



UAE Banking Pulse

Quarter 2, 2020



الإمارات
THE EMIRATES

FOREWORD

Alvarez & Marsal Middle East Limited (A&M) is delighted to publish the Q2'20 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 sector. The Pulse aims to help banking executives and board members stay current on industry trends.

In this edition, we have made a change to our coverage universe by replacing Emirates Islamic Bank (EIB) with National Bank of Fujairah (NBF), as Emirates NBD reports consolidated financials including EIB. Hence, for consistency of comparison, all historical quarters data has been adjusted to include NBF instead of EIB.

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.

The UAE Central Bank continues with its measures to strengthen the financial system and support the economy impacted by COVID-19. It has unveiled additional measures within the Targeted Economic Support Scheme (TESS) launched initially in March 2020 to further enhance the capacity of the banking sector to support the economy. These measures include relaxation of Net Stable Funding Ratio and the Advances to Stable Resources Ratio by 10% points for domestic banks until 31st December 2021.

According to Central Bank's credit sentiment survey for Q2'20, domestic corporate credit demand is likely to pick up in the coming period, while personal credit is still expected to witness a sluggish trend. Also, banks with large retail operations are expected to announce redundancies and the focus on cost optimization will continue.

We hope 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



Co-Authors



Dr. Saeeda Jaffar

Co-Author, Managing Director
Head of Middle East

- 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



Asad Ahmed

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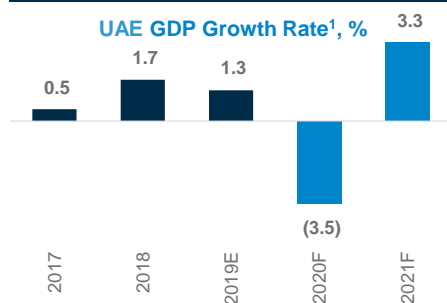
- 30+ years of experience in banking
- Focuses on performance improvement, turn-around, credit management, and formulating and managing strategic and operational changes in financial institutions
- Former CEO of banks in the UAE & Kenya

**CONTACT
DETAILS**

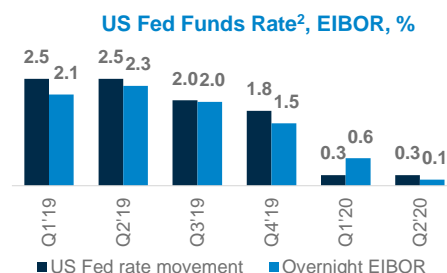
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UAE Macro & Sector Overview

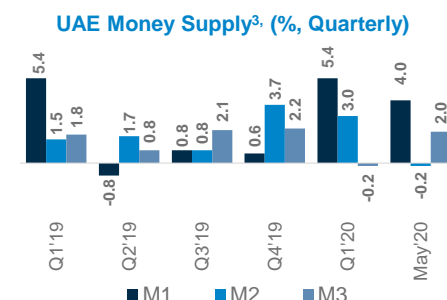
Macro overview



- **The IMF forecasts UAE's GDP growth to decline by 3.5% in FY'20**, before growing by +3.3% in FY'21
- Uncertainty regarding the duration of coronavirus pandemic coupled with low oil prices and the delay in Expo 2020 are the major factors impacting economic growth
- Average Q2'20 Emirates NBD Purchasing Managers' Index (PMI) fell to 47.1 compared to 47.9 in Q1'20, due to decline in output, new orders and employment



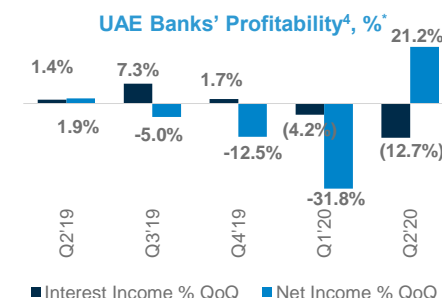
- In July'20, the US Fed decided to maintain interest rates near zero until the economy recovers. It also pledged to maintain its bond purchases
- The overnight EIBOR saw an additional decline in Q2'20, to reach at multi-period low levels
- **Interest rates in the UAE are likely to remain at record low levels**, as the central bank would look to support the economy from the ongoing headwinds



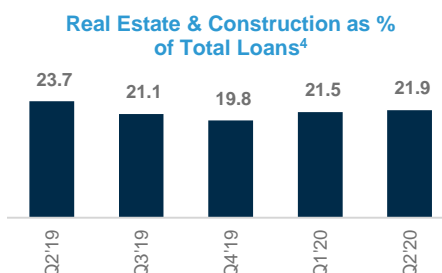
- M2 money supply fell 0.2% in May'20 to AED 1,451.9bn compared to March'20, while it increased by 9.9% YoY
- The decline in M2 money supply compared to March'20 was due to drop in quasi monetary deposits
- M1 increased by 4.0% in May'20 to AED 564.3bn compared to March'20. On an annual basis, M1 increased by 11.3%
- M3 increased by 2.0% compared to March'20, and increased 7.9% YoY to reach AED 1,747.8bn

¹ IMF, ² US Board of Federal Reserve, ³ UAE Central Bank, ⁴ Company filings, ENBD net income adjusted for one time gain of AED 4.4bn from disposal of stake in jointly controlled entity during 2019, DIB's net income adjusted for one-time gains of AED 1.0bn on bargain purchase in 2020, ⁵ Bloomberg & A&M Analysis, ⁶ based on data of 7 banks, weighted average exposure of all banks; * Data for top ten UAE banks by asset size as of June 30th 2020

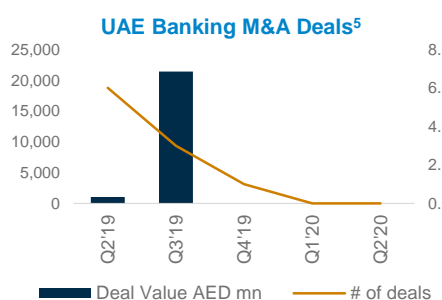
Banking overview Q2'20



- Total interest income of top ten UAE banks declined at a faster pace (-12.7%), compared to the previous quarter, as interest rates reached multi-period low levels
- Net profit growth rebounded (+21.2% QoQ), as lower operating expenses (-10.5% QoQ) and impairment charges (-30.1% QoQ) helped in offsetting reduced income
- While corporate credit demand is likely to improve in the near term, low interest rates would nullify this positive impact and limit interest income growth



- The UAE banks exposure to the real estate sector increased further by ~40 bps⁶
- The UAE's real estate market is expected to be under pressure in the near term, due to economic slowdown and persistent oversupply conditions
- The UAE central bank said that economic recovery is expected in H2'20, due to TESS and economic stimulus packages, which will also support the real estate sector



- UAE banking sector saw no deal taking place in Q2'20 partially due to the impact of the coronavirus pandemic which had lowered business confidence
- M&A deals are most likely be in favor of the buyers as need for cash could result in acceptance of low valuation multiples offered by them

Pulse: Improved Operating Efficiency and Lower Impairments Helped in Offsetting Lower Operating Income; Supporting Bottom-line

➔ Improved
 ↔ Stable
 ➔ Worsened

	Metric	Q1'20	Q2'20	Q2'19	Q3'19	Q4'19	Q1'20	Q2'20	Key Trends of Q2'20
Size	Loans and Advances (L&A) Growth (QoQ)	0.8%	➔ 1.0%					1	Despite tough market conditions, there was an overall growth in L&A (+1.0%) and deposit (+1.1%)
	Deposits Growth (QoQ)	0.6%	➔ 1.1%					2	LDR has remained stable at 87.7% and is largely in line with the trend seen in last couple of years
Liquidity	Loan-to-Deposit Ratio (LDR)	87.7%	↔ 87.7%					3	
Income & Operating Efficiency	Operating Income Growth (QoQ)	-2.3%	➔ -9.2%					4	Operating income growth declined further in Q2'20, due to reduced interest and fee income performance
	Operating Income / Assets	3.4%	➔ 3.0%					5	
	Non-Interest Income(NII) / Operating Income	29.9%	➔ 28.4%					6	NIM compressed further to reach multi-period low levels
	Yield on Credit (YoC)	6.7%	➔ 5.8%					7	Operating efficiency improved as total expenses declined at a faster pace (~10%), helping C/I to improve to 33.4%
	Cost of Funds (CoF)	1.9%	➔ 1.5%					8	
	Net Interest Margin (NIM)	2.5%	➔ 2.3%					9	CoR declined to 1.4%, after rising substantially in the preceding quarter. Coverage ratio decreased further, as NPLs increased ~9%
	Cost-to-Income Ratio (C/I)	33.8%	➔ 33.4%					10	
Risk	Coverage Ratio	94.5%	➔ 89.2%					11	Increased cost efficiency and reduced provisioning supported profitability growth
	Cost of Risk (CoR)	2.1%	➔ 1.4%					12	
Profitability	Return on Equity (RoE)	9.0%	➔ 9.4%					13	RoRWA increased slightly while the capital adequacy ratio improved after declining considerably in the previous quarter
	Return on Assets (RoA)	0.9%	➔ 1.1%					14	
	Return on Risk-Weighted Assets (RoRWA)	1.3%	➔ 1.6%					15	
Capital	Capital Adequacy Ratio (CAR)	16.2%	➔ 17.1%					16	

