



UAE Banking Pulse

Quarter 2, 2019

FOREWORD

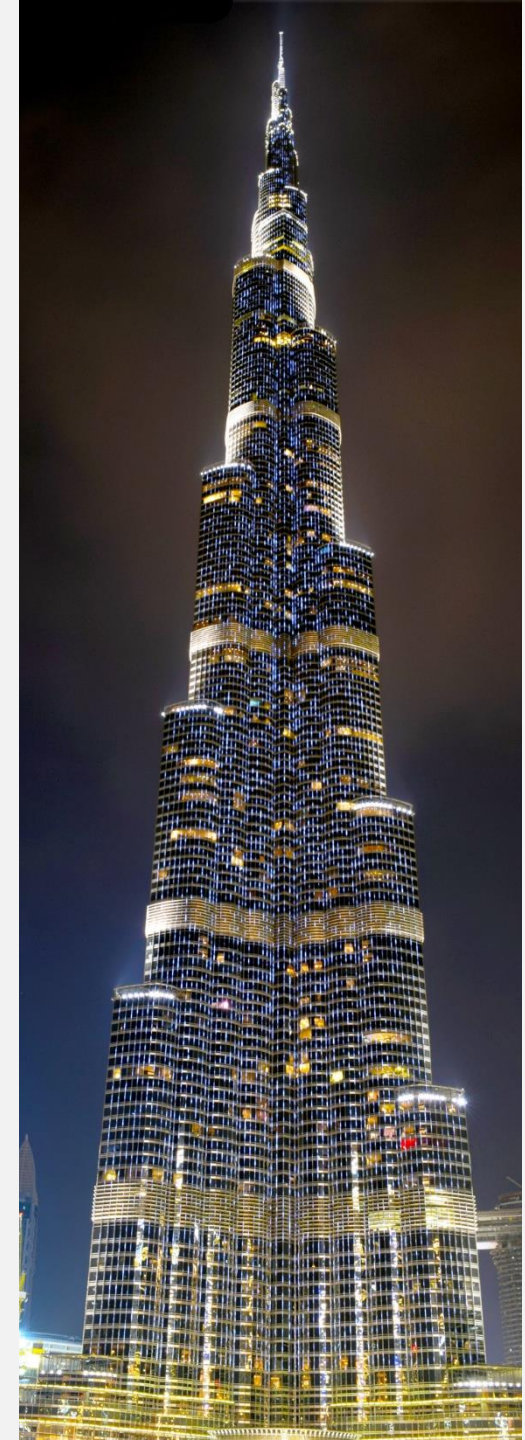
Alvarez & Marsal Middle East Limited (A&M) is delighted to publish the Q2'19 edition of the UAE Banking Pulse ("The Pulse"). In this quarterly series, we share results from our research examining the top ten largest listed UAE banks by assets, and highlight key performance indicators of the UAE banking 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



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- 18+ years of international experience in management consulting and industry
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- 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
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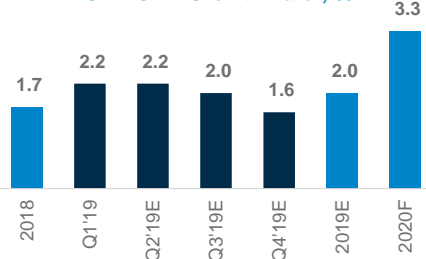
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UAE Macro & Sector Overview

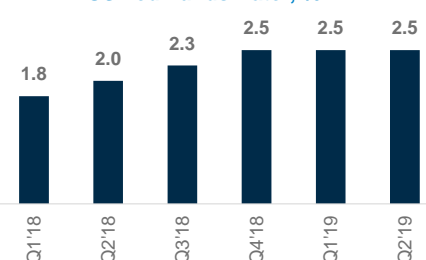
Macro overview

UAE GDP Growth Rate¹, %



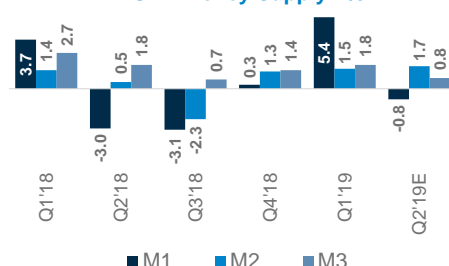
- In Q1'19 GDP grew by 2.2% YoY, backed by steady performance in non-oil sector, which was up 1.6% YoY
- The GDP is projected to grow by 2.0% in FY19 primarily driven by a robust government spending, policy reforms, and healthy private sector performance
- The average Q2'19 Emirates NBD Purchasing Managers' Index (PMI) stood at the highest level since Q2'14 as private sector gained momentum in the last two quarters

US Fed Funds Rate², %



- The US Federal Reserve reduced its funds rate in Jul'19 for the first time since 2008
- The Fed reduced its benchmark interest rate by 25 bps to 2.25% in Jul'19 and indicated the possibility of a further cut this year to support the record-long US economic expansion
- The move was likely driven by fears of global economic slowdown, intensifying US-China trade tensions, and lower inflation

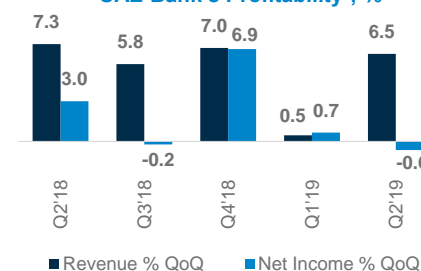
UAE Money Supply³, %



- M2, one of the best indicators for the availability of liquidity in the economy, registered a large increase of 1.7% YoY in Q2'19
- M2 was up primarily because of quarterly increase in non-government resident deposits, which jumped 1.5% YoY to AED 1,273.7bn
- The YTD average oil price of about \$66 per barrel is close to the UAE's 2019 fiscal break even level of \$65 per barrel, which is expected to support the fiscal balances

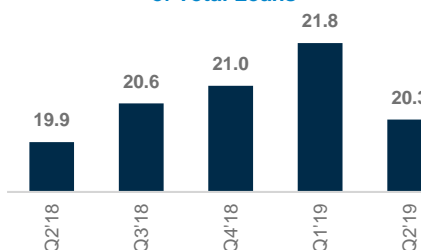
Banking overview Q2'19

UAE Bank's Profitability⁴, %*



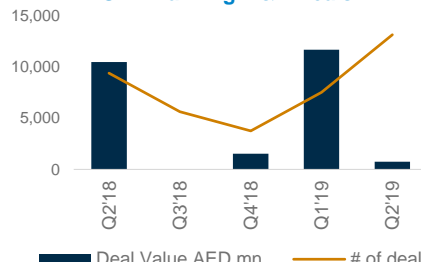
- The top ten UAE banks reported steady performance in top line during Q2'19 but well below the 2018 average of 5.6%, as the economy continued to recover at a slow pace
- Major banks including FAB, ENBD, and DIB reported significant impairments, averaging 12.9%, which adversely impacted the bottomlines
- For the rest of 2019, margins are likely to stay under pressure due to rate cut in Jul'19 and expected cut in Sep'19
- Downward revisions in interest-bearing deposits (~47% of bank total deposits) are likely to reduce cost of funding and ease pressure from lower yields

Real Estate & Construction as % of Total Loans⁵



- During Q2'19, major initiatives were announced such as freehold law and launch of Golden Card to boost economic diversification and stimulate demand in real estate sector
- Despite collective efforts, sector continues to remain under pressure and may lead to higher delinquencies for banks
- The UAE banks' exposure to sector though declined in Q2'19, remains at a level which presents a concentration risk

