



UAE Banking Pulse

Quarter 3, 2020



الإمارات
THE EMIRATES

FOREWORD

Alvarez & Marsal Middle East Limited (A&M) is delighted to publish the Q3'20 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.

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 metrics has been updated, where required, to reflect appropriate comparative information.

Provisions for the first 9 months, of the 10 banks under review has increased by ~2x YoY, reflecting both the effect of COVID-19, and the reduced economic activity. Allowance for impairment during this period, is 31% of Operating Income, compared to 18% for FY'19. We note that coverage ratio of 7 banks from our universe of 10, is below 100%. At the end of this year – and unless extended – the TESS program is scheduled to expire. Current deferrals totaling AED 51bn+ under this program, may have an additional impact on provisions during 2021.

As per IMF estimates, UAE GDP is expected to contract by 6.6% in 2020 before turning positive in 2021. The lowered economic activity and the low interest environment continued to pressure NIM for the banks. So also, while CAR remains very robust, the ROA and ROE in the sector remain below historical levels.

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



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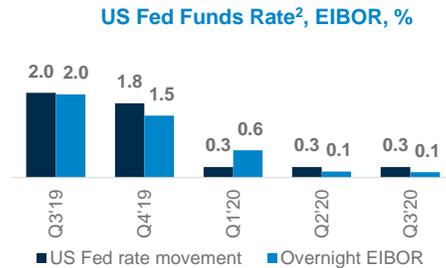
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UAE Macro & Sector Overview

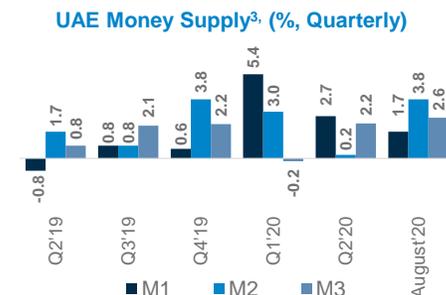
Macro overview



- In October'20, the IMF forecasted UAE's GDP to contract by 6.6% in FY'20, compared to its earlier forecast (negative 3.5%). However, growth will rebound to +1.3% in FY'21 and +2.2% in FY'22
- The downgrade reflects the impact of Covid-19 on the nation's vital sectors and decline in oil prices
- Average Q3'20 Emirates NBD Purchasing Managers' Index (PMI) rose to 50.4 compared to 47.1 in Q2'20, due to improvement in demand and output



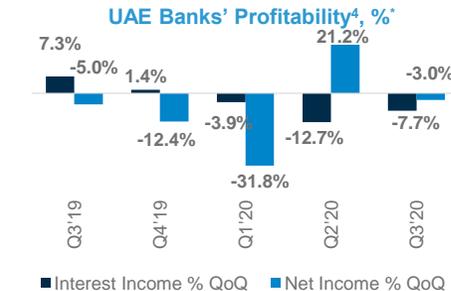
- In November'20, the US Fed reiterated its decision to maintain interest rates near zero as the US economy is far from being fully recovered
- The overnight EIBOR saw a further decline in Q3'20, to reach at multi-period low levels
- With a view to support the economy against COVID-19 headwinds, the UAE's central bank would most likely hold rates at current levels in the foreseeable future



- M2 money supply rose by 3.8% in August'20 to AED 1,513.5bn compared to June'20, it increased by 11.1% YoY
- The increase as compared to June'20 was due to 1.6% growth in monetary deposits
- M1 increased by 1.7% in August'20 to AED 566.9bn compared to June'20. On an annual basis, M1 increased by 11.4%
- M3 increased by 2.6% compared to June'20, and grew 10.1% YoY to reach AED 1.8tn

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 September 30th 2020

Banking overview Q3'20



- Total interest income of top ten UAE banks continued to decline for the third consecutive quarter (-7.7% QoQ), as low interest rate environment impacted asset yields
- After rebounding strongly in the preceding quarter, net income declined by ~3% QoQ, as lower interest and other operating income impacted profitability
- Persistent slowdown in the economy would likely weigh on the banks' profitability in the near term



- The UAE banks exposure to the real estate sector increased further by ~10 bps⁶
- The UAE's real estate market is expected to remain buyer friendly in the foreseeable future
- The UAE central bank predicted that the real estate sector would receive support from the TESS and other measures announced post the outbreak of the COVID-19



- UAE banking sector reported no new deals during Q3'20
- DIB finished the integration of Noor Bank following completion of the merger
- In October'20, FAB resumed its discussions to acquire the Egyptian operations of Lebanon-based Bank Audi
- In November'20, Emirates NBD announced that it is still reviewing the acquisition of BLOM Bank's Egyptian operations

Pulse: UAE Banks' Profitability Remains Impacted, as Low Interest Environment Weighs on Income Stream

