower Policy Rates Unlikely to Lift Loan Demand

Loans to Deposits Ratio (%)



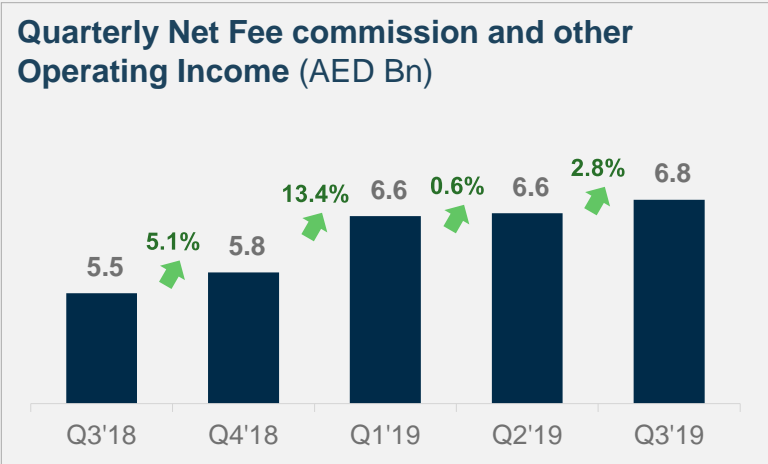
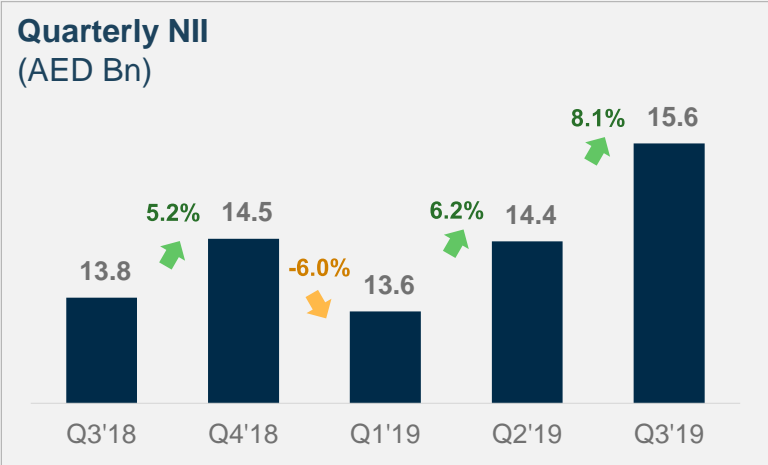
Note: The green zone is an area of healthy liquidity
 Source: Financial statements, A&M analysis
 ** Excluded Emirates NBD due to ratio driven by consolidation of DenizBank

KEY TAKEAWAYS**

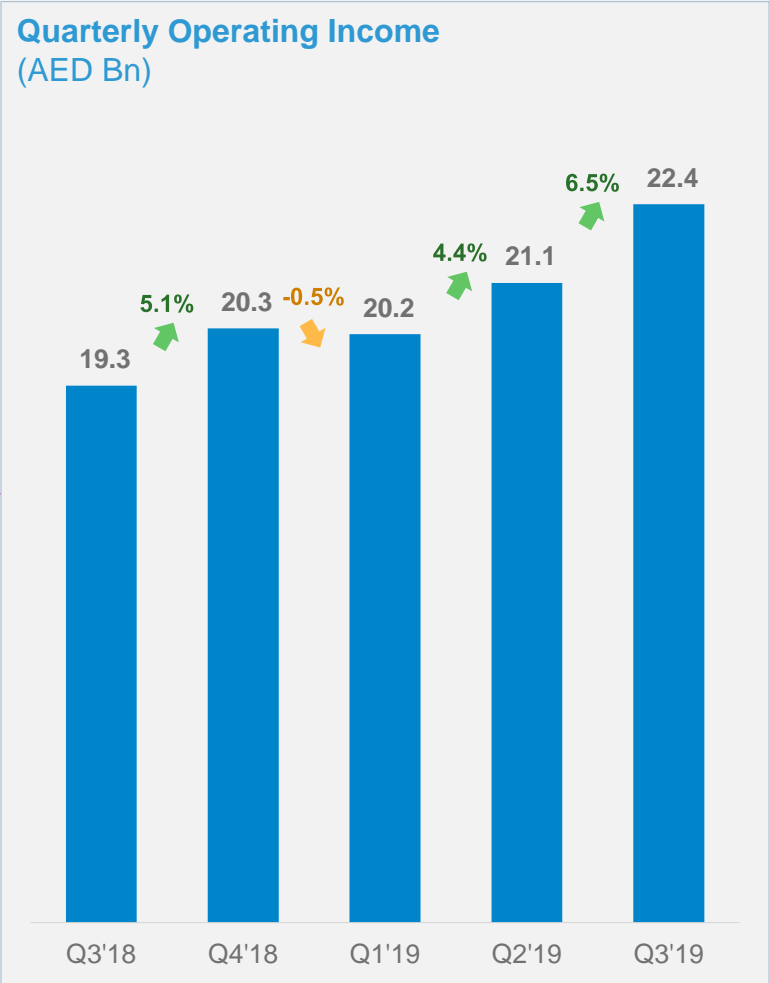
- Loans to Deposits Ratio (LDR) (excluding Emirates NBD) marginally increased to 86.4% in Q3'19 from 86.3% in Q2'19
- The LDR for RAK and SIB increased sharply to reach a range of 90%–100%, as these banks witnessed increase in L&A compared to decline in deposits