UAE Banking M&A Deals⁶



- The pace of M&A activity could slowdown owing to less-supportive ownership structures i.e. banks with lesser common owners
- However increasing regulatory requirements, digital spending, and competition are likely to support the case for consolidation in the sector
- During Q2'19 ADCB, UNB, and Al-Hilal Bank merged to create the #3 bank in the country with AED 416bn of assets

¹ UAE Central Bank and IMF forecasts, ² US Board of Federal Reserve, ³ UAE Central Bank, ⁴ Company filings, The spurt in Q2, 19 revenues is largely attributable to consolidation of UNB and Al-Hilal Bank into ADCB, ENBD net income adjusted for one time gain of AED 2.0bn from disposal of stake in jointly controlled entity ⁵ Bloomberg & Axience research, ⁶ Bloomberg and Axience research; * Data of top 10 UAE banks shortlisted on the basis of asset size as of June 30, 2019

Pulse: NIMs up marginally amid tightening liquidity conditions

→ Improved ← Stable → Worsened

	Metric	Q1'19	Q2'19	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19	Key Trends of Q2'19
Size	Loans and Advances Growth (QoQ)	1.5%	7.7%						1 The volatility seen in bank size for Q2'19 was driven by the consolidation of UNB and Al-Hilal Bank into ADCB
	Deposits Growth (QoQ)	-0.5%	8.5%						
Liquidity	Loan-to-Deposit Ratio (LDR)	88.3%	87.6%						2 Excluding ADCB impact QoQ growth in deposits (2.8%) exceeded L&A growth (1.6%)
Income & Operating Efficiency	Operating Income Growth (QoQ)	-0.5%	4.3%						3 The operating income was negatively impacted by increased impairment charges at leading banks (64% of total impairments) and higher cost of funding
	Operating Income / Assets	3.6%	3.6%						
	Non-Interest Income(NII) / Operating Income	32.6%	31.5%						
	Yield on Credit (YoC)	7.1%	7.2%						4 NIM remained stable during the period
	Cost of Funds (CoF)	2.1%	2.2%						
	Net Interest Margin (NIM)	2.5%	2.5%						
	Cost-to-Income Ratio (C/I)	31.8%	32.9%						5 The increase in C/I ratio was primarily due to ADCB's consolidation with UNB & Al-Hilal bank, which increased from 34.9% to 40.2%
	Coverage Ratio	108.6%	113.8%						
Risk	Cost of Risk (CoR)	0.8%	0.9%						6 The CoR is up marginally as Net Loan Loss provisions increased during the quarter
	Return on Equity (RoE)	15.6%	14.7%						
Profitability	Return on Assets (RoA)	1.9%	1.8%						7 The RoE for Q2'19 was mainly impacted by consolidation of ADCB, UNB and Al-Hilal, which resulted in 67% increase in ADCB's equity compared to 2.5% increase in net income
	Return on Risk-Weighted Assets (RoRWA)	2.8%	2.6%						
Capital	Capital Adequacy Ratio (CAR)	17.4%	17.6%						8 ROA declined by 1bp due to lower profit margins. The CAR improved marginally due to improvement in risk weighted assets

Note 1: QoQ stand for quarter over quarter

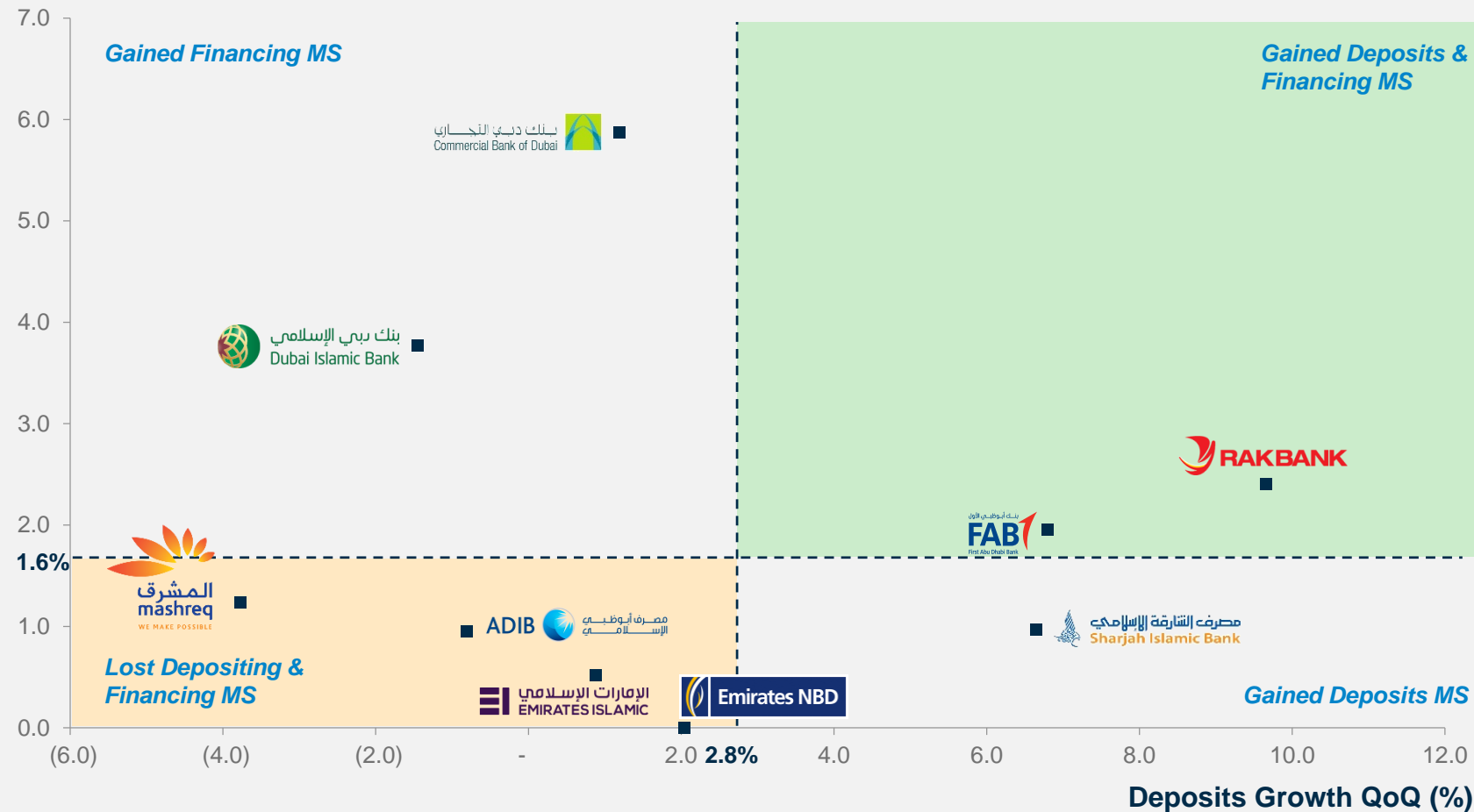
Note 2: Growth in loans & advances and deposits were presented QoQ instead of YoY

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

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

Muted L&A growth puts pressure on margins amid rising deposits

L&A Growth QoQ (%)



KEY TAKEAWAYS**

- Excluding ADCB banks maintained steady QoQ growth with deposits (up 2.8%) and L&A (up 1.6%)
- RAK bank reported the highest deposits growth of 9.7% and increase in loans & advances of 2.4%
- Mashreq, SIB, DIB and ADIB deposits declined by 3.8%, 1.9%, 1.4% and 0.8%, respectively. However, for the same banks L&A increased by 1.2%, 1.0%, 3.8% and 1.0%, respectively leading to tight liquidity position