Note 1: QoQ stand for quarter over quarter

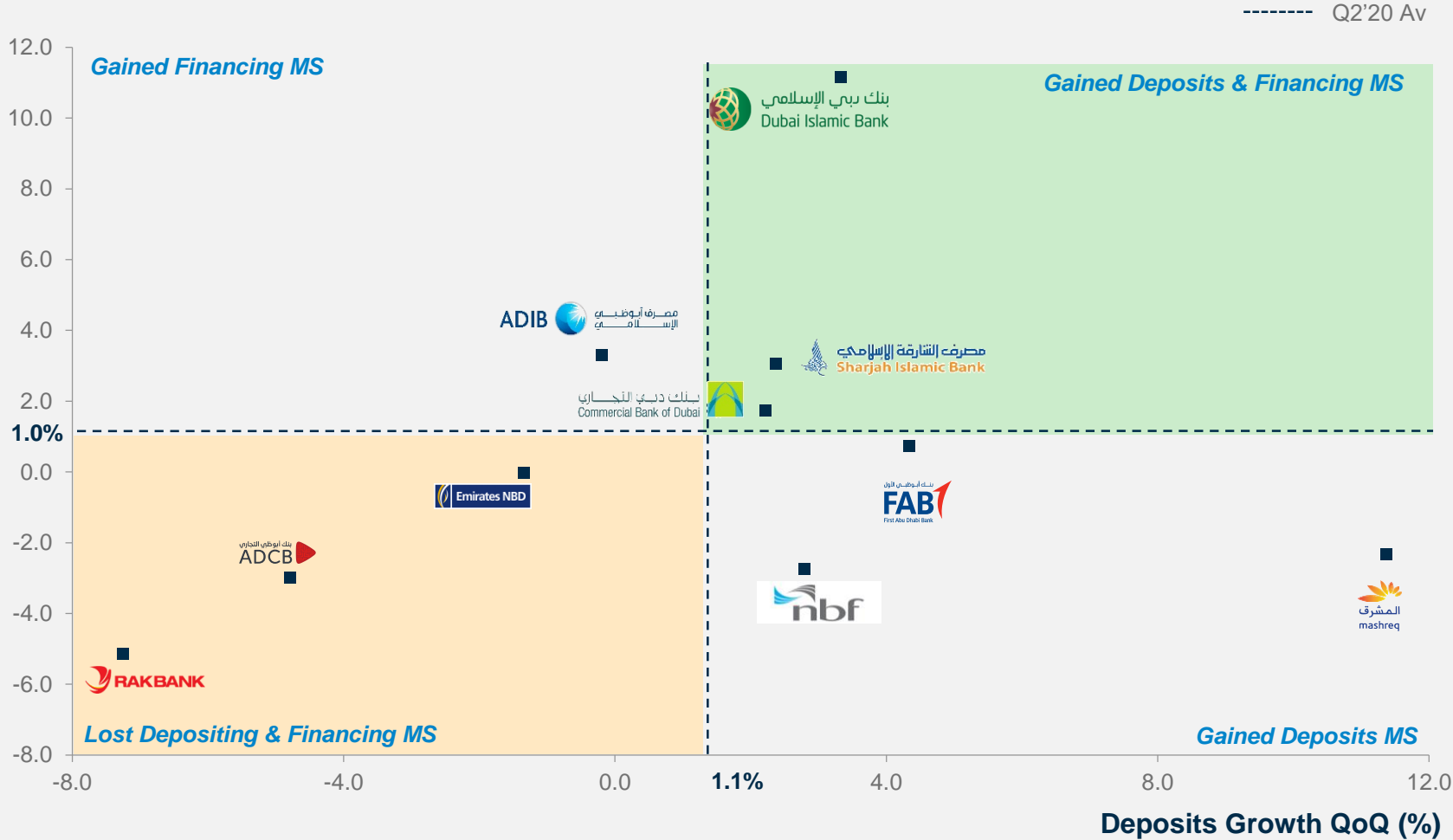
Note 2: Growth in loans & advances and deposits were presented QoQ instead of YoY

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

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

DIB Reported Double-Digit L&A Growth, While RAK Saw Negative Growth for Deposit and L&A

L&A Growth QoQ (%)



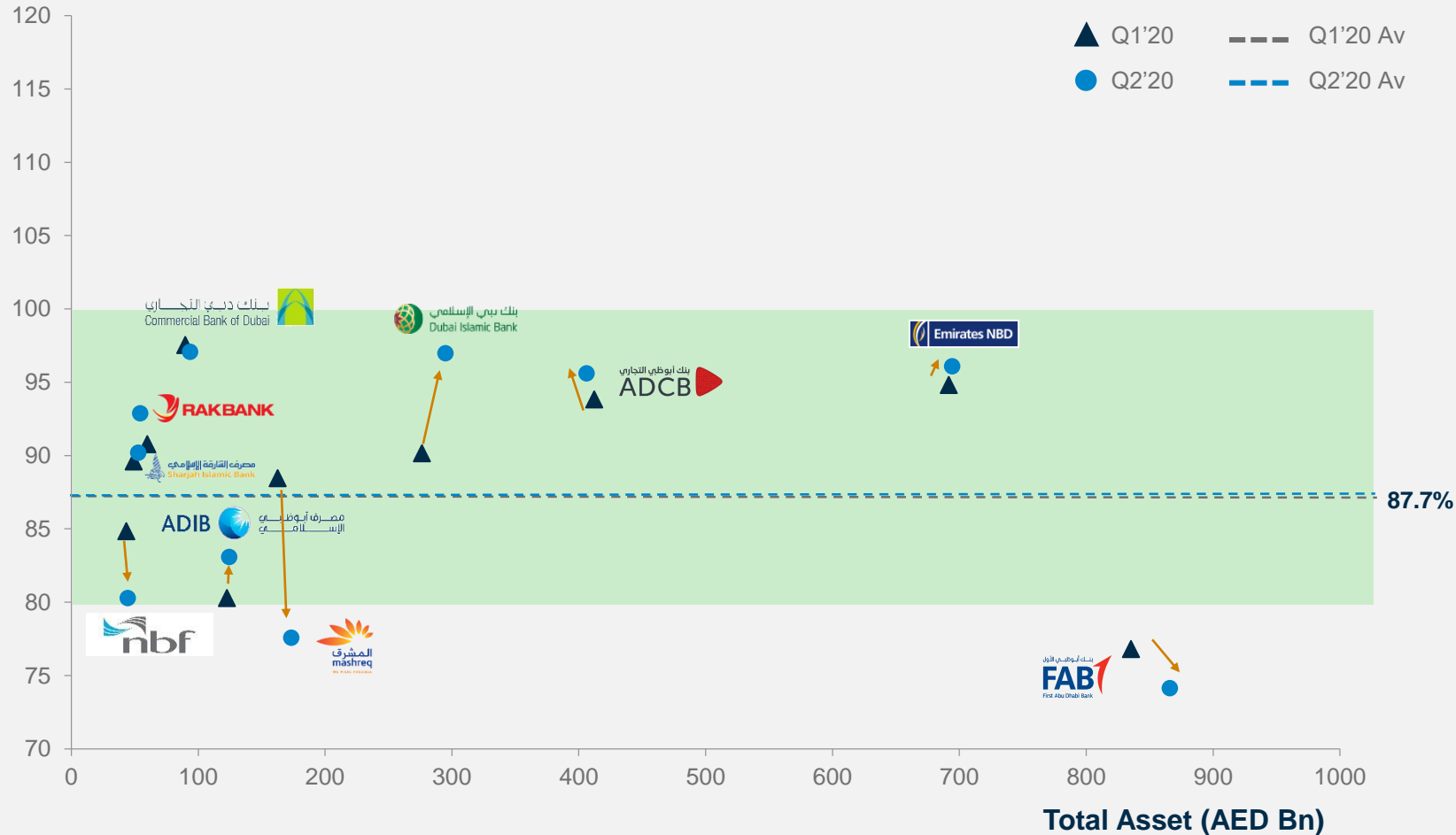
KEY TAKEAWAYS

- Banks' L&A (+1.0%) and deposit (+1.1%) increased from earlier quarter
- DIB reported highest growth in L&A (+11.2%) as the bank's wholesale and public sector lending increased substantially
- MSQ reported the strongest deposit growth (+11.4%), as time deposits increased ~13%
- RAKBANK reported the steepest decline in both deposits (-7.3%) and L&A (-5.1%)
 - L&A dropped as lending declined across all segments
 - Deposits fell on account of a outflows in time deposits