→ Improved ← Stable → Worsened

| | Metric | Q2'20 | Q3'20 | Q3'19 | Q4'19 | Q1'20 | Q2'20 | Q3'20 | Key Trends of Q3'20 |
|-------------------------------|---|-------|-------|-------|-------|-------|-------|-------|--|
| Size | Loans and Advances (L&A) Growth (QoQ) | 1.0% | 0.0% | | | | | | 1 L&A remained broadly flat during Q3'20, which was the slowest growth in last six quarters. Deposit growth improved to 4.2% QoQ |
| | Deposits Growth (QoQ) | 1.1% | 4.2% | | | | | | |
| Liquidity | Loan-to-Deposit Ratio (LDR) | 87.7% | 84.1% | | | | | | 2 LDR fell to 84.1% from 87.7% as deposits grew at faster rate compared to L&A |
| Income & Operating Efficiency | Operating Income Growth (QoQ) | -9.2% | -3.4% | | | | | | 3 Operating income continued to decline for the third consecutive quarter on the back of reduced net interest income |
| | Operating Income / Assets | 3.0% | 2.8% | | | | | | |
| | Non-Interest Income(NII) / Operating Income | 28.4% | 30.9% | | | | | | |
| | Yield on Credit (YoC) | 5.8% | 5.3% | | | | | | 4 NIM continued its declining trend and touched multi-period low levels After declining for two consecutive quarters, C/I ratio increased to 34.3% in Q3'20 |
| | Cost of Funds (CoF) | 1.5% | 1.3% | | | | | | |
| | Net Interest Margin (NIM) | 2.3% | 2.0% | | | | | | |
| | Cost-to-Income Ratio (C/I) | 33.4% | 34.3% | | | | | | 5 CoR declined to 1.3% as compared to 1.4% in the preceding quarter. Coverage ratio increased, after declining substantially in Q2'20 |
| Risk | Coverage Ratio | 89.2% | 90.3% | | | | | | 6 |
| | Cost of Risk (CoR) | 1.4% | 1.3% | | | | | | |
| Profitability | Return on Equity (RoE) | 9.4% | 8.8% | | | | | | 7 RoE and RoA declined, tracking lower net income |
| | Return on Assets (RoA) | 1.1% | 1.0% | | | | | | |
| | Return on Risk-Weighted Assets (RoRWA) | 1.6% | 1.5% | | | | | | |
| Capital | Capital Adequacy Ratio (CAR) | 17.1% | 17.6% | | | | | | 8 RoRWA decreased slightly, while the capital adequacy ratio improved for the second consecutive quarter |

Note 1: QoQ stand for quarter over quarter

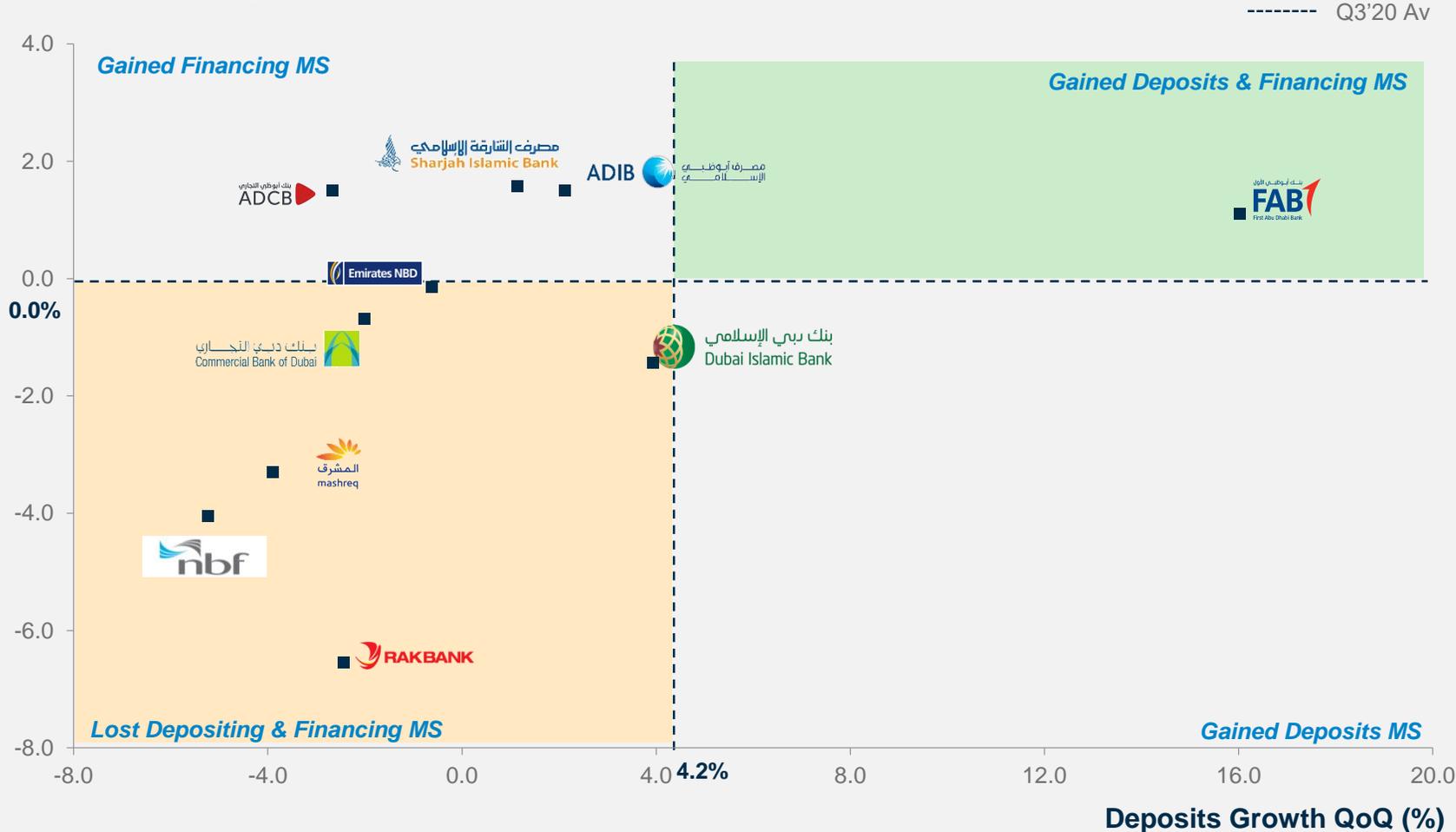
Note 2: Growth in loans & advances and deposits were presented QoQ instead of YoY

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

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

FAB reported Highest Growth in Deposits while RAKBANK Reported the Steepest Decline in L&A