Operating Income is Driven up by Non-Interest Income

➔ Improved ↔ Stable ➡ Worsened



+

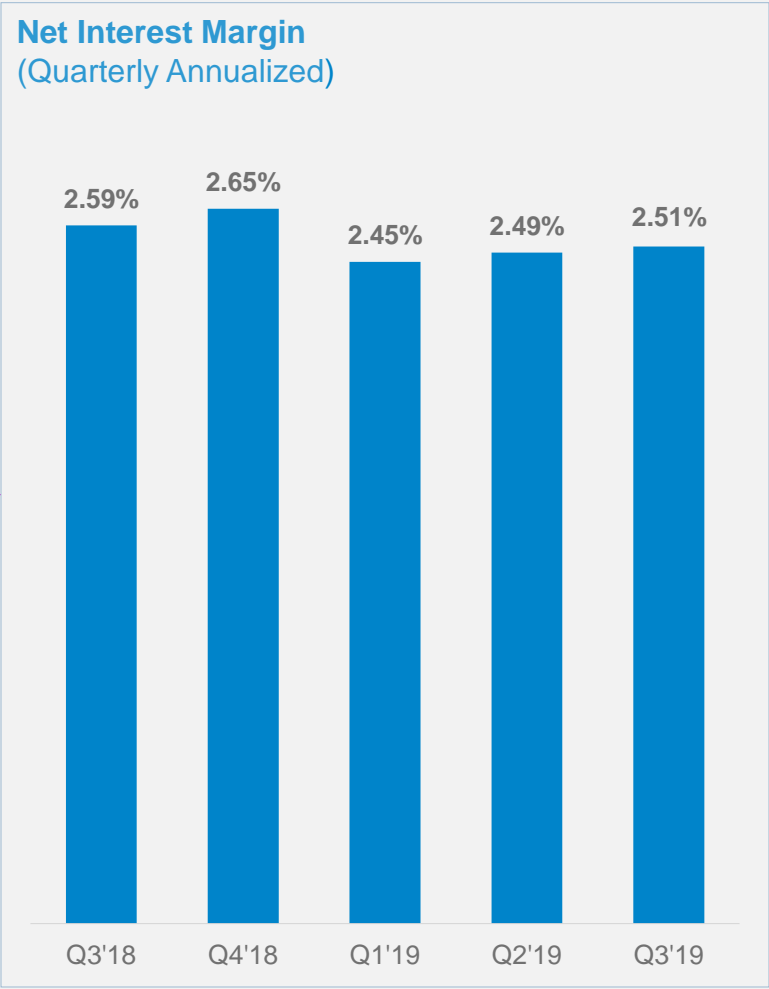
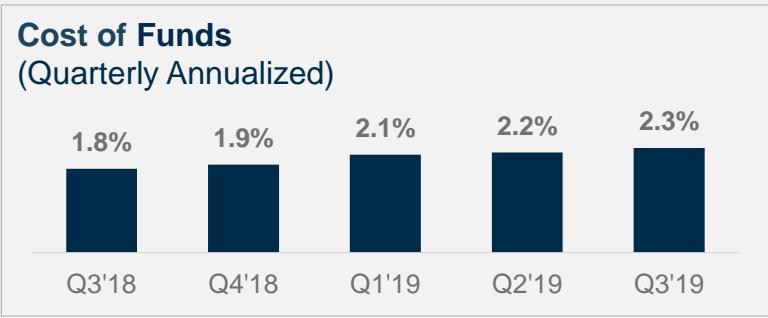
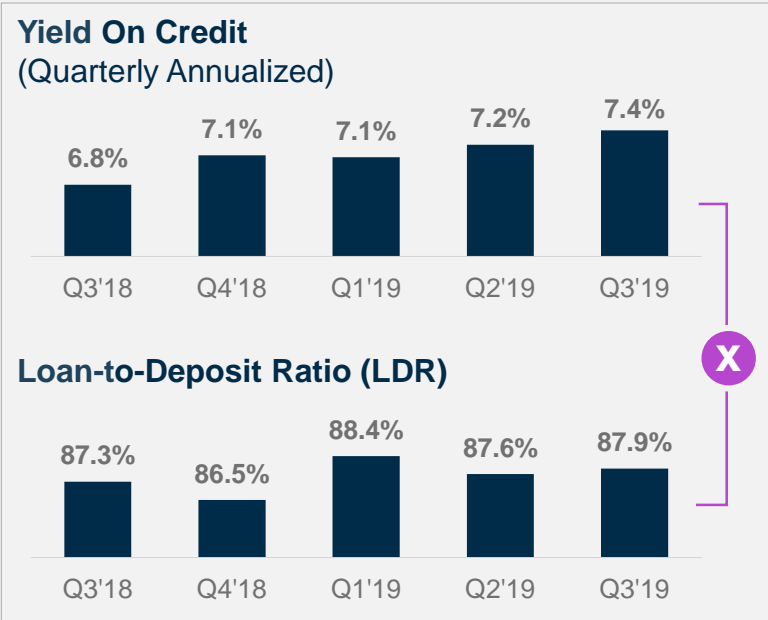


KEY TAKEAWAYS

- The 6.5% expansion in operating income was primarily driven by Emirates NBD which reported a 54.2% QoQ increase in net fee and commission income
- The increase in net fee and commission income of Emirates NBD was driven by consolidation of DenizBank in its Q3'19 earnings
- Excluding Emirates NBD's merger impact, the operating income increased marginally by 0.8%

Note: Some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

Marginal Improvement Trend in NIM Continues in Q3'19



KEY TAKEAWAYS

- NIM improved marginally by 2.3 bps during Q3'19 to 2.51% compared to 2.49% in Q2'19
- The marginal improvement in NIM was supported by stable L&A and increase in Yield on Credit
- The increasing competition for deposits continue to push up the cost of funds