Note: MS stands for market share
 Source: Financial statements, Investor presentations, A&M analysis

DIB's LDR Increased the Most while MSQ's LDR Reported a Sizeable Decline

Loans to Deposits Ratio (%)



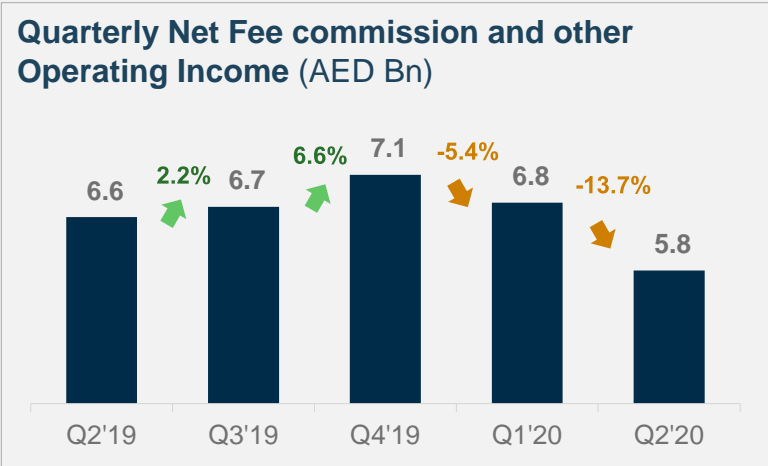
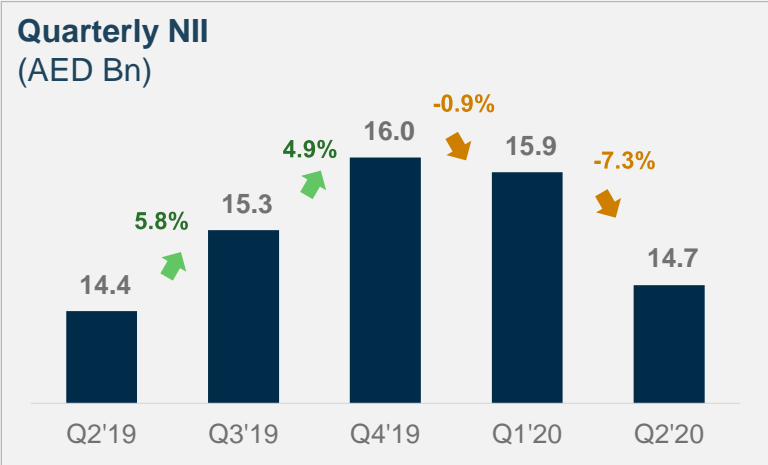
KEY TAKEAWAYS

- Average LDR remained broadly unchanged at 87.7%
- DIB showed the highest increase in LDR to 97.0% in Q2'20 compared to 90.2% in Q1'20
- ADIB showed the second highest increase in LDR to 83.1% from 80.3% in Q1'20
- On the other hand, MSQ reported the highest decline to 77.6% from 88.5% in the preceding quarter
- Similarly, NBF's LDR fell to 80.3% from 84.9% in Q1'20

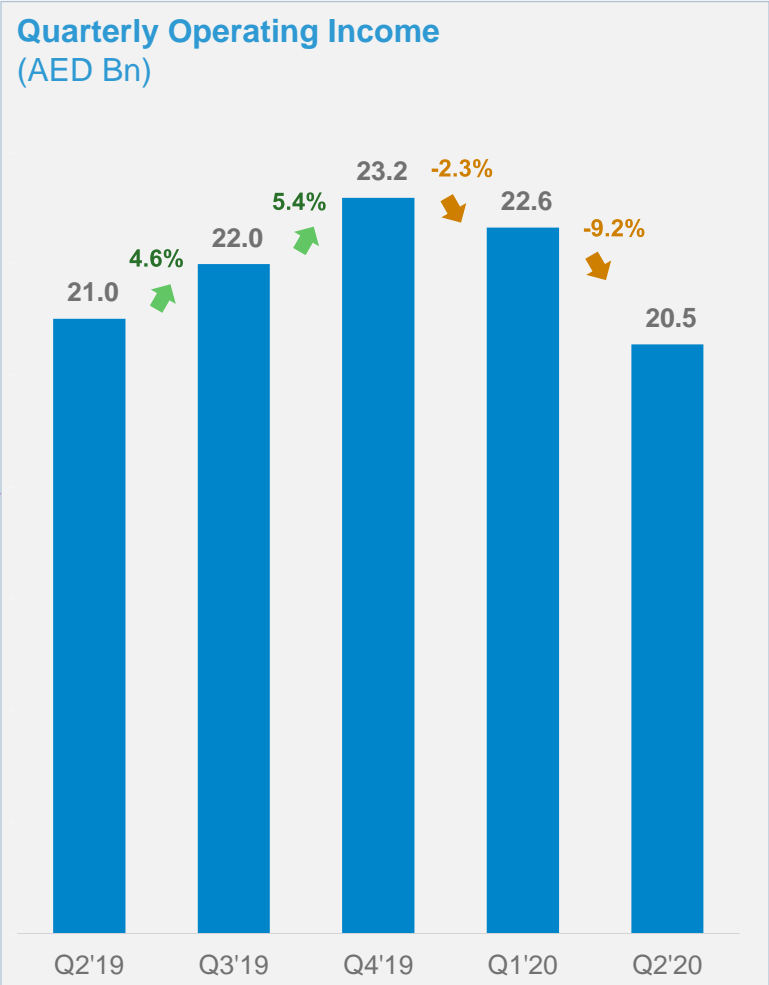
Note: The green zone is an area of healthy liquidity
Source: Financial statements, A&M analysis