L&A Growth QoQ (%)



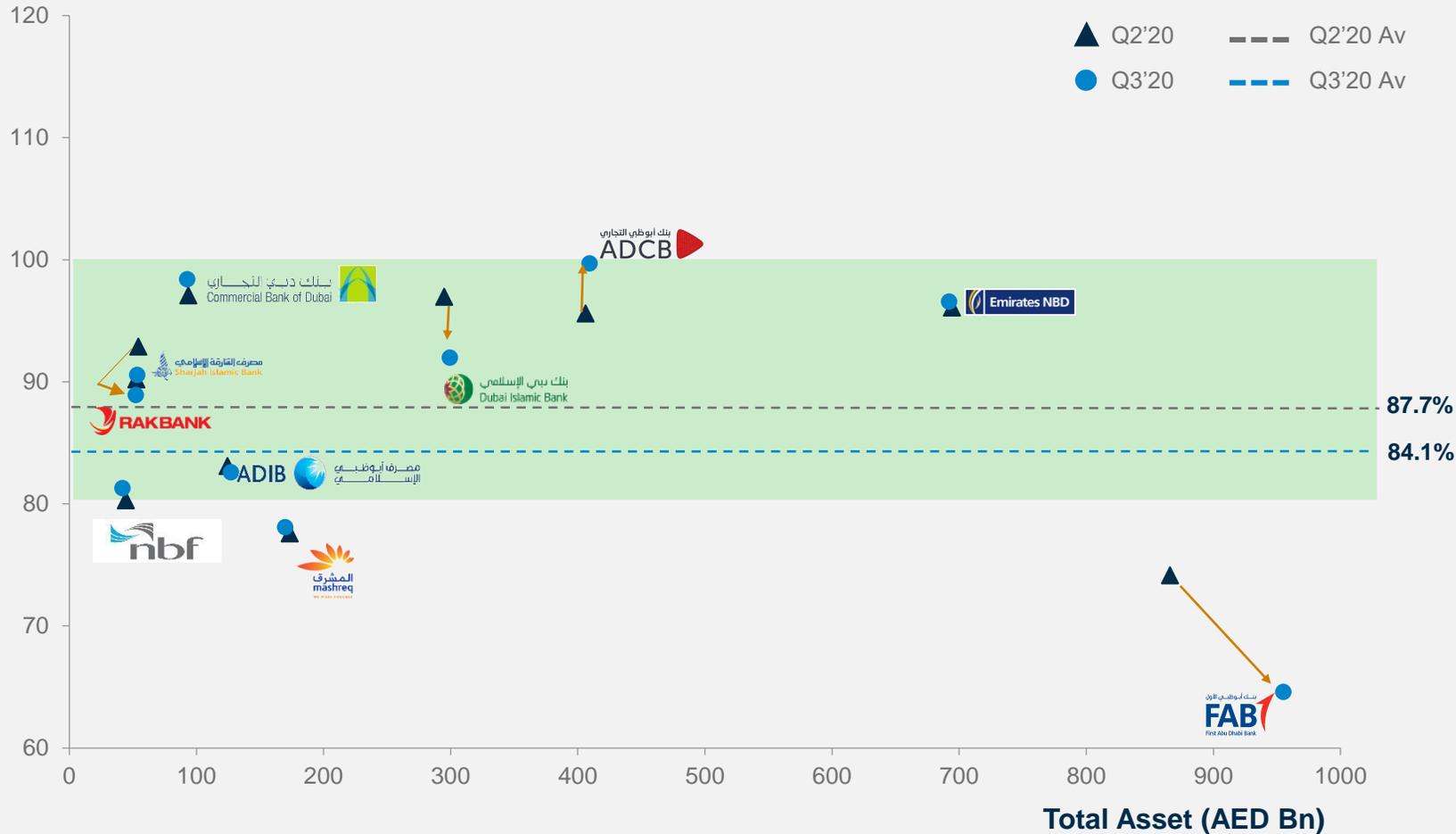
KEY TAKEAWAYS

- Top ten UAE banks' L&A balances remained flattish, while deposits increased 4.2% QoQ
- RAKBANK reported the steepest decline in L&A (-6.6%), on the back of reduced credit uptake from SMEs
- SIB and ADCB reported highest growth in L&A of 1.6% and 1.5%, respectively
- FAB reported a very high growth in deposits (+16.0%), as government deposits increased substantially (+44%)
- DIB reported the second highest increase in deposits (+3.9%), amid increased inflow from savings and investment deposits

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

Decline in Aggregate LDR was Primarily Driven by a Sizeable Drop in FAB's LDR

Loans to Deposits Ratio (%)