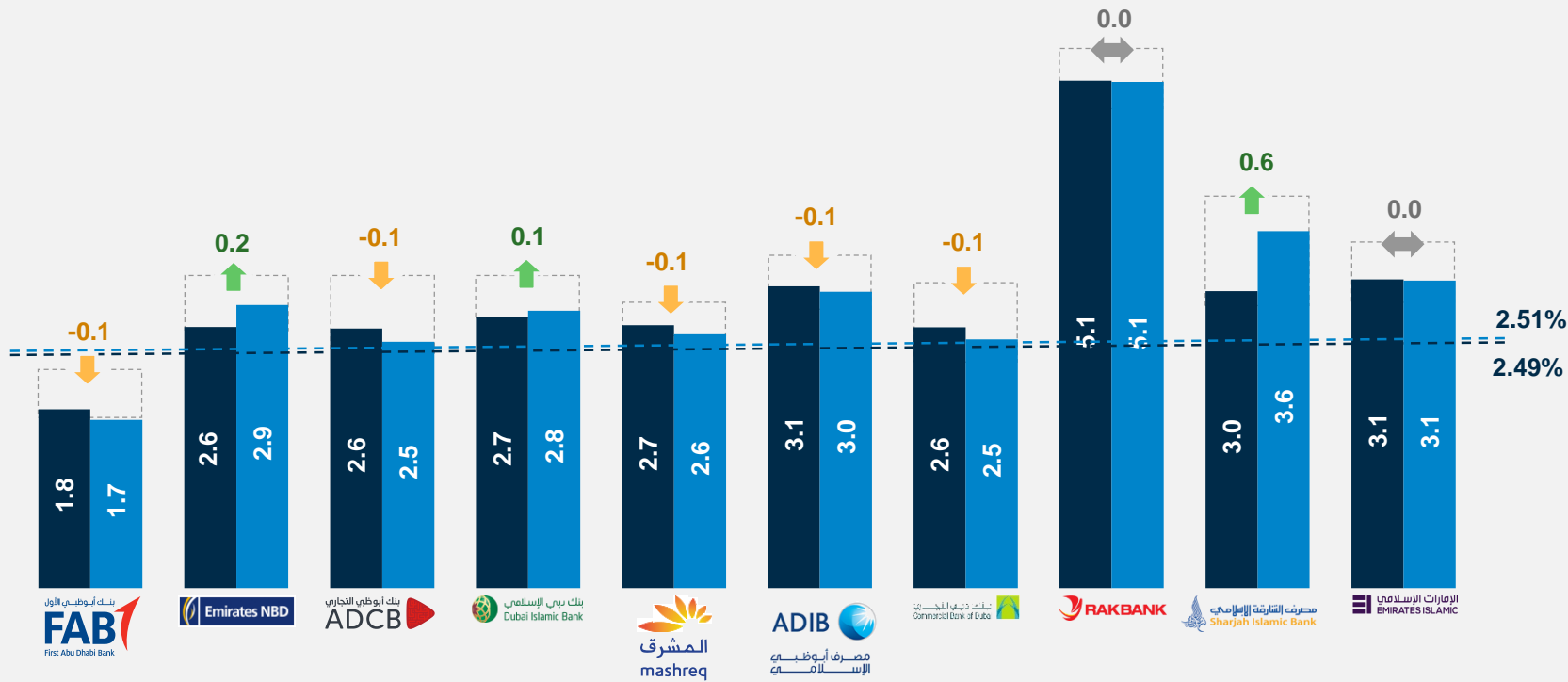
Note: Relation between elements above represents a functionality and not necessarily an exact mathematical formula
 Source: Financial statements, Investor presentations, A&M analysis

Mixed Trend Seen in NIM for the Coverage Universe

➔ Improved ↔ Stable ➔ Worsened

Net Interest Margin (% Quarterly)

■ Q2'19 ■ Q3'19 - - - Q2'19 Av - - - Q3'19 Av



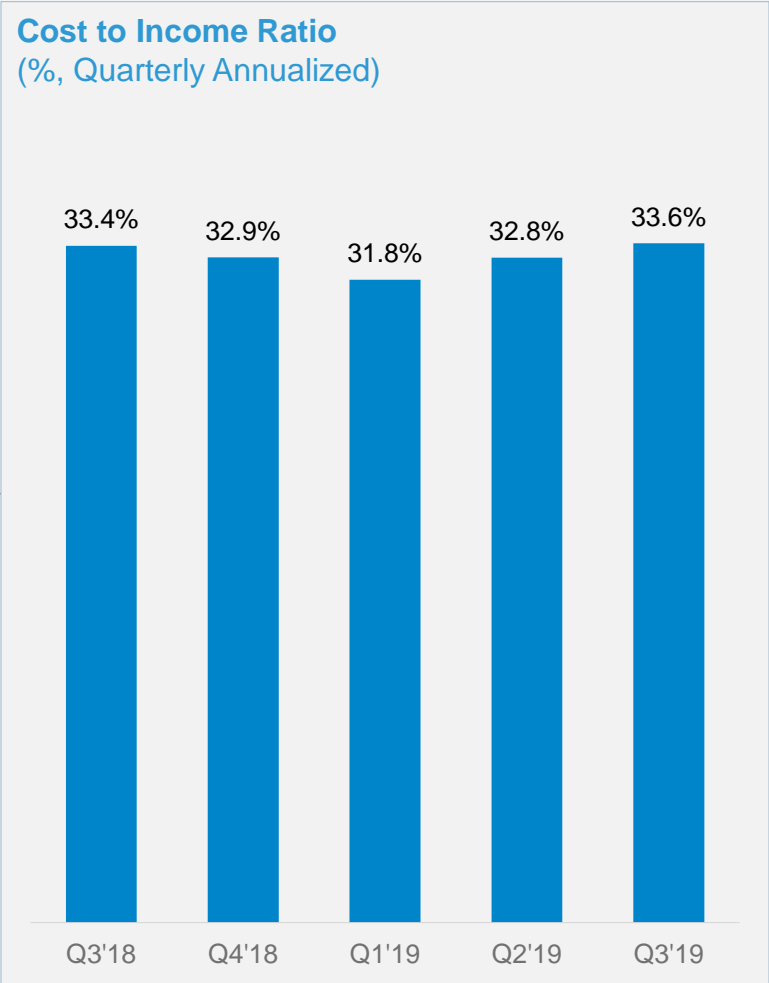
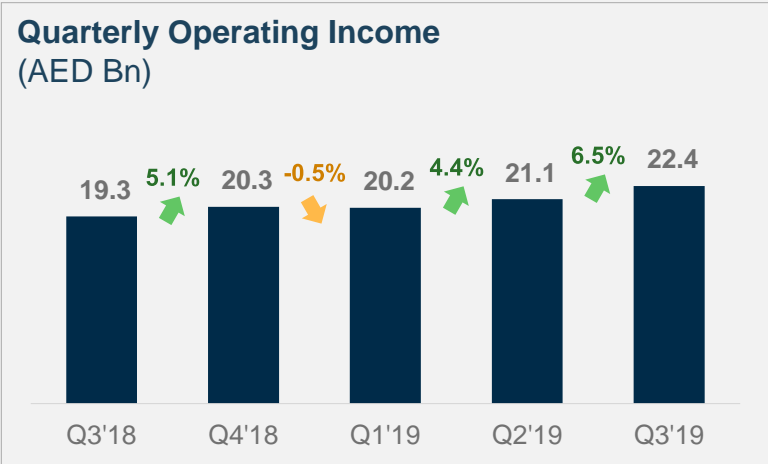
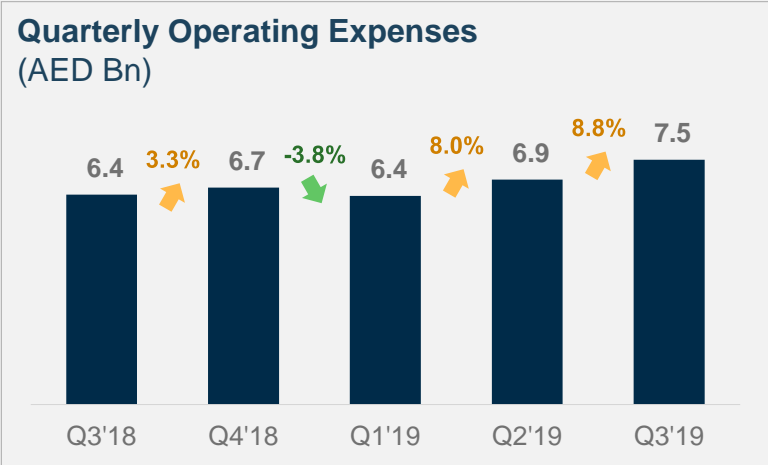
KEY TAKEAWAYS