Operating Income Declined For the Second Consecutive Quarter

➔ Improved
 ↔ Stable
 ➔ Worsened



+

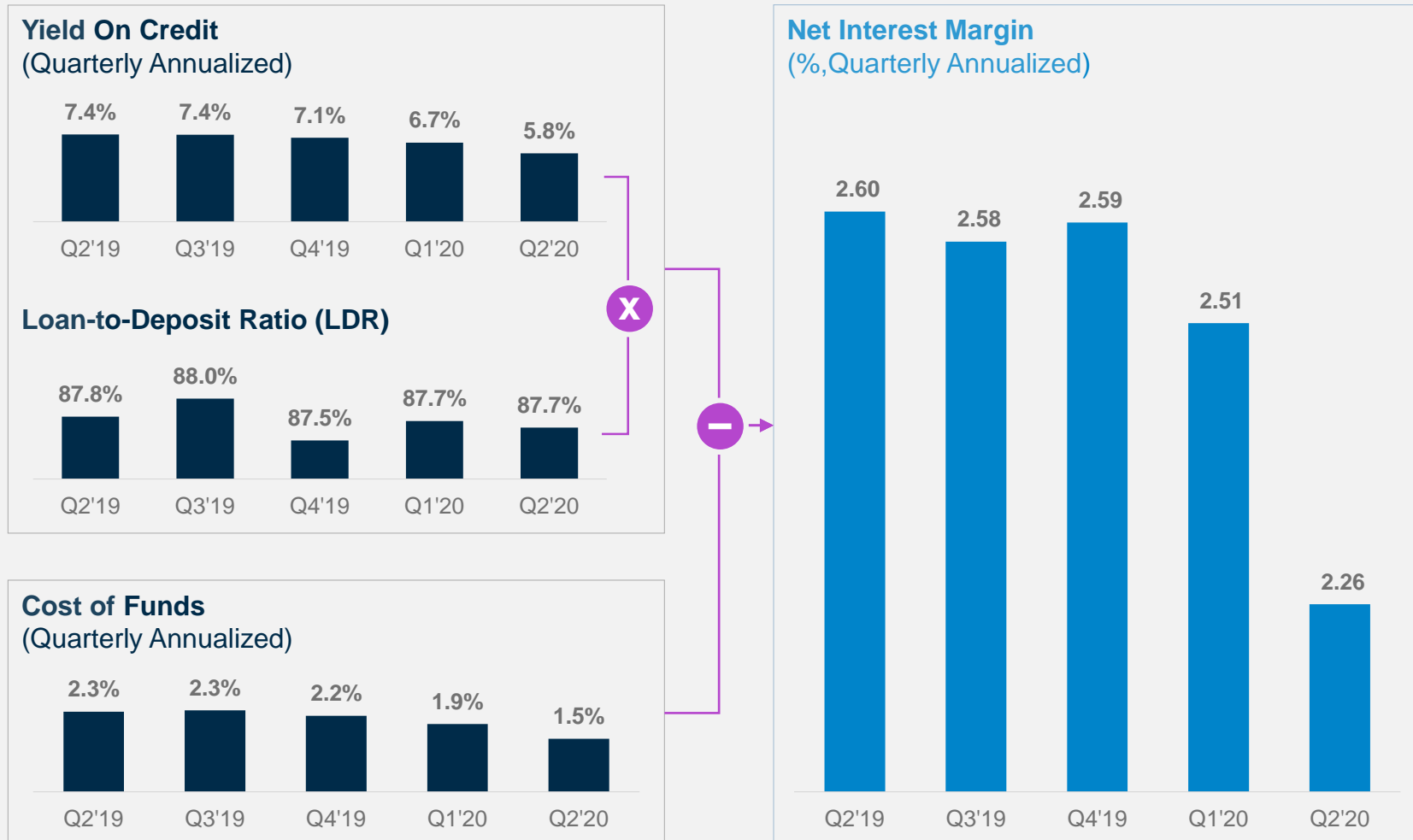


KEY TAKEAWAYS

- Operating income declined by 9.2% QoQ, as net interest income and non-interest income declined by 7.3% and 13.7%, respectively
- Non-interest income fell, as lockdowns limited the income arising from cards and new business volumes
- Amongst the top three banks, ENBD reported the highest decline in operating income (-16.6% QoQ), as NII and fee income fell ~12% and ~37%, respectively
- FAB, on the other hand, reported an increase in total operating income (+5.0%), driven by higher NII (+6.6%)

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

4 NIM Witnessed Sizeable Contraction, on the Back of Low Interest Rates



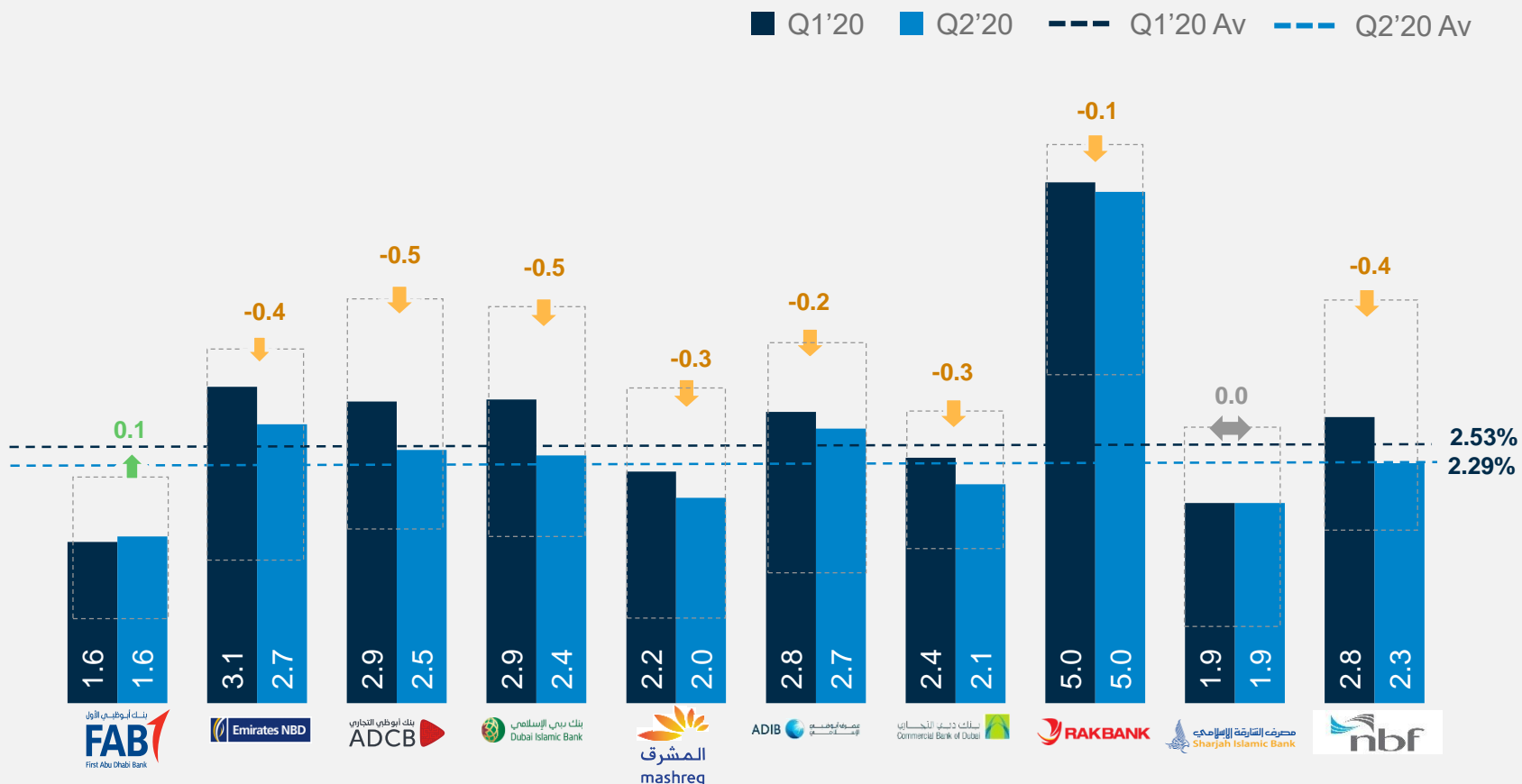
KEY TAKEAWAYS

- NIM compressed further and at a faster pace (~24 bps QoQ) in Q2'20, reaching multi-period low levels
- The contraction in NIM was largely because the fall yield of credit (~90 bps) was more than double compared to that of cost of funds (~42 bps)

NIM Fell Across Most of the Banks

→ Improved ↔ Stable → Worsened

Net Interest Margin (% Quarterly)