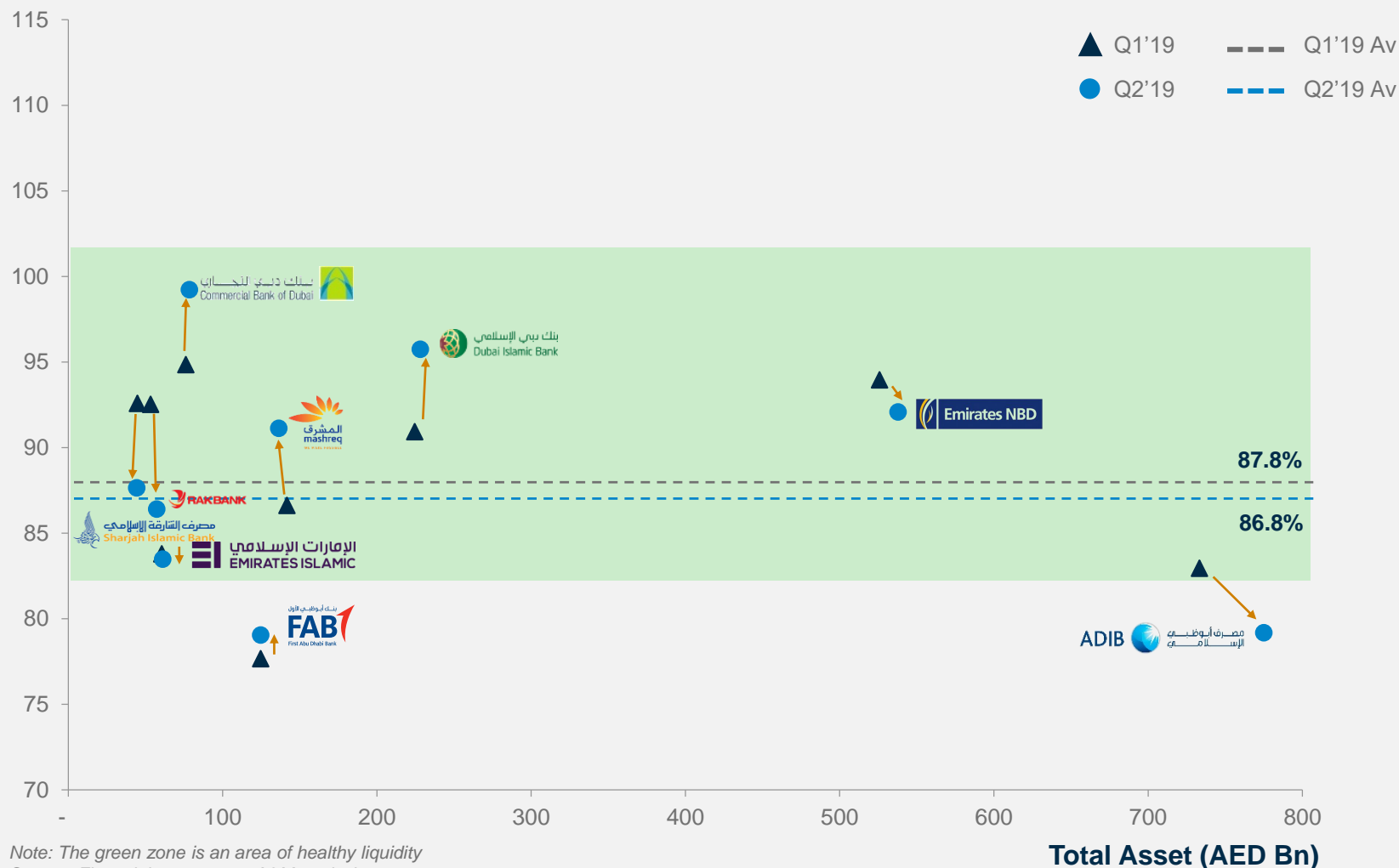
Note: MS stands for market share

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

** Excluded ADCB due to higher ratios driven by consolidation of Al-Hilal bank

1 Liquidity conditions seemingly tightened amid slowing deposit growth for select banks

Loans to Deposits Ratio (%)



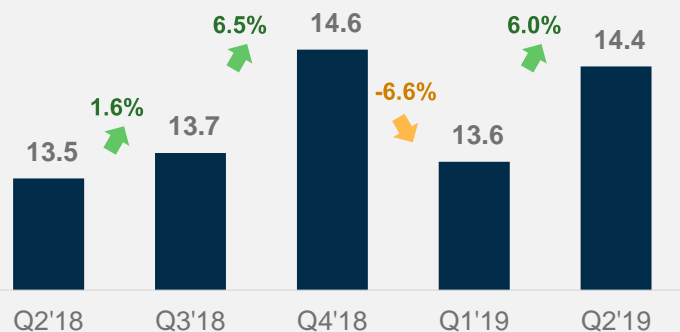
KEY TAKEAWAYS**

- Excluding ADCB, LDR decreased to 86.8% in Q2'19 from 87.8% of Q1'19; the decrease was primarily attributable to lower growth in L&A (1.6%) versus deposits growth (2.8%)
- However the LDR for DIB, Mashreq, and CDB increased sharply to the range of 90%-100% as these banks witnessed increase in L&A against falling deposits

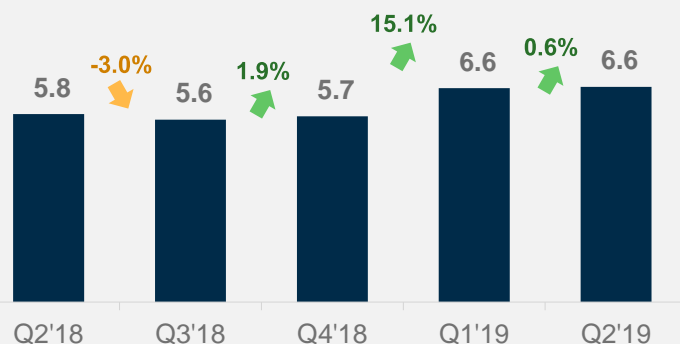
Operating income largely flat amid rising costs

→ Improved ← Stable → Worsened

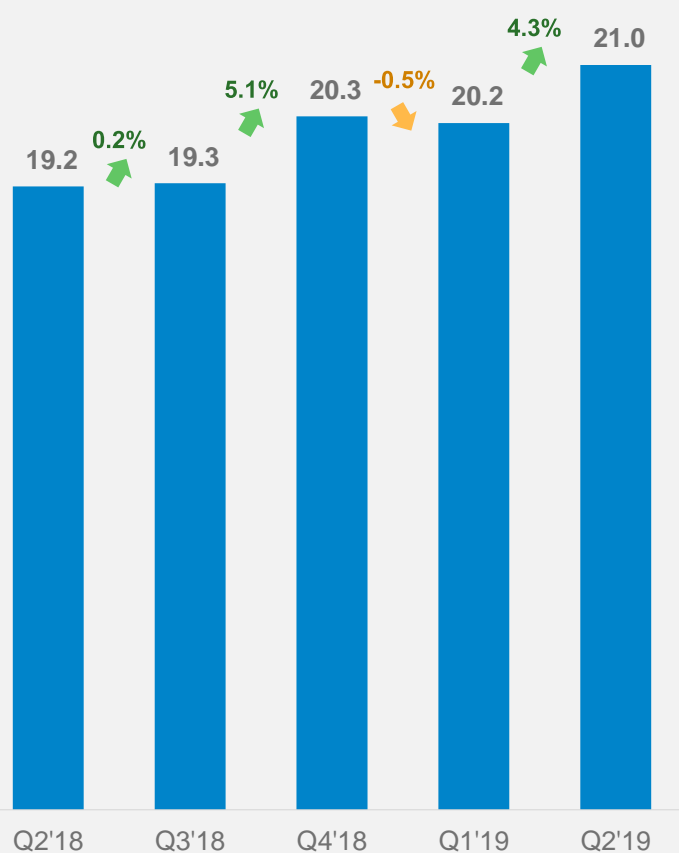
Quarterly NII
(AED Bn)