- Three banks observed an improvement and two banks witnessed stability in NIM during the quarter
- SIB, ENBD, and DIB showcased improvement in NIM by 0.6%, 0.2%, and 0.1%, respectively during Q3'19
- The improvement in NIM of Emirates NBD was due to the positive impact of DenizBank consolidation
- RAK and EIB had stable ratio compared with Q2'19

Note: Some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

C/I Ratio Deteriorated for all the Coverage Banks

➔ Improved ↔ Stable ➔ Worsened



KEY TAKEAWAYS

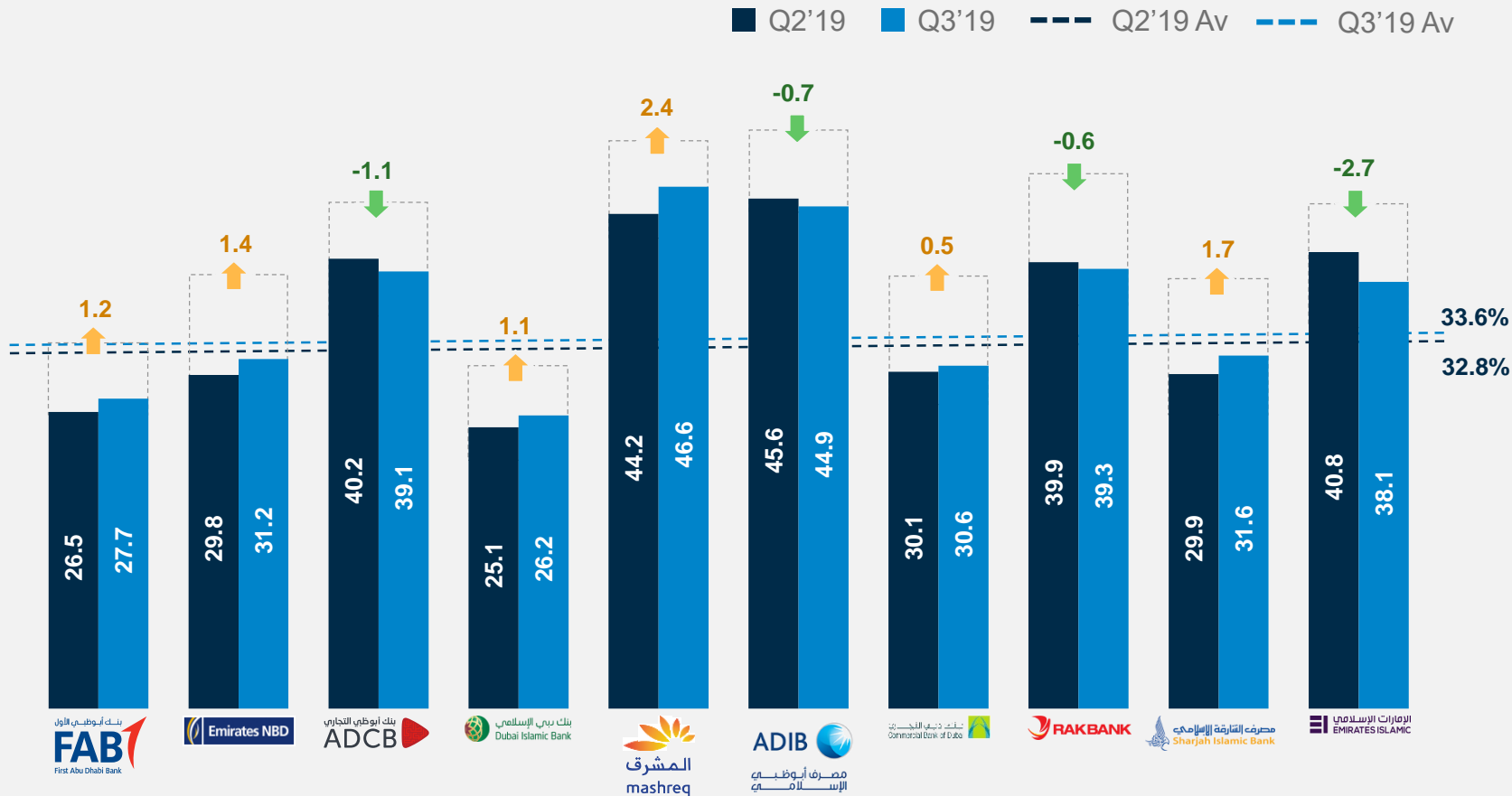
- The higher C/I ratio of the coverage universe was driven by higher operating expenses
- SG&A cost for Emirates NBD reported as 31.5% which marginally impacted the overall universe's total cost which in turn pushed up the C/I ratio
- Excluding Emirates NBD, C/I ratio was 34.4% in Q3'19 as compared to 33.7% in Q2'19