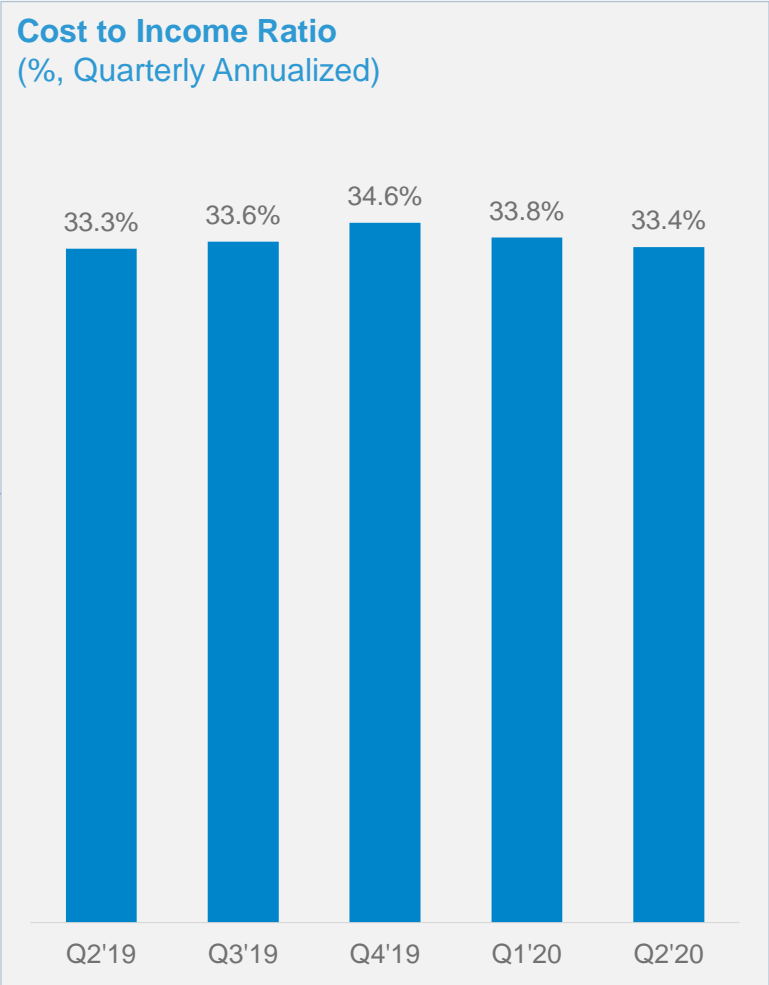
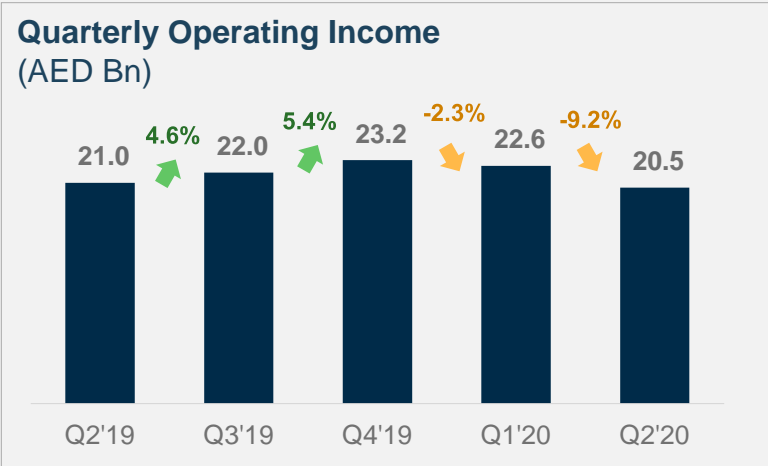
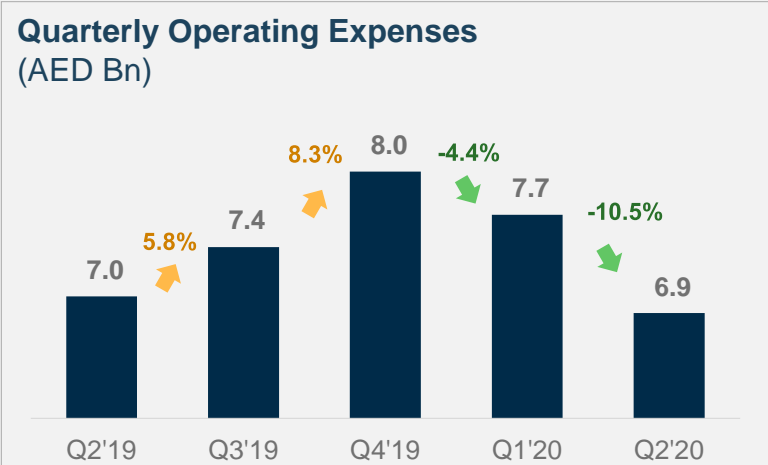
Note: Some numbers might not add up due to rounding
Source: Financial statements, investor presentations, A&M analysis

KEY TAKEAWAYS

- NIM fell by ~24 bps QoQ, as system-wide interest rates reached multi-period low levels
- DIB reported the steepest contraction (~54 bps QoQ), followed by ADCB (~47 bps QoQ)
- On the other hand, FAB's NIM increased by 5 bps to 1.62%
- While ENBD's NIM fell 36 bps, the bank received some support of higher margins through its Turkish subsidiary, DenizBank

Banks Continue to Optimize Their Expenses, in Light of Tough Operating Environment

➡ Improved ↔ Stable ➡ Worsened



KEY TAKEAWAYS

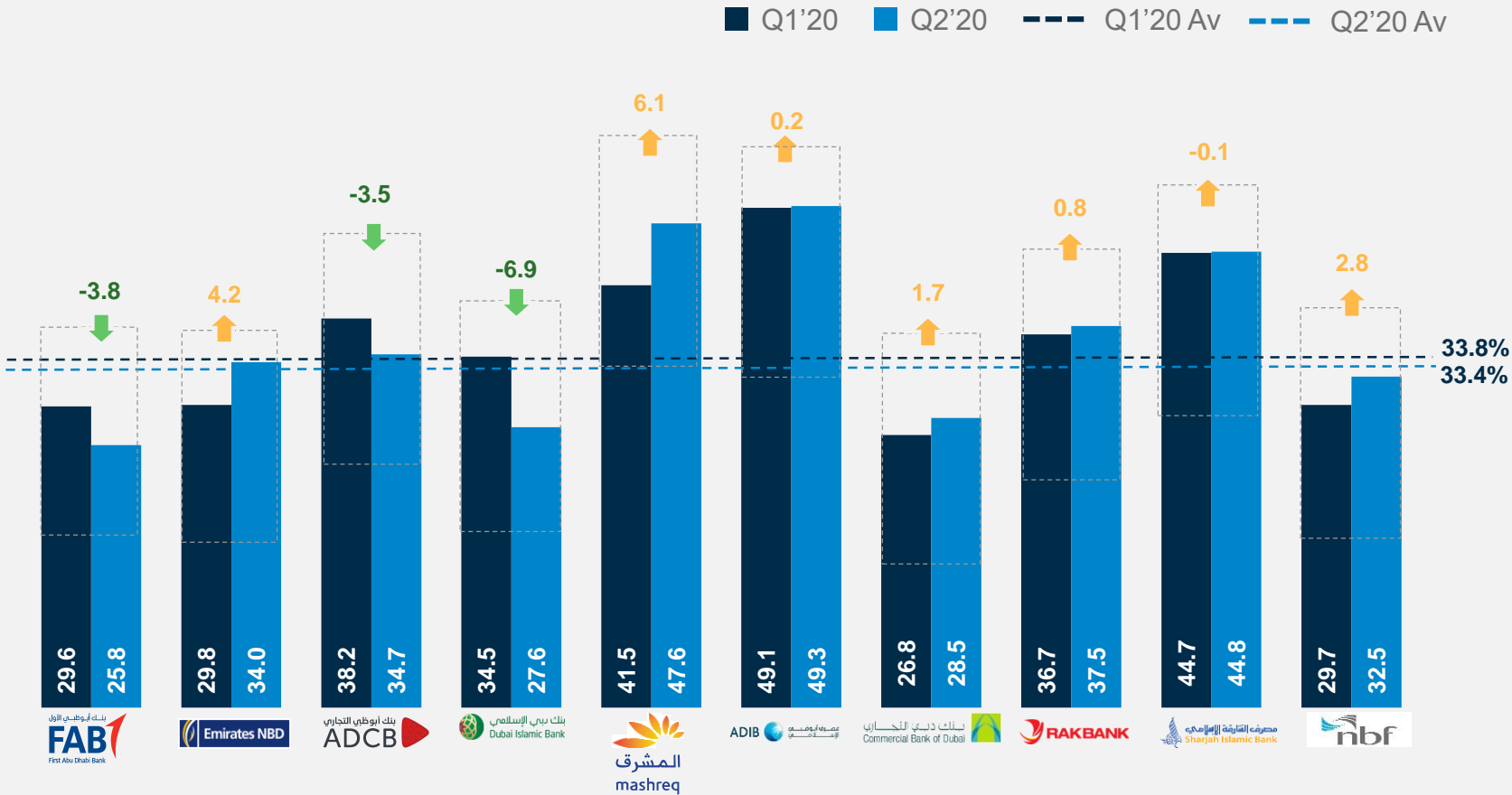
- C/I ratio improved for the second consecutive quarter to reach 33.4%
- Persistent decline in the operating expenses, led to the improvement in the C/I ratio
- Banks are likely to focus more on improving their efficiency in the coming period, as challenging operating environment calls for increased efforts towards cost optimization