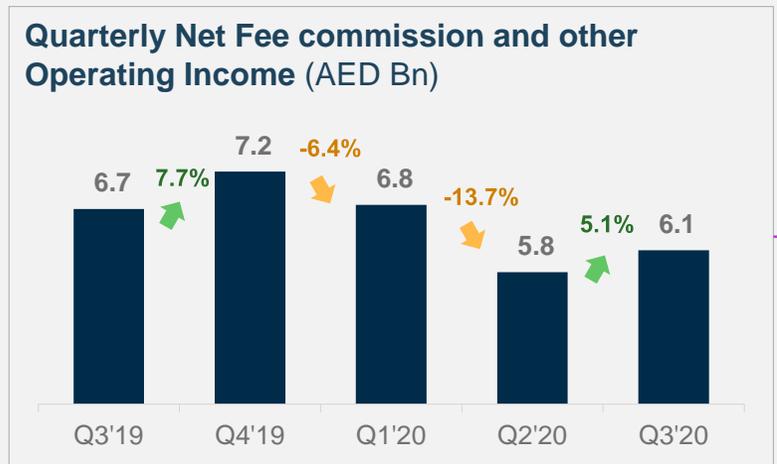
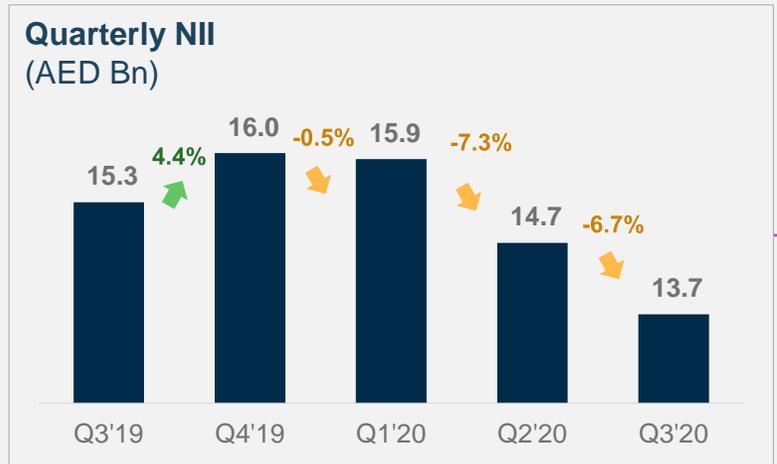
KEY TAKEAWAYS

- Average LDR decreased to 84.1% in Q3'20 compared to 87.7% in Q2'20
- FAB reported the highest decrease in LDR to 64.6% in Q3'20 compared to 74.1% in Q2'20
- On the other hand, ADCB (+4.1% points) and CBD (+1.3% points) reported the largest increase in their LDR during the quarter

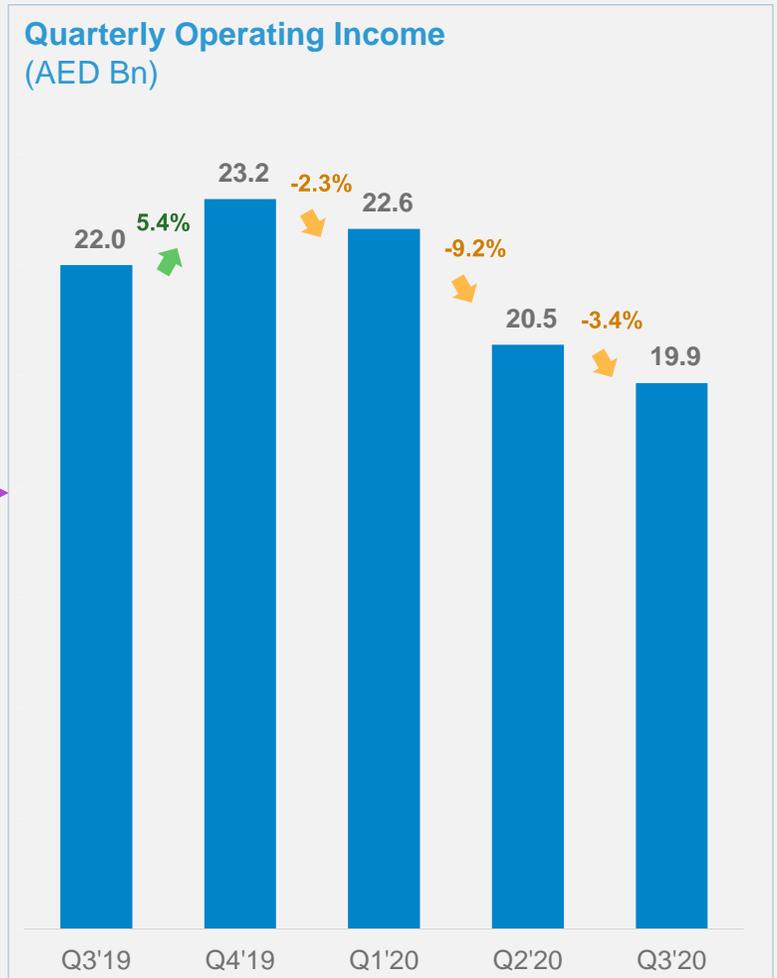
Note: The green zone is an area of healthy liquidity
 Source: Financial statements, A&M analysis