Quarterly Net Fee commission and other Operating Income (AED Bn)



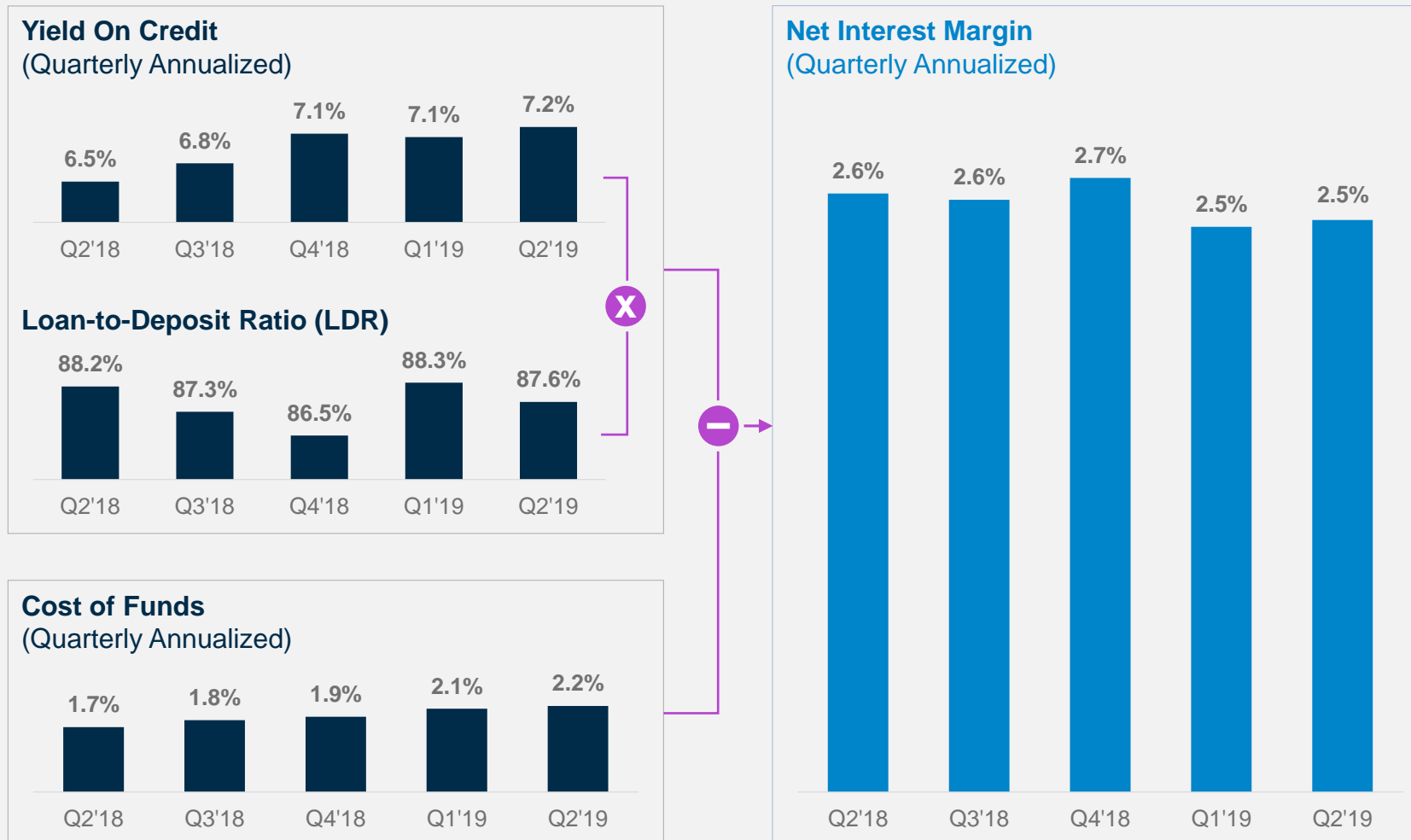
Quarterly Operating Income
(AED Bn)



KEY TAKEAWAYS

- The 4.3% increase in operating income was primarily driven by ADCB which reported a 26.8% QoQ increase in NII
- The increase in NII for ADCB was due to consolidation of UNB and Al-Hilal bank in its Q2'19 earnings
- Excluding ADCB's consolidation impact, the operating income improved marginally by 1.4%