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

Efficiency Ratio of DIB and FAB Showed the Highest Improvement

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

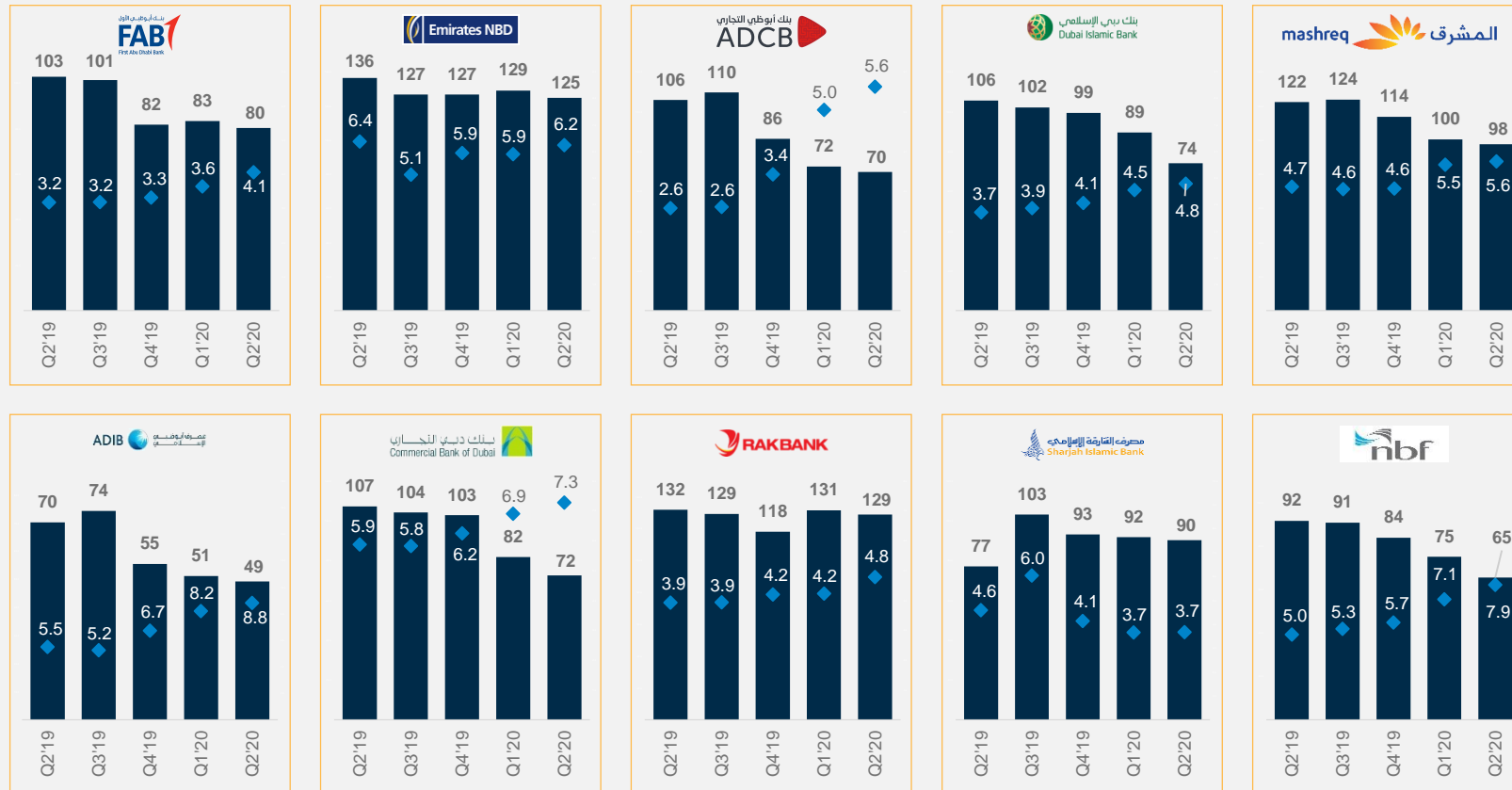
KEY TAKEAWAYS

- While there was an improvement in the overall cost efficiency, only three banks reported lower C/I ratios
- The largest improvement was seen in DIB's C/I (-6.9% points), followed by FAB (-3.8% points)
- C/I ratios for MSQ and ENBD deteriorated the most, as operating income declined substantially for both banks
- ADCB and ENBD have announced job cuts in the range of 400 – 800 people in July'20. Hence, there could be additional improvement in the efficiency ratios of these banks in the coming quarters

Coverage and NPL / Net Loans Ratios Deteriorated for Most Banks

■ Coverage Ratio, % ◆ NPL / Net loans, %

Coverage Ratio¹ and NPL / Net Loans Ratio (% , Quarterly)



Note: Scaling and some numbers might not add up due to rounding

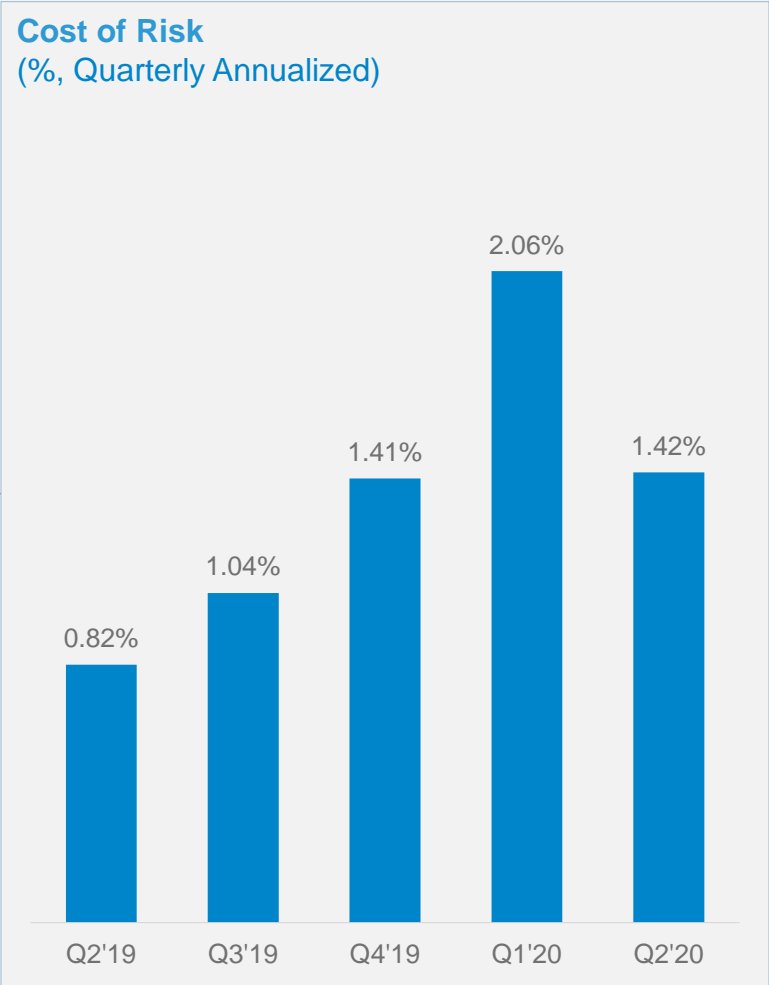
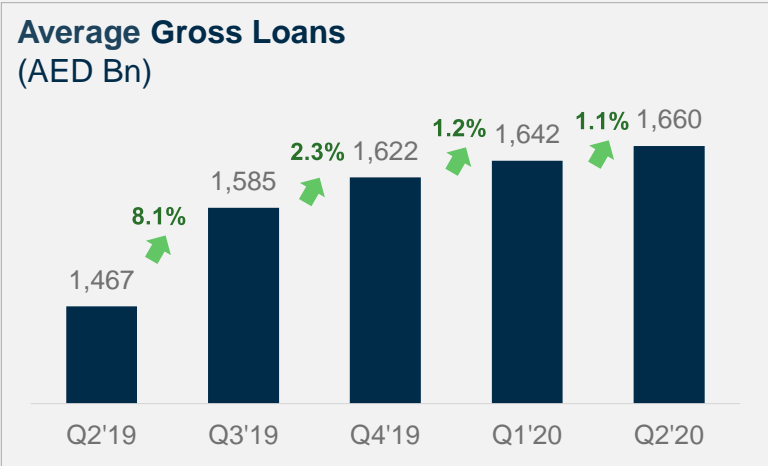
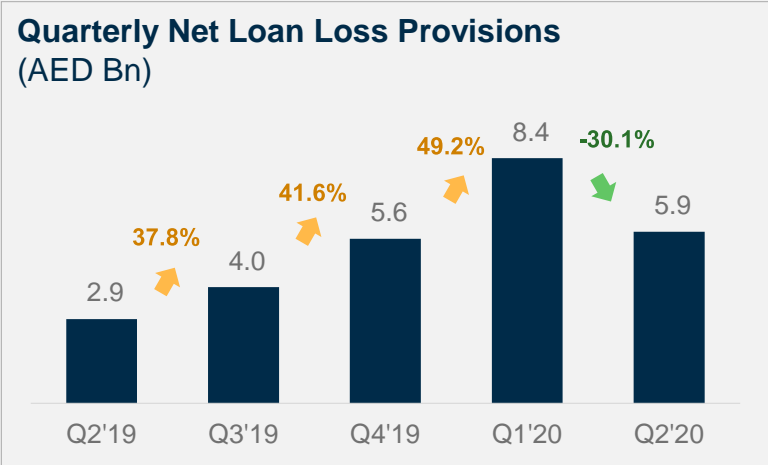
Source: Financial statements, investor presentations, A&M analysis, ¹ accumulated allowance for impairment / NPL