Note: Some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

4 Rise in Staff Cost moved up the SG&A Expenses for Most Banks

➔ Improved
 ↔ Stable
 ➔ Worsened

Cost to Income Ratio (% , Quarterly)



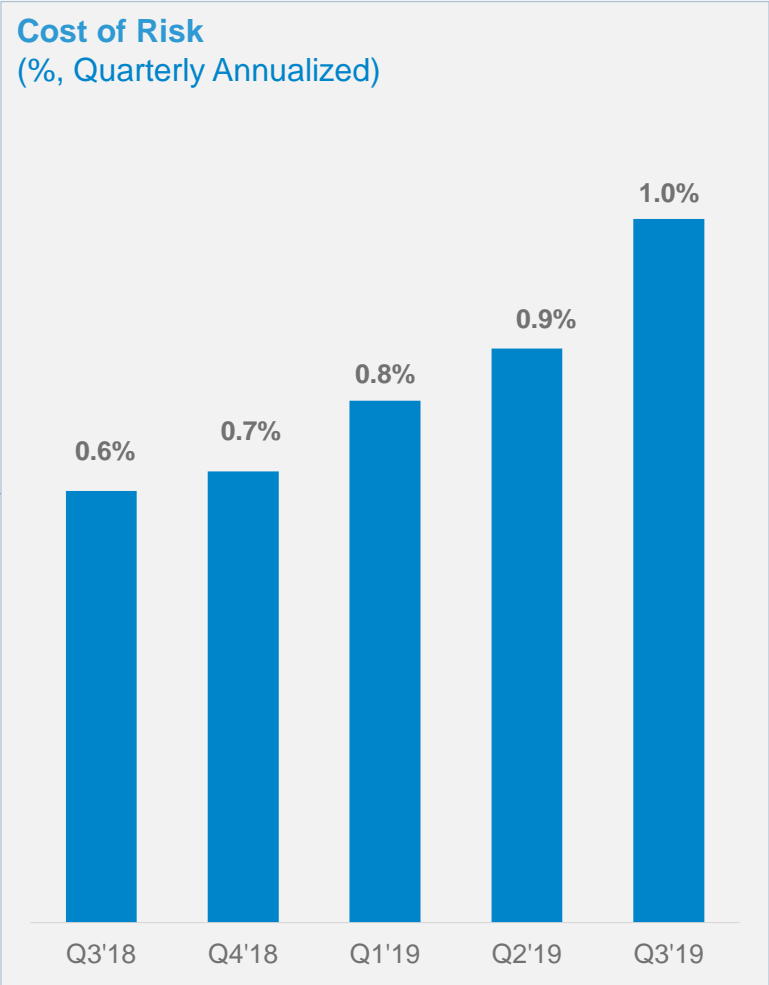
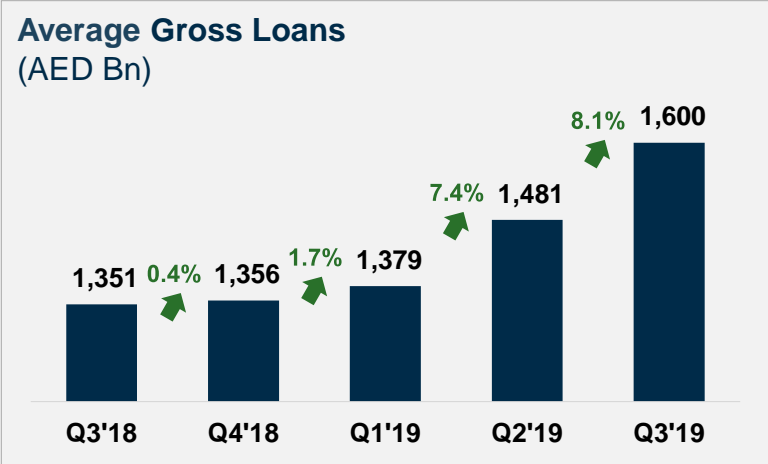
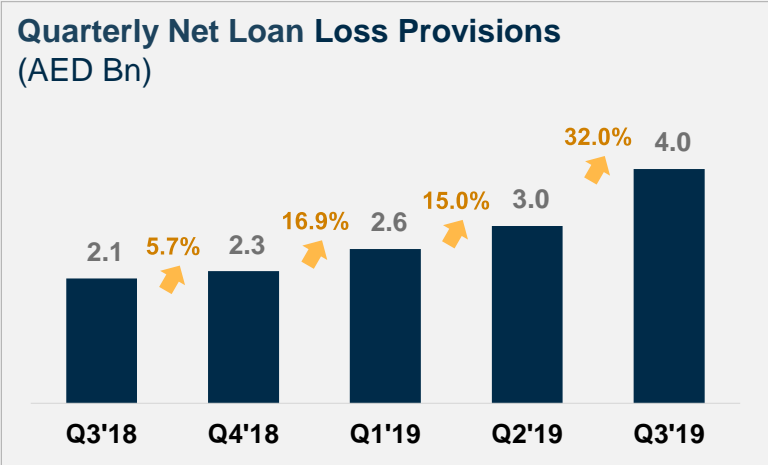
Note: Scaling and some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis
 *Comparison on QoQ basis

KEY TAKEAWAYS

- C/I ratio was higher* for six banks out of the total coverage universe
- Mashreq, SIB, and Emirates NBD witnessed the highest escalation in C/I ratio by 2.4%, 1.7%, and 1.4%, respectively
- The increase in Emirates NBD's C/I ratio was primarily driven by higher SG&A costs of 31.5% due to merger impact
- The C/I ratio improved for EIB, ADCB, ADIB, and RAK by 2.7%, 1.1%, 0.7%, and 0.6%, respectively