3 Operating Income Continued to Decline for the Third Consecutive Quarter

➔ Improved ↔ Stable ➔ Worsened



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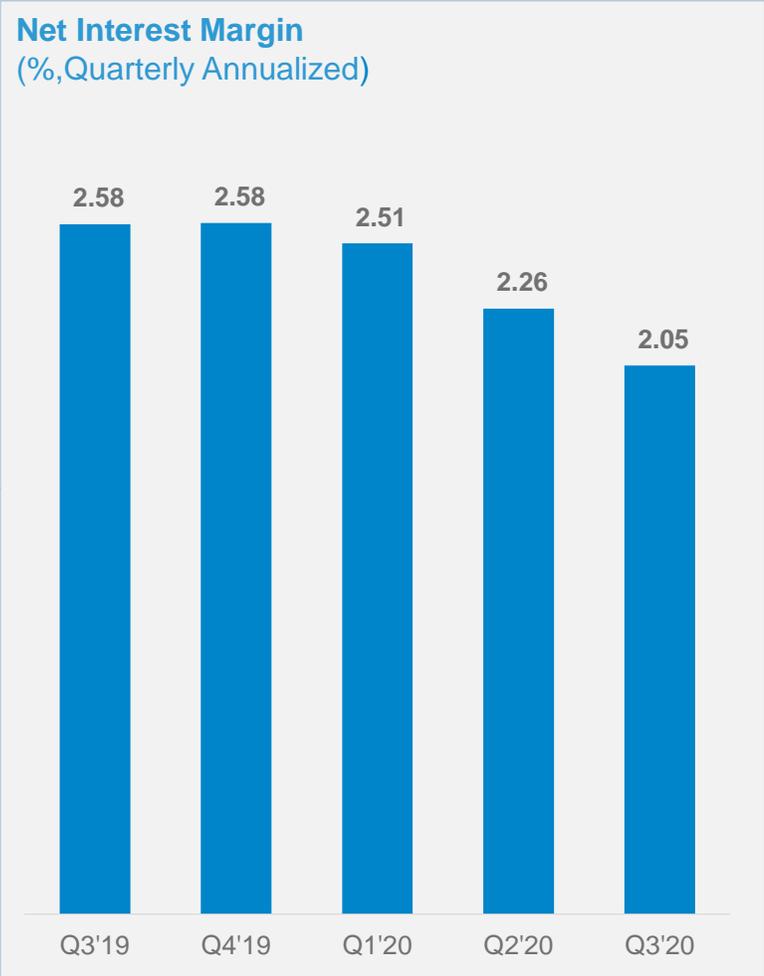
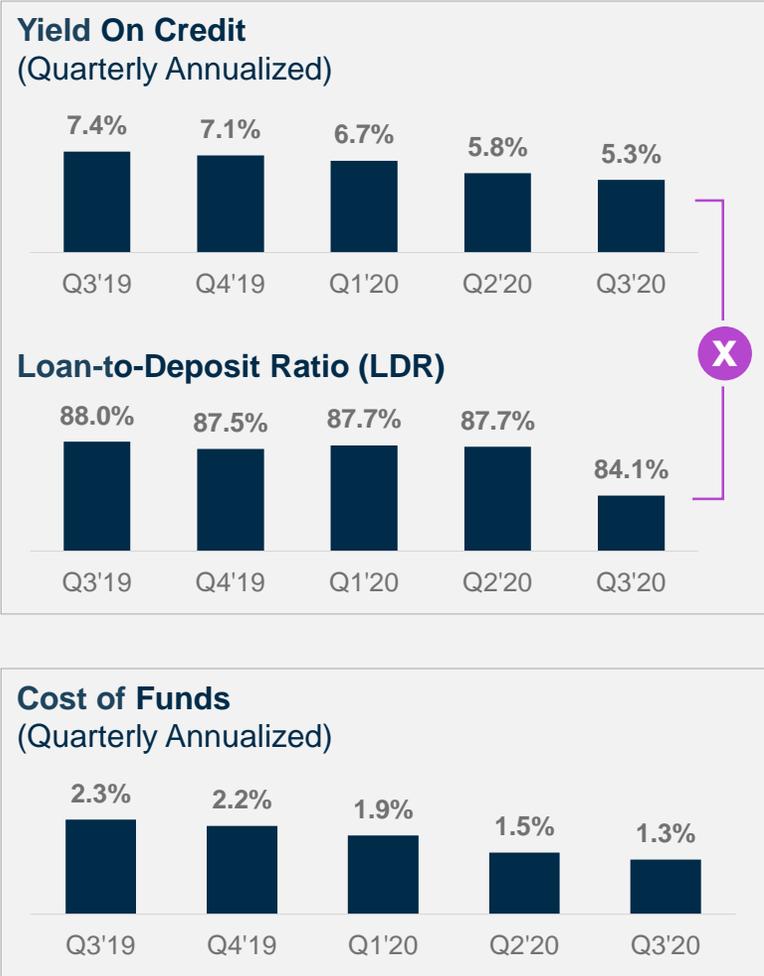


KEY TAKEAWAYS

- Operating income declined by 3.4% QoQ, as net interest income declined by 6.7%. However, non-interest income increased 5.1% QoQ
- The rise in the non-interest income was primarily driven by 17.7% QoQ growth in the fees & commission income
- Among the individual banks, MSQ (-12.8% QoQ) and FAB (-10.2% QoQ), reported the highest drop in total operating income
- ADIB (+8.8% QoQ) reported the highest increase in its total operating income, as the bank's fee income jumped ~46%, driven by increased fee income on cards (+40%)