KEY TAKEAWAYS

- Coverage ratio for most of the banks declined in Q2'20, as banks reported lower provisioning
- CBD's and NBF's coverage ratio declined the most (~10% points)
- RAK and ENBD had the highest coverage ratios at 129% and 125%, respectively
- NPL / net loan ratio increased across the board, as slowdown in economic activities resulted in higher NPLs
- NBF (+0.9% points) and ADIB (+0.6% points) reported the highest increase in NPL / net loan ratio
- Overall, coverage ratio declined to 89.2%, which is the lowest since we started tracking from 2018.
- Consolidated NPL ratio moved marginally up to 5.5%

Cost of Risk Fell, but Still Remains Above its 2-Year Average Levels

➡ Improved ↔ Stable ➡ Worsened



KEY TAKEAWAYS

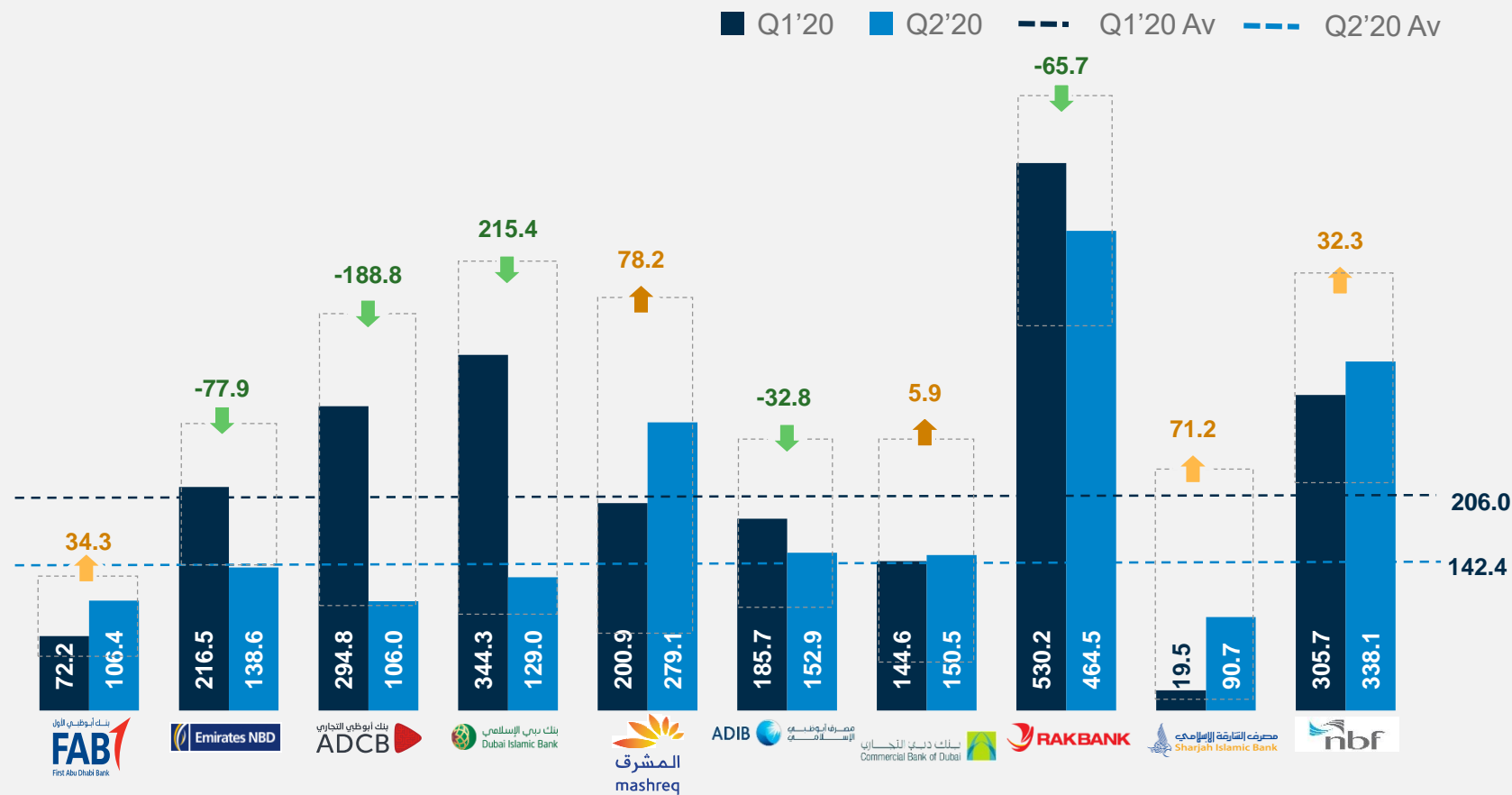
- After increasing for three consecutive quarters, CoR decreased by ~64 bps, as banks reduced their provisioning
- ADCB's (-64.5% QoQ) and ENBD's (-35.4% QoQ) loan loss provisions declined the most
- On the other hand, SIB (+5.0x QoQ) and FAB (+43.7% QoQ), reported a sharp increase in provisioning in Q2'20

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

DIB and ADCB Reported the Highest Decline in Cost of Risk

➔ Improved ➔ Stable ➔ Worsened

Cost of Risk (bps) – Net of Reversals



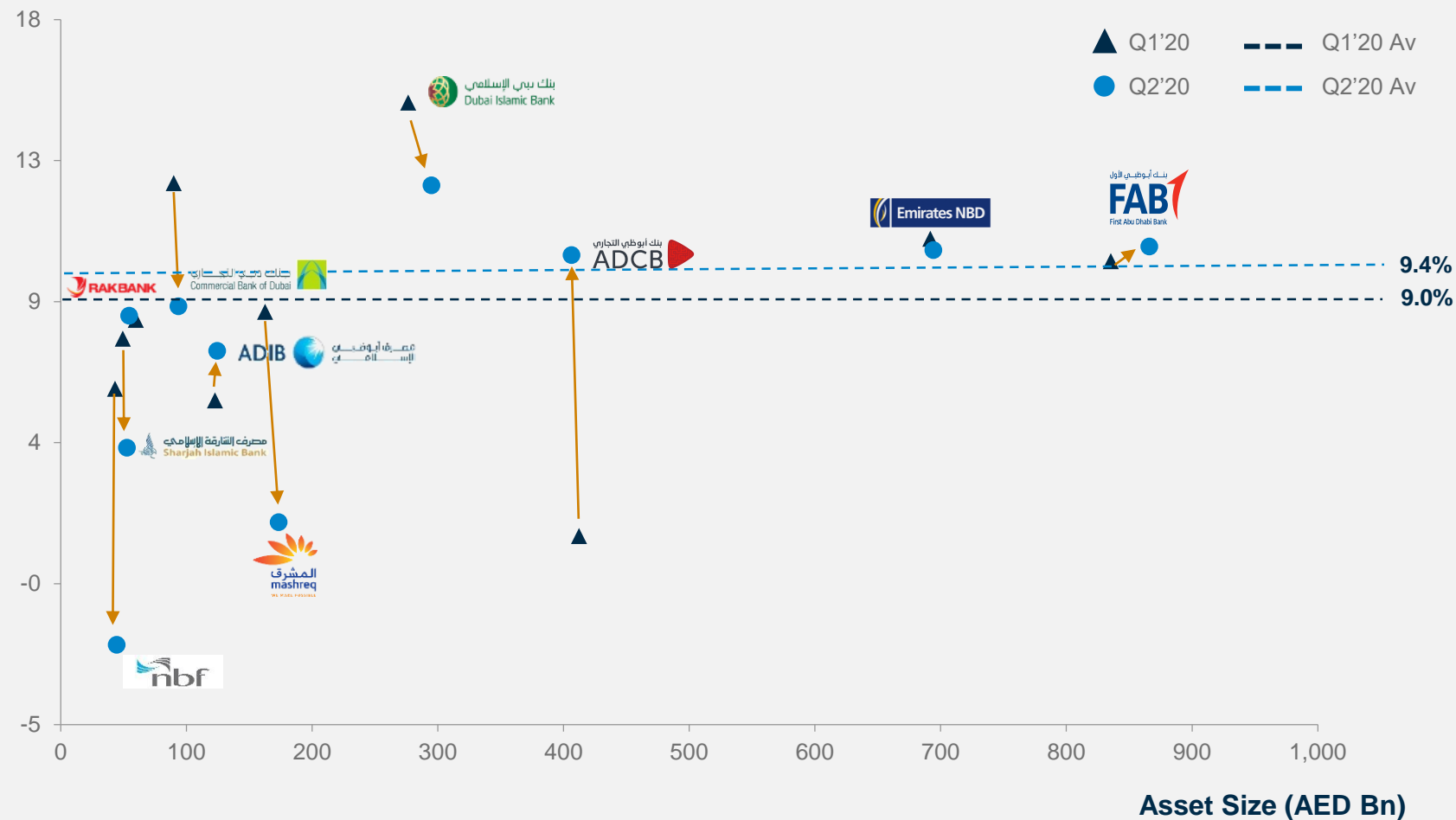
KEY TAKEAWAYS

- DIB’s cost of risk declined at the fastest pace (215.4 bps), as the bank had reported one-off impairment charges in Q1’20
- ADCB’s cost of risk fell by ~189 bps QoQ, as the bank reported lower provisioning on NMC Health, Finabl and related entities
- MSQ (+78.2 bps) and SIB (+71.2 bps) reported the highest increase in cost of risk during the quarter