NIM improved marginally as yields on credit edged-up



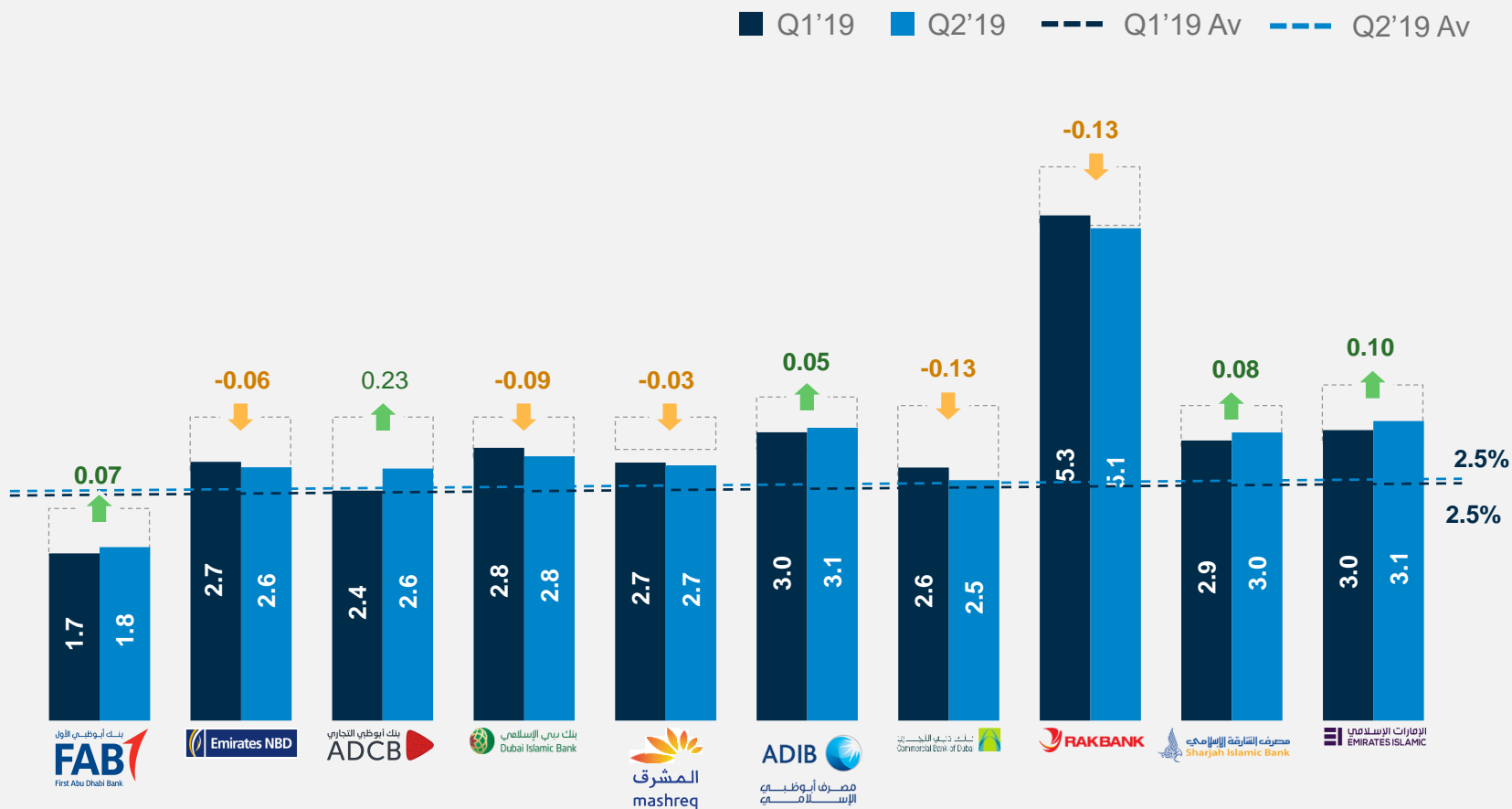
KEY TAKEAWAYS

- NIM improved marginally by 3bps in Q2'19 to 2.48% over Q1'19
- The improvement was largely driven by increase in loans and advances, and a stabilized yield on credit
- The increased competition for deposits and tighter liquidity continue to push up the cost of funds

Mixed trend seen in NIM for the coverage universe

→ Improved ↔ Stable → Worsened

Net Interest Margin (%)



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

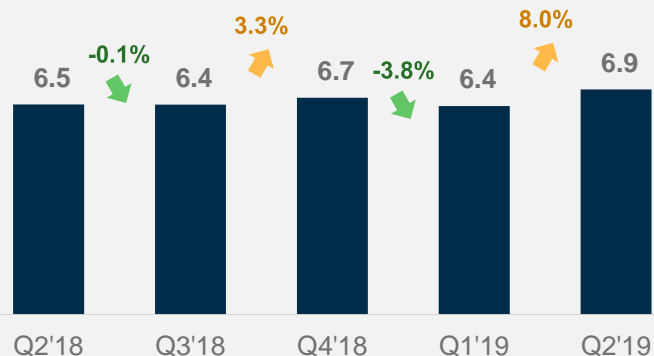
KEY TAKEAWAYS

- Half of the banks within coverage universe witnessed an improvement in NIM
- FAB, ADIB, SIB, ADCB, and EIB witnessed an expansion ranging from 0.05% to 0.23% in NIM in Q2'19
- The anticipated US Fed funds rate cut in July'19 impacted loan pricing in Q2'19 for some banks

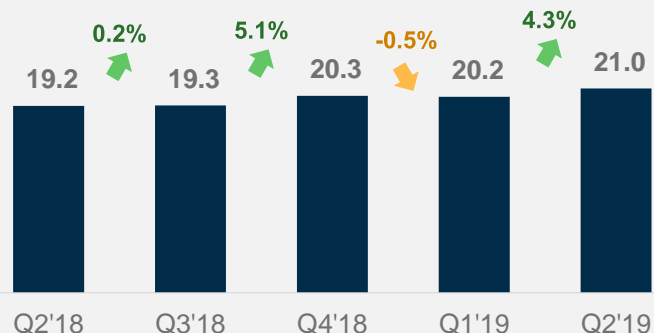
C/I ratio excluding ADCB improved during the quarter

→ Improved ← Stable → Worsened

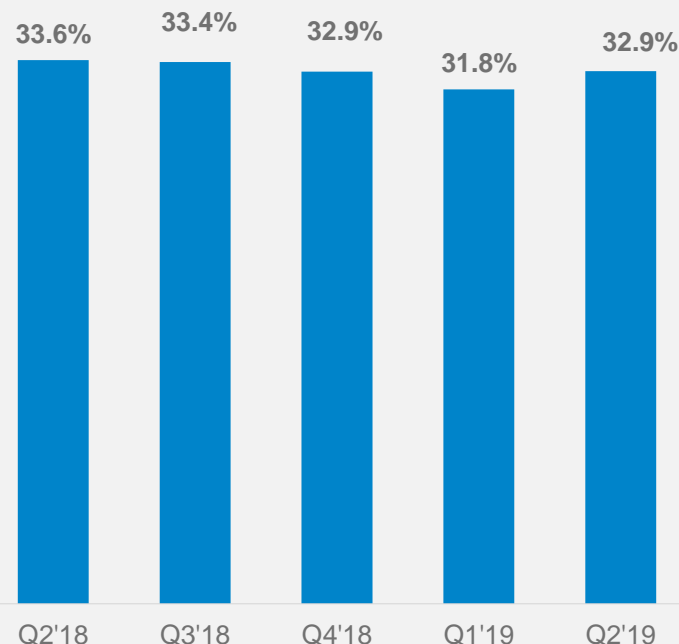
Quarterly Operating Expenses
(AED Bn)



Quarterly Operating Income
(AED Bn)



Cost to Income Ratio
(%, Quarterly Annualized)