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

NIM Continue to Fall, Tracking Lower System-wide Rates



KEY TAKEAWAYS

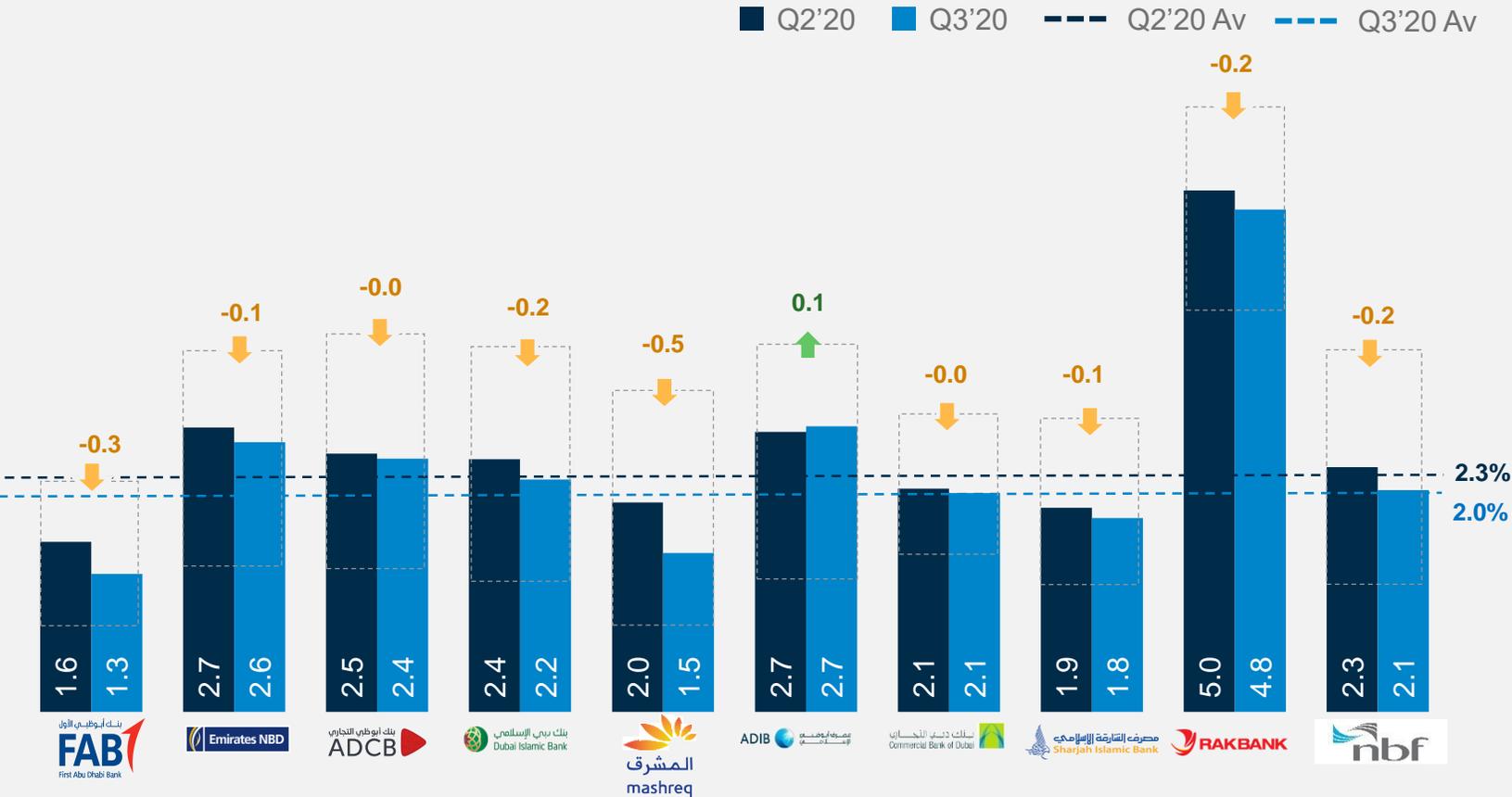
- NIM contracted further by ~21 bps QoQ, reaching its multi-period low levels in Q3'20
- Yield on credit fell ~47 bps QoQ, while cost of funds declined ~17 bps. This was primary reason behind the drop in NIM

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

NIM Declined Across Most of the Banks

→ Improved ← Stable → Worsened

Net Interest Margin (% Quarterly)



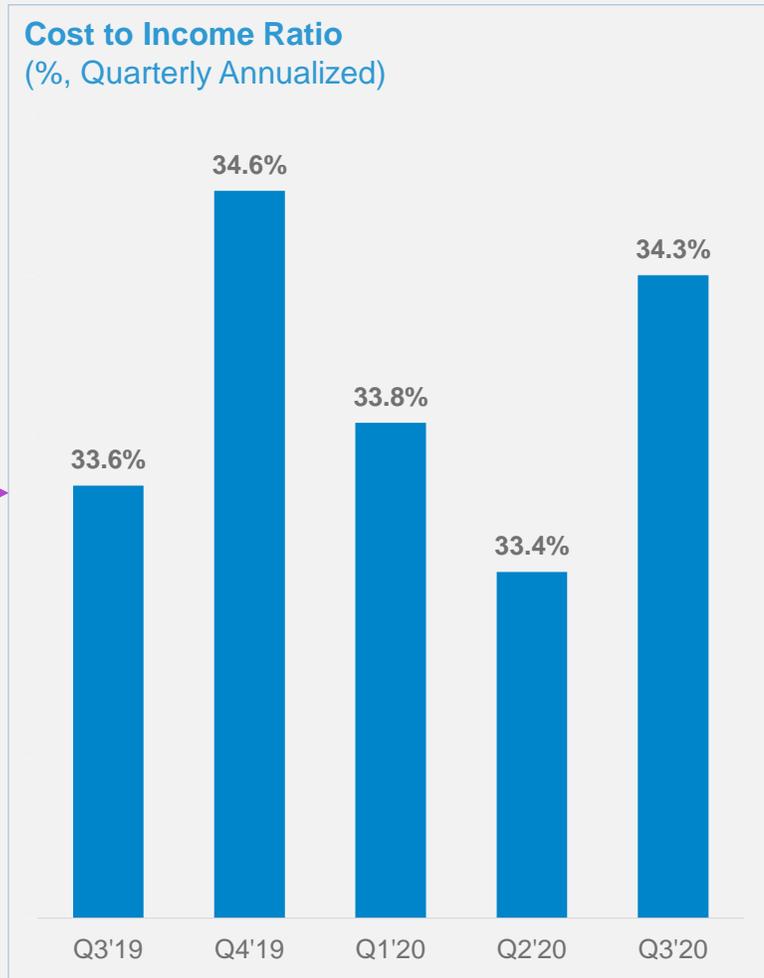
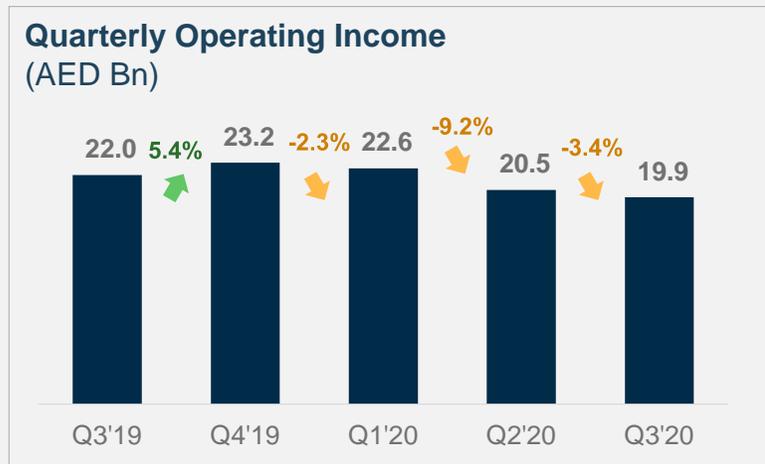
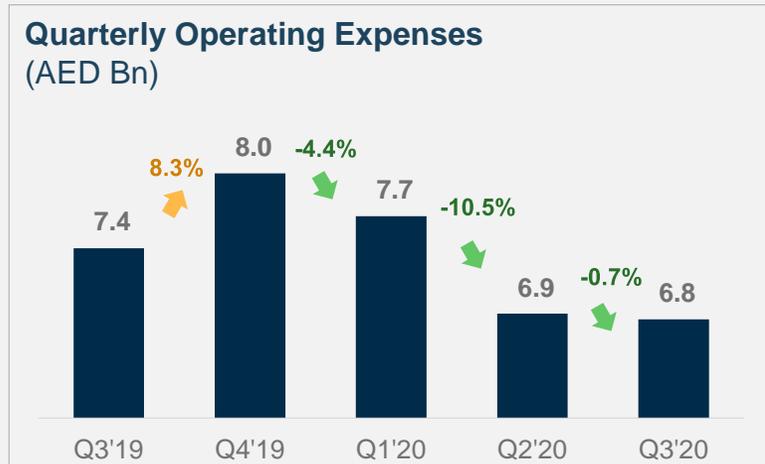
KEY TAKEAWAYS