Note: Scaling and some numbers might not add up due to rounding
Source: Financial statements, investor presentations, A&M analysis, DIB’s cost of risk recalculated for Q1’20

RoE Improved in Q2'20

Return on Equity (%)

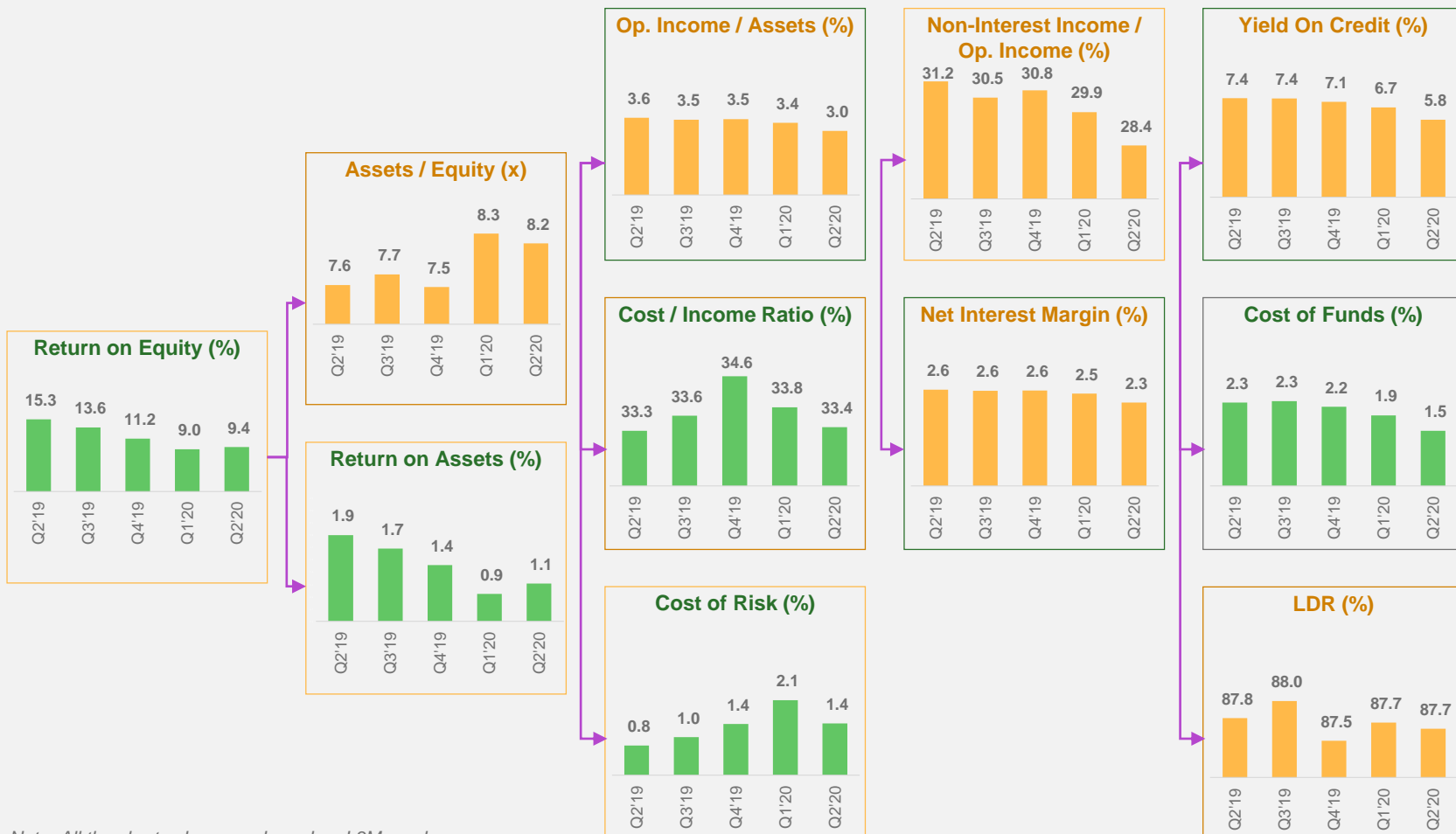


KEY TAKEAWAYS

- Average RoE for the universe increased to 9.4% during Q2'20, compared to 9.0% during Q1'20
- DIB reported the highest RoE (12.6%), followed by FAB (10.6%)
- NBF reported losses during the quarter, and consequently, the bank's RoE remained in the negative range

Banks Likely to Focus on Cost Optimization Measures, as Tough Operating Conditions might Weigh on Profitability

■ 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

- While there was a marginal increase in RoE, the outlook on profitability still remains negative
- Domestic banking sector is set to face headwinds in foreseeable future, in the form of after effects of COVID-19, low oil prices and delay in Expo 2020
 - While central bank's survey expects a pick up in corporate credit demand for Q3'20, the recovery would likely be fragile
 - Low interest environment along with a possible increase in impairments is expected to weigh on profitability
 - Banks might resort to additional job cuts and increased focus towards digitization to save costs and support bottom-line

GCC Banking Consolidation

GCC list of M&A transactions in banking sector since January 2019

Announcement Date	Target Company	Target Country	Acquirer Company	% Sought	Consideration (AED Mn)	Deal Status*
30-Jun-20	Al Khalij Commercial Bank PQSC	Qatar	Masraf Al Rayan QSC	100%	4,404	Pending
25-Jun-20	Samba Financial Group SJSC	Saudi Arabia	National Commercial Bank SJSC	100%	57,252	Pending
31-Dec-19	Alizz Islamic Bank SAOG	Oman	Oman Arab Bank SAOC	81%	NA	Pending
12-Sep-19	Ahli United Bank BSC	Bahrain	Kuwait Finance House KSCP	100%	21,431	Pending
15-Aug-19	Cqur Bank LLC	Qatar	VTB Bank PJSC	19%	NA	Completed
08-Aug-19	DenizBank AS	Turkey	Emirates NBD PJSC	0.20%	NA	Completed
20-Jun-19	Warba Bank KSCP	Kuwait	Kuwait & Middle East Financial Investment Co KSCP	75.70%	NA	Proposed
12-May-19	Gulf Bank KSCP	Kuwait	Alghanim Industries Ltd	16%	NA	Completed
21-Apr-19	HSBC Saudi Arabia Ltd	Saudi Arabia	HSBC Holdings PLC	2%	31	Completed
10-Apr-19	Invest bank PSC	UAE	Emirate of Sharjah United Arab Emirates	50%	989	Completed
07-Apr-19	Noor Bank PJSC	UAE	Dubai Islamic Bank PJSC	100%	NA	Completed
03-Apr-19	Oman United Exchange Co	Oman	Private Investor	25%	NA	Completed
15-Mar-19	Banque Saudi Fransi	Saudi Arabia	Olayan Investments, Ripplewood Advisors LLC	5%	1,609	Completed
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

Source: Bloomberg

*Proposed Status: Board suggests shareholders to consider the acquisition

*Pending Status: Acquisition has announced

*Completed Status: Acquisition has completed

Glossary








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Glossary

	Metric	Abbreviation	Definition
Size	Loans and Advances Growth		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	866.0	FAB	
Emirates NBD	694.3	ENBD	
Abu Dhabi Commercial Bank	406.2	ADCB	
Dubai Islamic Bank	294.8	DIB	
Mashreq Bank	173.3	MSQ	
Abu Dhabi Islamic Bank	124.4	ADIB	
Commercial Bank of Dubai	93.7	CBD	
National Bank of Ras Al-Khaimah	54.3	RAK	
Sharjah Islamic Bank	52.7	SIB	
National Bank of Fujairah	44.5	NBF	

Note: Banks are sorted by assets size

* As on 30th June 2020