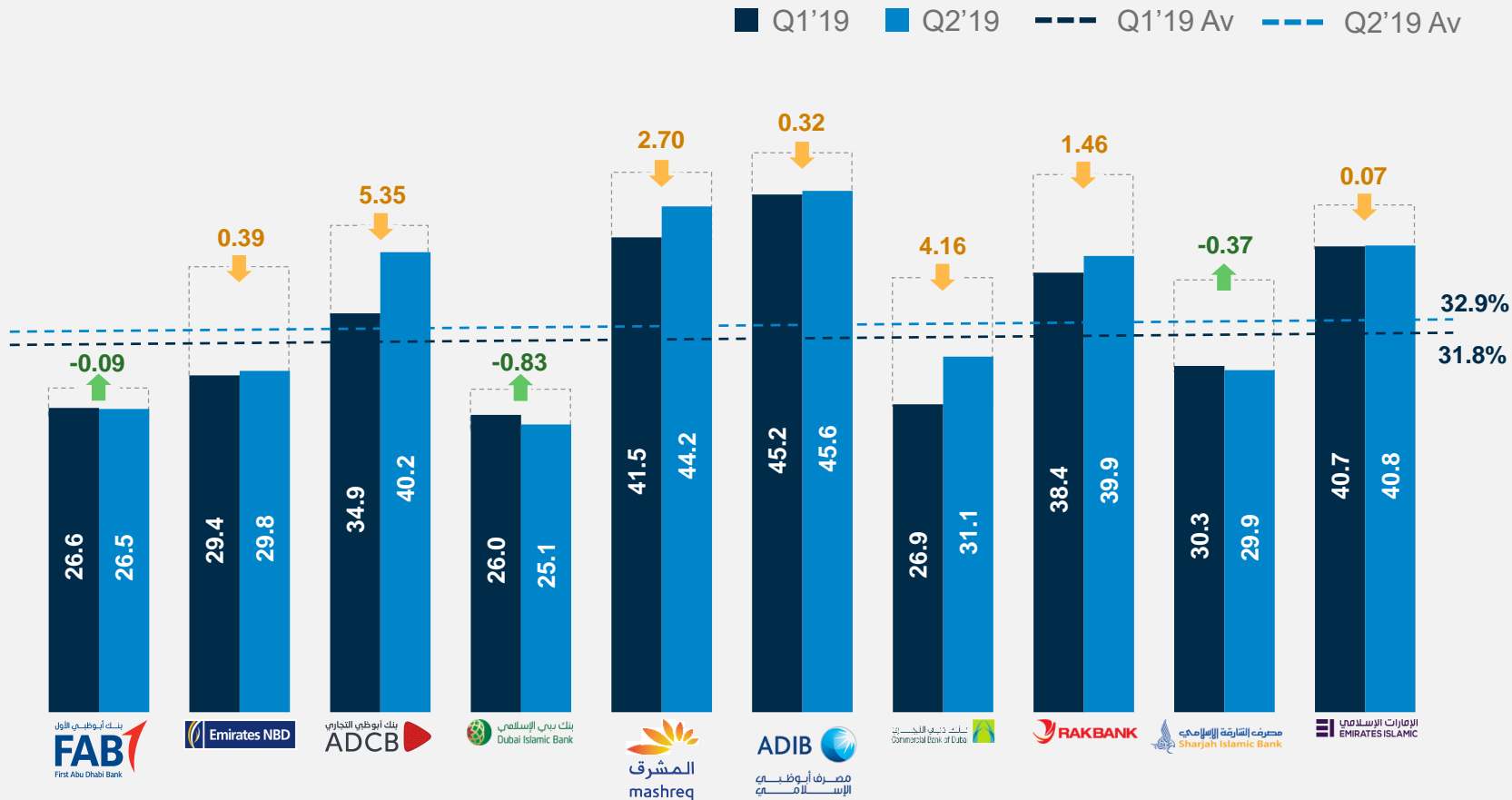
KEY TAKEAWAYS

- Increase in C/I ratio was primarily attributable to consolidation of UNB and Al-Hilal bank into ADCB
- The consolidation resulted in 46.3% higher SG&A cost for the bank which impacted overall coverage cost pushing up the C/I ratio
- Excluding ADCB, C/I ratio was 31.7% for Q2'19 as compared with 31.4% in the previous quarter

4 Rising staff costs pushed the SG&A expenses up for most banks

→ Improved ↔ Stable → Worsened

Cost to Income Ratio (% Quarterly)



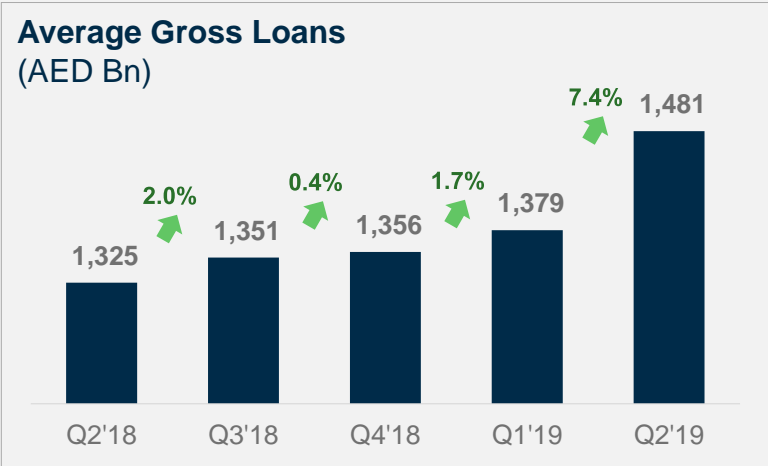
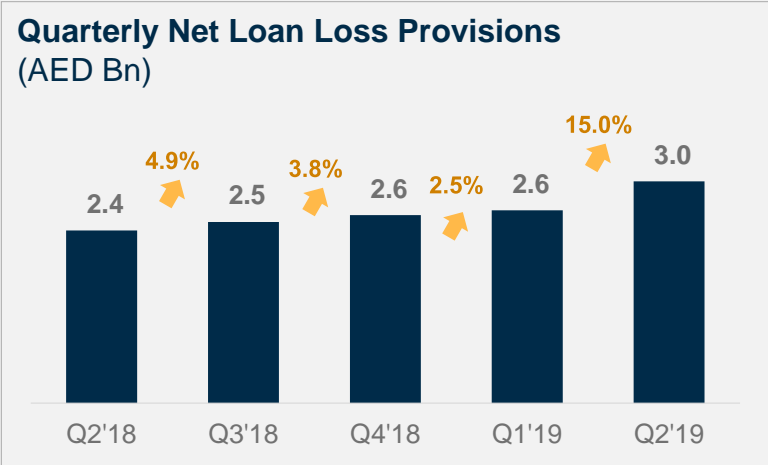
KEY TAKEAWAYS

- Seven banks from the coverage universe, witnessed increase in their C/I Ratios
- ADCB, CBD and Mashreq exhibited the highest increase of 5.3%, 4.2%, and 2.7%, respectively in C/I ratio
- The increase in ADCB's C/I ratio was primarily attributable to 46% increase in SG&A due to consolidation impact
- The C/I ratio declined for FAB, SIB, and DIB by 0.1%, 0.4%, and 0.8% respectively

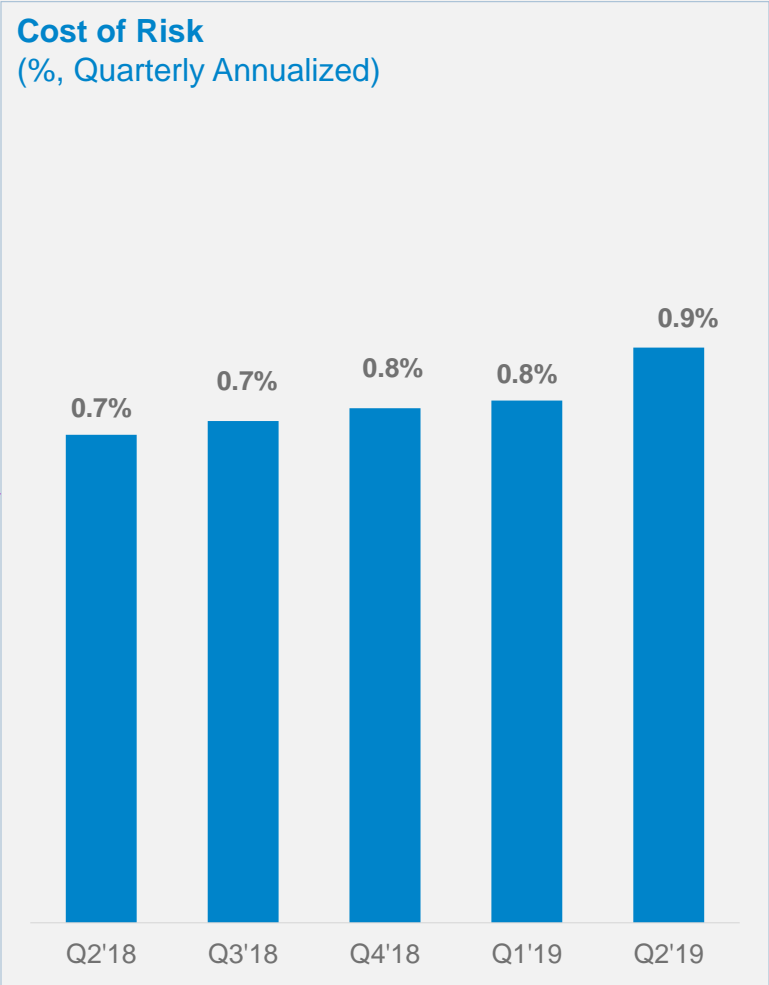
Note: Scaling and some numbers might not add up due to rounding
Source: Financial statements, investor presentations, A&M analysis