Cost of Risk Increased due to Increase in Net Loan Loss Provisions

➔ Improved ↔ Stable ➔ Worsened



KEY TAKEAWAYS

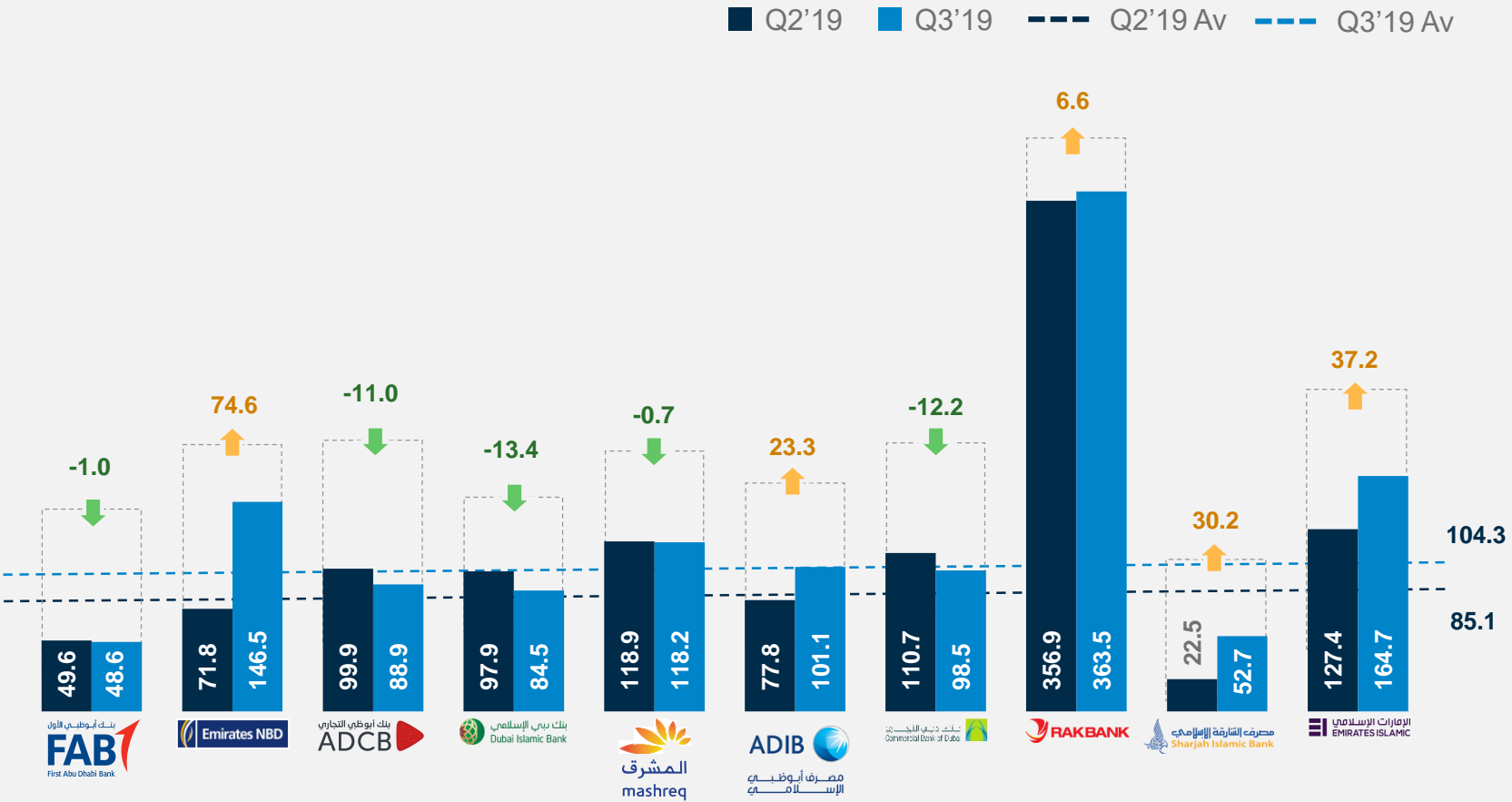
- The CoR was reported at 1.0% as the banks witnessed surge in their net loan loss provisions by 32.0% during Q3'19
- Increasing pressure in real-estate and construction sector amid softening oil economy likely to increase the CoR