- During Q3'20, NIM fell by ~21 bps QoQ, led by a sizeable drop yield on credit
- MSQ reported the steepest contraction in NIM (~48 bps QoQ), followed by FAB (~31 bps QoQ)
 - The decline in FAB's NIM was led by lower net interest income, reflecting the full impact of rate cuts and lower interest in suspense reversals
- ADIB was the only bank to report a marginal (~5 bps QoQ) increase in NIM

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

5 Cost to Income Ratio Increased as Decline in Operating Income Outplayed Cost Optimization

➔ Improved
 ↔ Stable
 ➔ Worsened



KEY TAKEAWAYS

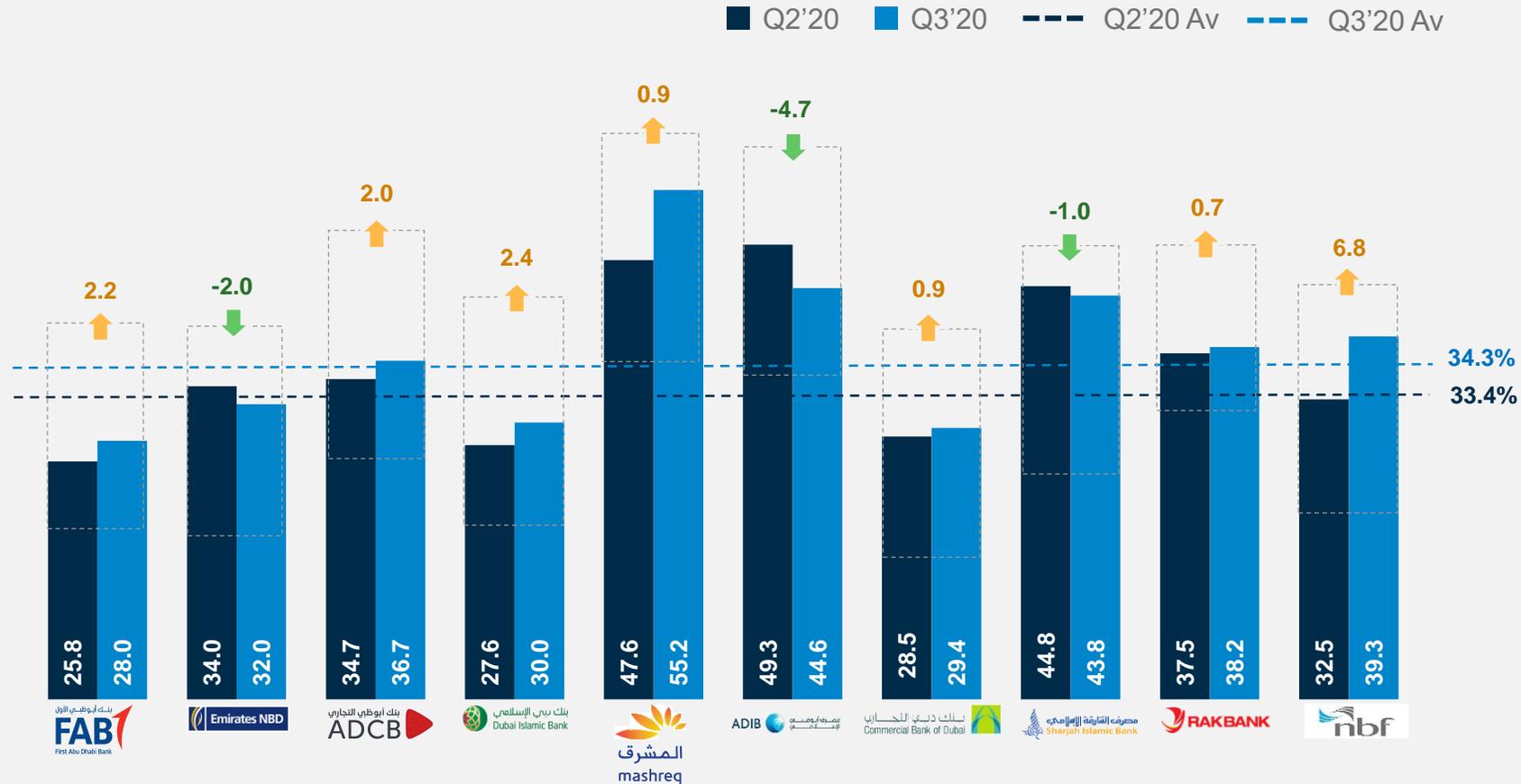
- C/I ratio increased after improving in the last two quarters to reach 34.3% in Q3'20
- Operating expenses fell by 0.7% QoQ. However, the cost savings were outplayed by a broader decline in the operating income of 3.4%