Cost of Risk increased due to increase in net loan loss provisions

➡ Improved ↔ Stable ➡ Worsened



1



KEY TAKEAWAYS

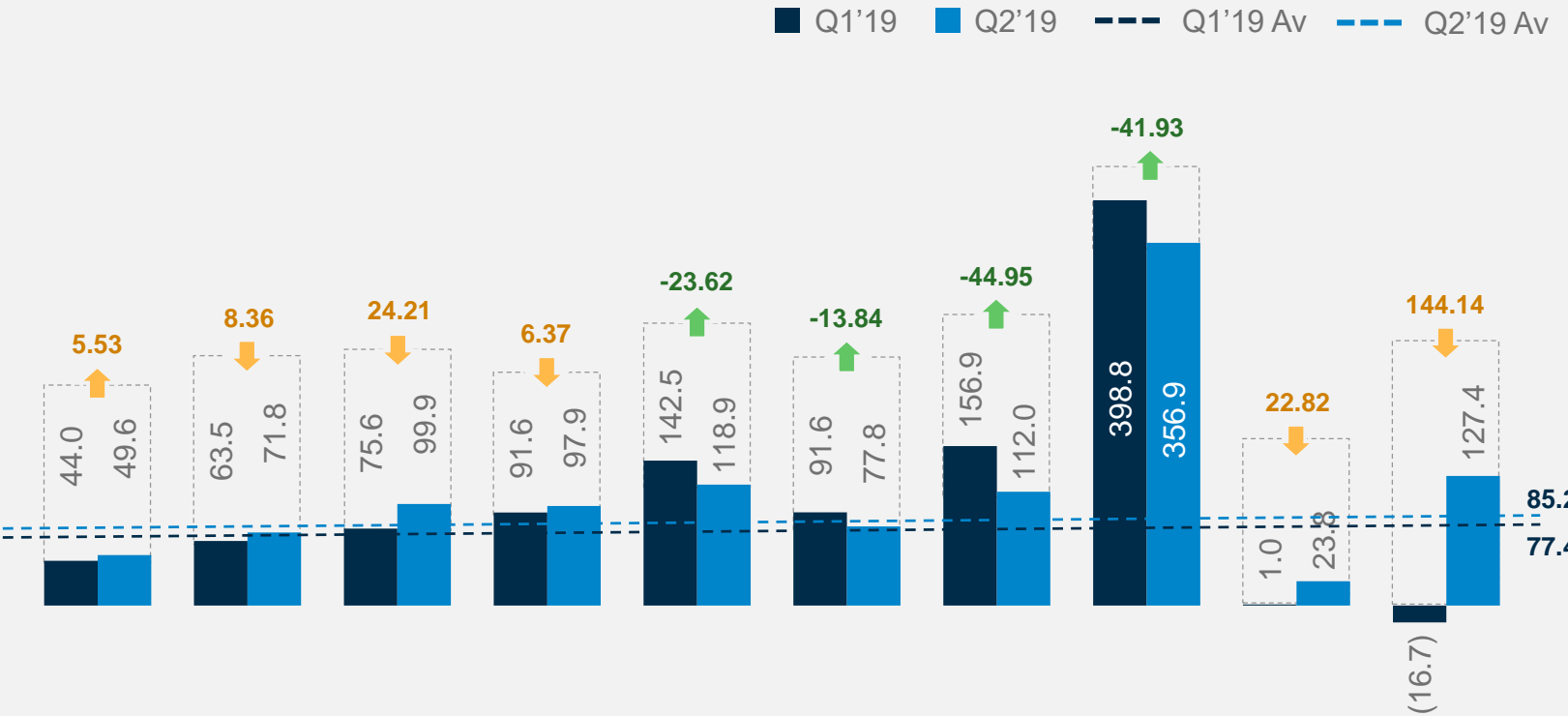
- The CoR was marginally up at 0.9% as banks increased their net loan loss provisions by 15.0% in the quarter
- The CoR is likely to increase further on account of pressure seen in the real estate, hospitality, and retail sector amid softening economic conditions

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 four of the top ten banks

➔ Improved
 ↔ Stable
 ➔ Worsened

Cost of Risk (bps) – net of reversals



KEY TAKEAWAYS

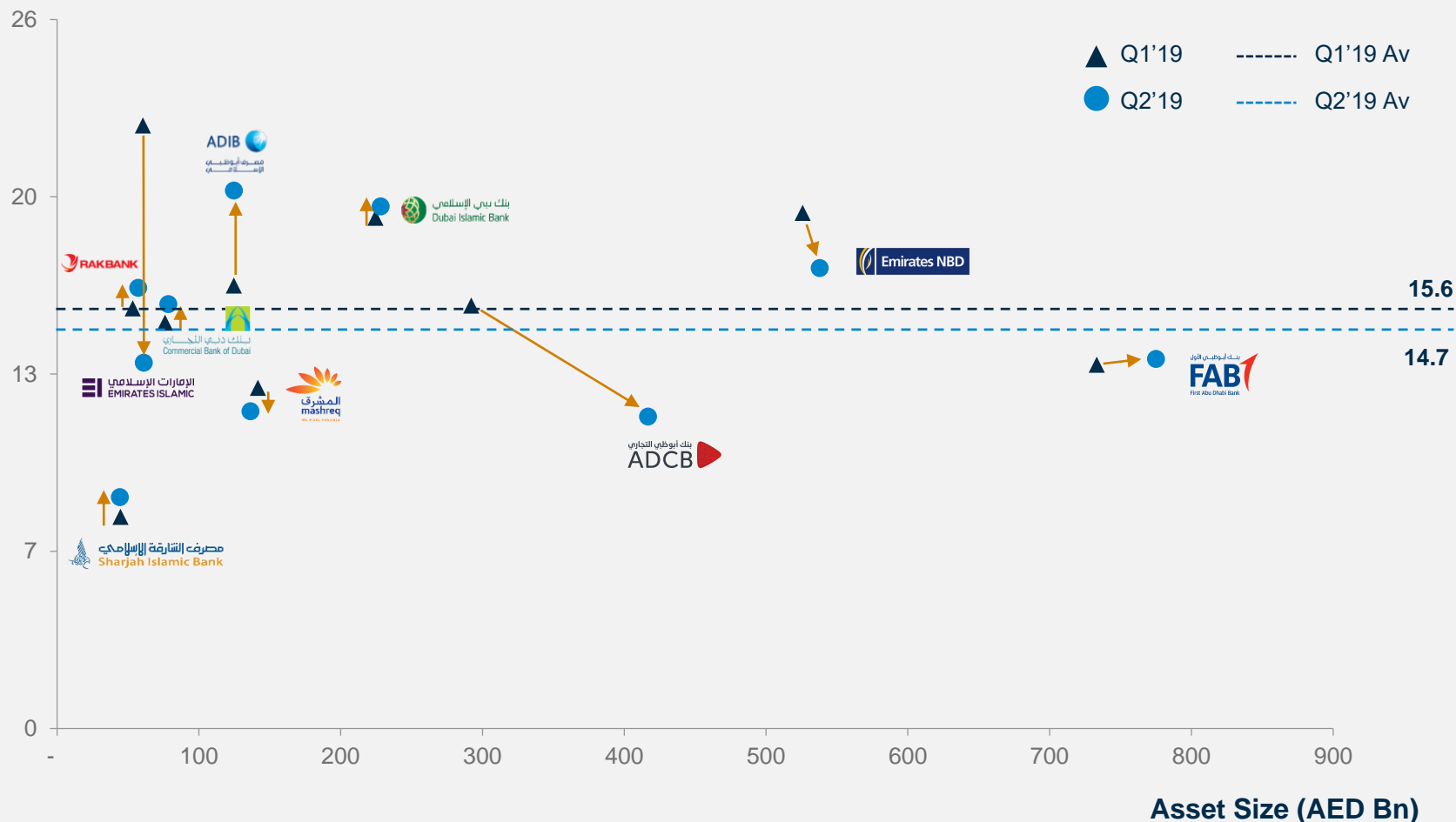
- CBD, RAK, Mashreq, and ADIB banks reported the highest decline in CoR of 45 bps, 42 bps, 24bps, and 14bps, respectively
- EIB, ADCB, and SIB witnessed the highest increase in CoR of 144bps, 24bps, and 21bps, respectively