Note: Scaling and some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

Cost of Risk Improved for Five of the Top Ten Banks

➔ Improved ↔ Stable ➔ Worsened

Cost of Risk (bps) – Net of Reversals



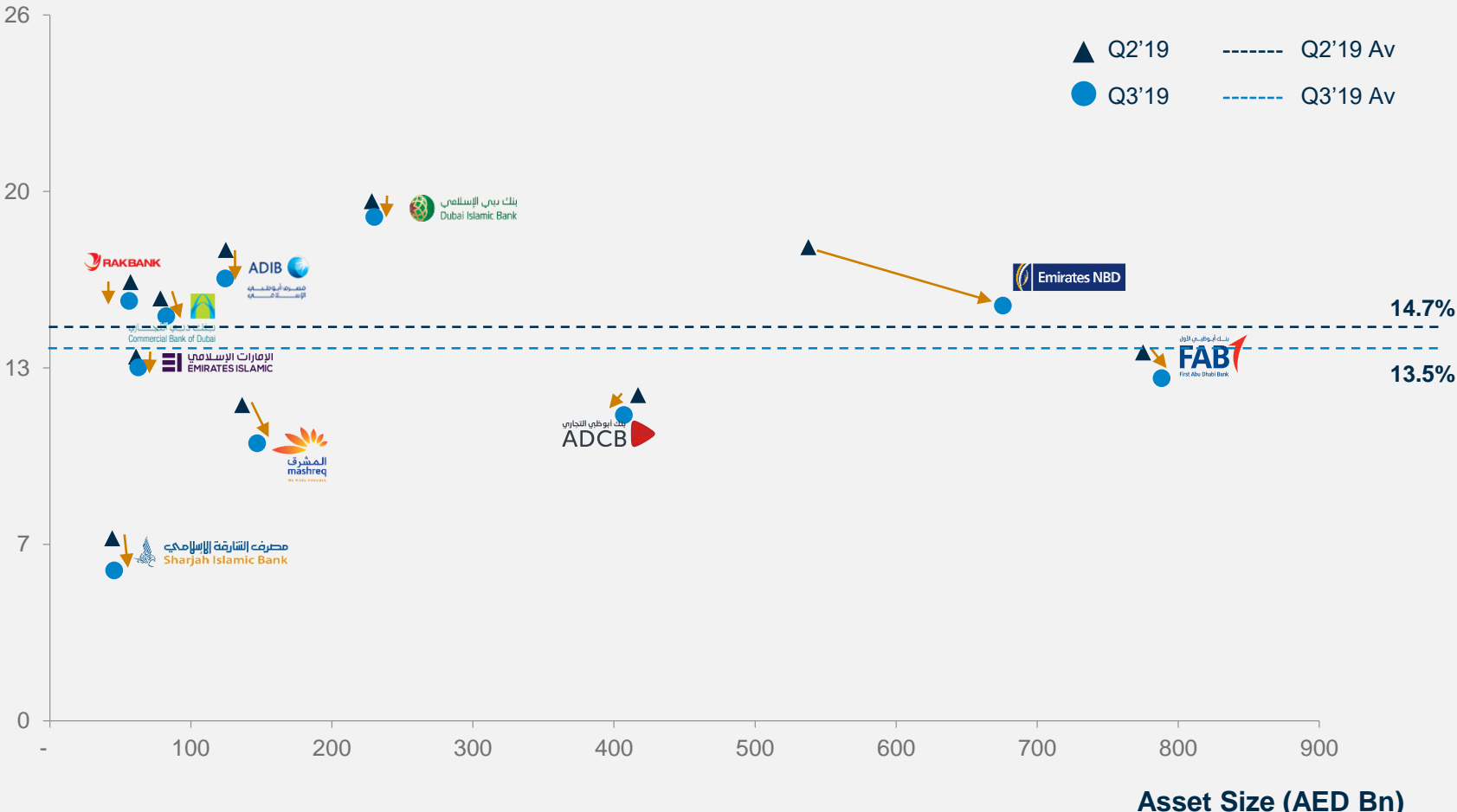
KEY TAKEAWAYS

- CoR improved for DIB, CBD, and ADCB by 13.4bps, 12.2bps, and 11.0bps, respectively
- ENBD, EIB, SIB, ADIB, and RAK bank's CoR worsened by 74.6bps, 37.2bps, 30.2bps, 23.3bps, and 6.6bps, respectively

Note: Scaling and some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

RoE Declined for all the Coverage Banks

Return on Equity (%)

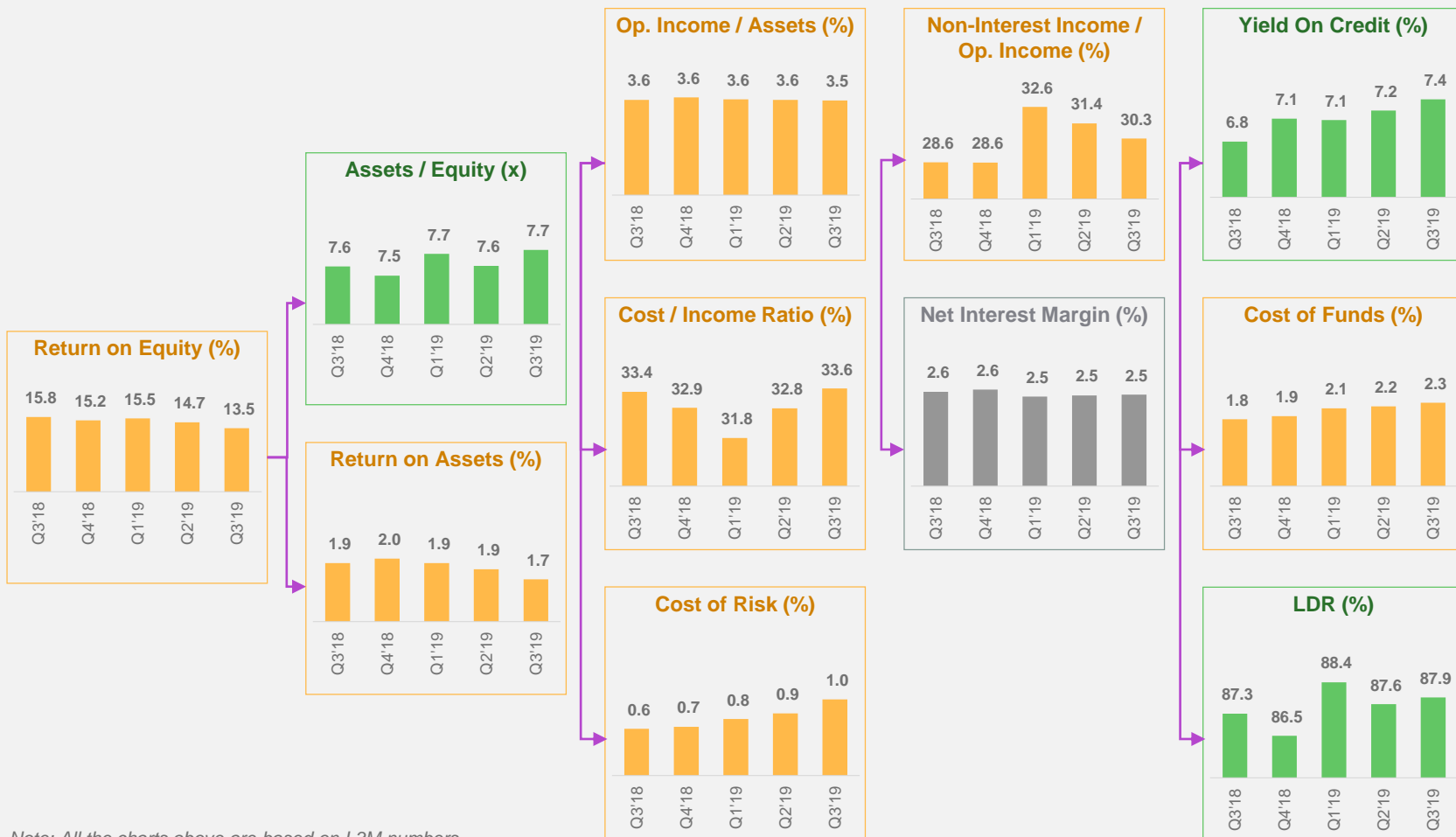


KEY TAKEAWAYS

- The average RoE for the coverage universe reported was 13.5% during Q3'19 compared to 14.7% in Q2'19
- RoE was impacted during Q3'19 as pressure on profitability margin continues due to interest rate cuts in Jul'19 and Sep'19
- Excluding Emirates NBD, RoE of the coverage universe dropped to 13.0% in Q3'19 compared to 14.0% during Q2'19