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

RoE increased for six out of ten banks

Return on Equity (%)

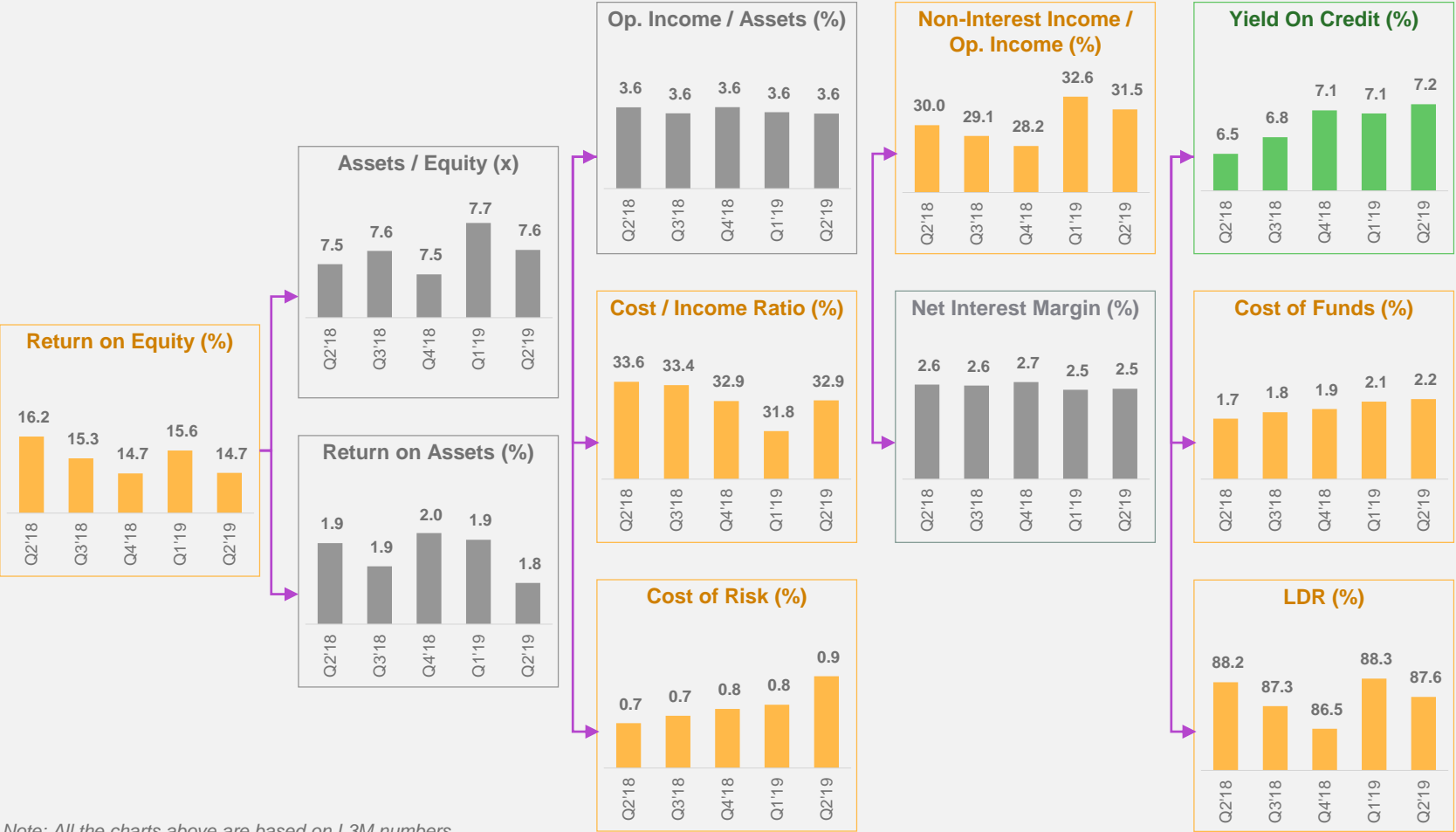


KEY TAKEAWAYS

- The Q2'19 reported RoE for the coverage companies was 14.7% compared with 15.6% in Q1'19
- The consolidation of UNB and Al-Hilal bank into ADCB increased ADCB's equity by 66.5% and net income by 2.5% which largely impacted the coverage RoE in Q2'19
- In addition, higher net impairments impacted EIB's RoE, which declined to 13.4% in Q2'19 from 22.1% during Q1'19
- Excluding ADCB, RoE for Q2'19 declined to 15.4% from 15.8% in Q1'19

Overall a lackluster quarter but earnings likely to stay under pressure

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 declined to 14.7%, driven by an increase in CoR and higher provisioning during Q2'19
- NIM continues to be under pressure amid slowing loan disbursements and increasing deposits
- Tighter liquidity conditions and downward revisions to interest rates are likely to put pressure on banks' margins going forward

GCC Banking Consolidation

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











GLOSSARY



Glossary

	Metric	Abbreviation	Definition
Size	Loans and Advances Growth		QoQ growth in EOP net loans and advances for the top 9
	Deposits Growth		QoQ growth in EOP customer deposits for the top 9
Liquidity	Loan-to-Deposit Ratio	LDR	(Net EOP loans and advances / EOP customer deposits) for the top 9
Income & Operating Efficiency	Operating Income Growth		QoQ growth in aggregate quarterly operating income generated by the top 9
	Operating Income / Assets		(Annualized quarterly operating income / quarterly average assets) for the top 9
	Non-Interest Income / Operating Income		(Quarterly non-interest income / quarterly operating income) for the top 9
	Net Interest Margin	NIM	(Aggregate annualized quarterly net interest income) / (quarterly average earning assets) for the top 9 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 9
	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 9
	Cost-to-Income Ratio	C/I	(Quarterly operating expenses / quarterly operating income) for the top 9
Risk	Coverage Ratio		(Loan loss reserves / non-performing loans) for the top 9
	Cost of Risk	CoR	(Annualized quarterly provision expenses net of recoveries / quarterly average gross loans) for the top 9
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 9
	Return on Assets	RoA	(Annualized quarterly net profit / quarterly average assets) for the top 9
	Return on Risk-Weighted Assets	RoRWA	(Annualized quarterly net profit generated / quarterly average risk-weighted assets) for the top 9
Capital	Capital Adequacy Ratio	CAR	(EOP tier I capital + tier II capital) / (EOP risk-weighted assets) for the top 9

Glossary (cont'd.)

Bank	Assets (AED Bn)*	Abbreviation	Logo
First Abu Dhabi Bank	775.0	FAB	
Emirates NBD	537.8	ENBD	
Abu Dhabi Commercial Bank	416.7	ADCB	
Dubai Islamic Bank	228.2	DIB	
Mashreq Bank	136.4	Mashreq	
Abu Dhabi Islamic Bank	124.7	ADIB	
Commercial Bank of Dubai	78.4	CBD	
Emirates Islamic Bank	61.1	EIB	
National Bank of Ras Al-Khaimah	57.3	RAK	
Sharjah Islamic Bank	44.3	SIB	

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