UAE Banks' Profitability Declined; Anticipating the Pressure to Continue

Improved Stable Worsened



Note: All the charts above are based on L3M numbers
 Op Income stands for Operating Income
 Scaling and some numbers might not add up due to rounding
 Source: Financial statements, Investor presentations, A&M analysis

KEY TAKEAWAYS

- RoE deteriorated to 13.5%, driven by rise in CoR and higher impairment allowance during Q3'19
- Fed funds rate cut during September'19 and in Qctober'19 are likely to put pressure on banks' margin in the next quarter

GCC Banking Consolidation

GCC list of M&A transactions in banking sector YTD – September'19

Announcement Date	Target Company	Target Country	Acquirer Company	% Sought	Consideration (AED Mn)	Deal Status*
29-Jan-19	Union National Bank PJSC	UAE	Abu Dhabi Commercial Bank PJSC	100%	11,531	Completed
29-Jan-19	Al-Hilal Bank PJSC	UAE	Abu Dhabi Commercial Bank PJSC	100%	NA	Completed
15-Mar-19	Banque Saudi Fransi	Saudi Arabia	Olayan Investments, Ripplewood Advisors LLC	5%	1,609	Completed
03-Apr-19	Oman United Exchange Co LLC	Oman	Private Investor	25%	NA	Completed
10-Apr-19	Invest bank PSC	UAE	Emirate of Sharjah United Arab Emirates	50%	989	Completed
21-Apr-19	HSBC Saudi Arabia Ltd	Saudi Arabia	HSBC Holdings PLC	2%	31	Pending
07-Apr-19	Noor Bank PJSC	UAE	Dubai Islamic Bank PJSC	100%	NA	Proposed
12-May-19	Gulf Bank KSCP	Kuwait	Alghanim Industries Ltd	16%	NA	Completed
20-Jun-19	Warba Bank KSCP	Kuwait	Kuwait & Middle East Financial Investment Co KSCP	-	NA	Proposed
08-Aug-19	DenizBank AS	Turkey	Emirates NBD PJSC	0.2%	NA	Pending
15-Aug-19	Cqur Bank LLC	Qatar	VTB Bank PJSC	19%	NA	Completed
12-Sept-19	Ahli United Bank BSC	Bahrain	Kuwait Finance House KSCP	100%	21,431	Pending

Source: Bloomberg

*Proposed Status: Board suggests shareholders to consider the acquisition

*Pending Status: Acquisition has announced

*Completed Status: Acquisition has completed







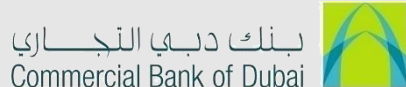



GLOSSARY



Glossary

	Metric	Abbreviation	Definition
Size	Loans and Advances Growth	L&A	QoQ growth in EOP net loans and advances for the top 10
	Deposits Growth		QoQ growth in EOP customer deposits for the top 10
Liquidity	Loan-to-Deposit Ratio	LDR	(Net EOP loans and advances / EOP customer deposits) for the top 10
Income & Operating Efficiency	Operating Income Growth		QoQ growth in aggregate quarterly operating income generated by the top 10
	Operating Income / Assets		(Annualized quarterly operating income / quarterly average assets) for the top 10
	Non-Interest Income / Operating Income		(Quarterly non-interest income / quarterly operating income) for the top 10
	Net Interest Margin	NIM	(Aggregate annualized quarterly net interest income) / (quarterly average earning assets) for the top 10 Earnings assets are defined as total assets excluding goodwill, intangible assets, and property and equipment
	Yield on Credit	YoC	(Annualized quarterly gross interest income / quarterly average loans & advances) for the top 10
	Cost of Funds	CoF	(Annualized quarterly interest expense + annualized quarterly capital notes & tier I sukuk interest) / (quarterly average interest bearing liabilities + quarterly average capital notes & tier I sukuk interest) for the top 10
	Cost-to-Income Ratio	C/I	(Quarterly operating expenses / quarterly operating income) for the top 10
Risk	Coverage Ratio		(Loan loss reserves / non-performing loans) for the top 10
	Cost of Risk	CoR	(Annualized quarterly provision expenses net of recoveries / quarterly average gross loans) for the top 10
Profitability	Return on Equity	RoE	(Annualized quarterly net profit attributable to the equity holders of the banks – annualized quarterly capital notes & tier I sukuk interest) / (quarterly average equity excluding capital notes) for the top 10
	Return on Assets	RoA	(Annualized quarterly net profit / quarterly average assets) for the top 10
	Return on Risk-Weighted Assets	RoRWA	(Annualized quarterly net profit generated / quarterly average risk-weighted assets) for the top 10
Capital	Capital Adequacy Ratio	CAR	(EOP tier I capital + tier II capital) / (EOP risk-weighted assets) for the top 10

Glossary (cont'd.)

Bank	Assets (AED Bn)*	Abbreviation	Logo
First Abu Dhabi Bank	788.1	FAB	
Emirates NBD	675.6	ENBD	
Abu Dhabi Commercial Bank	406.9	ADCB	
Dubai Islamic Bank	230.0	DIB	
Mashreq Bank	146.9	Mashreq	
Abu Dhabi Islamic Bank	124.3	ADIB	
Commercial Bank of Dubai	82.5	CBD	
Emirates Islamic Bank	62.7	EIB	
National Bank of Ras Al-Khaimah	56.3	RAK	
Sharjah Islamic Bank	45.6	SIB	

Note: Banks are sorted by assets size
* As on 30th September 2019