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

5 Efficiency Ratios of NBF and DIB Saw the Largest Deterioration

➔ Improved ↔ Stable ➔ Worsened

Cost to Income Ratio (% , Quarterly)



KEY TAKEAWAYS

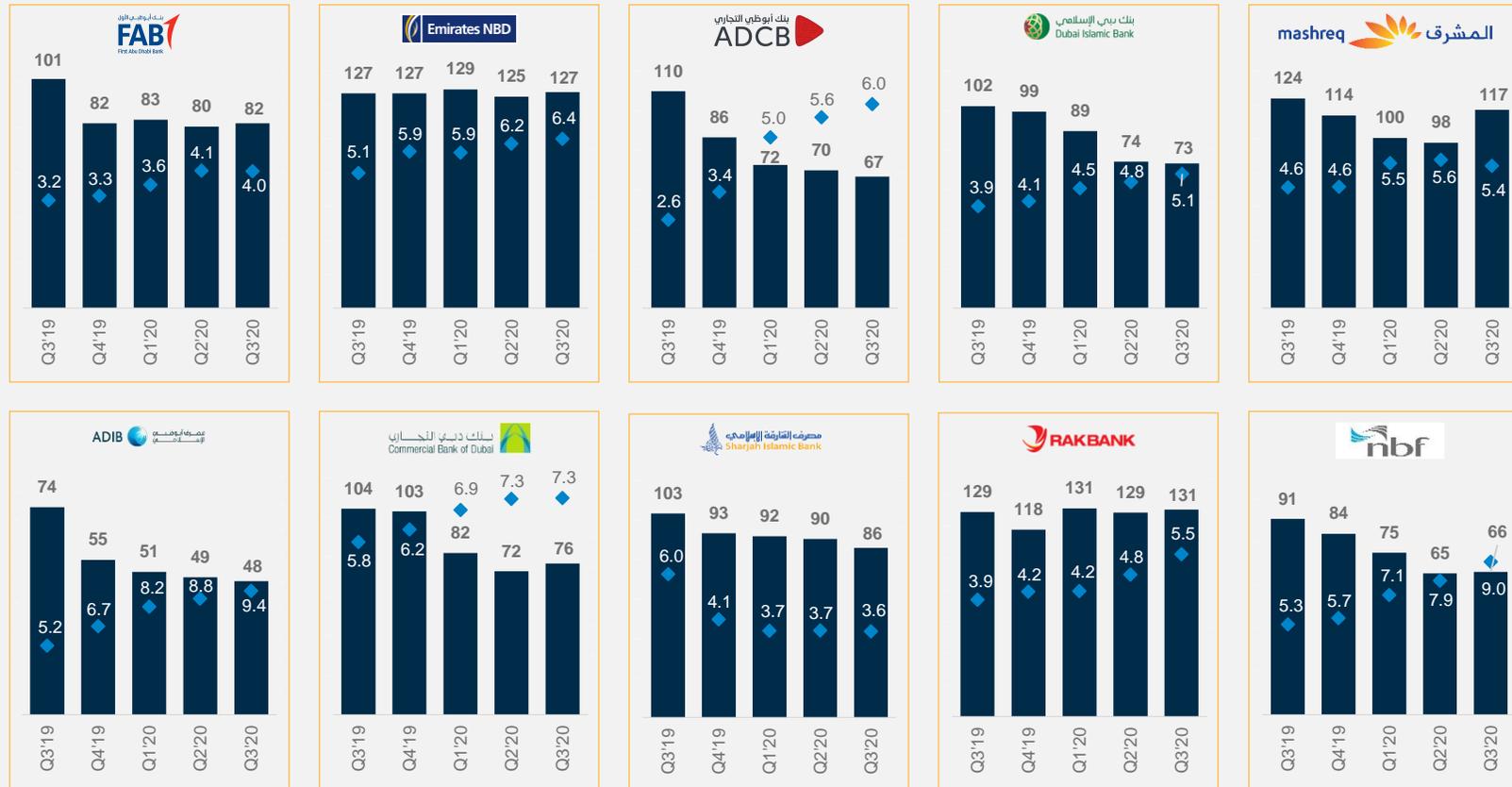
- Seven of the top ten banks reported increased C/I ratio
- NBF (+6.8% points QoQ) reported the largest deterioration in C/I ratio, as the bank's opex increased ~10% QoQ, while operating income fell ~9% QoQ
- On the other hand, ADIB's C/I ratio improved the most (-4.7% points QoQ), driven by:
 - Reduction in customer acquisition costs
 - Optimization of branch network
 - Introduction of technologies to streamline the processes

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

Coverage Ratio Improved Marginally, while NPL / Net Loans Ratios Deteriorated Further

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

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



KEY TAKEAWAYS

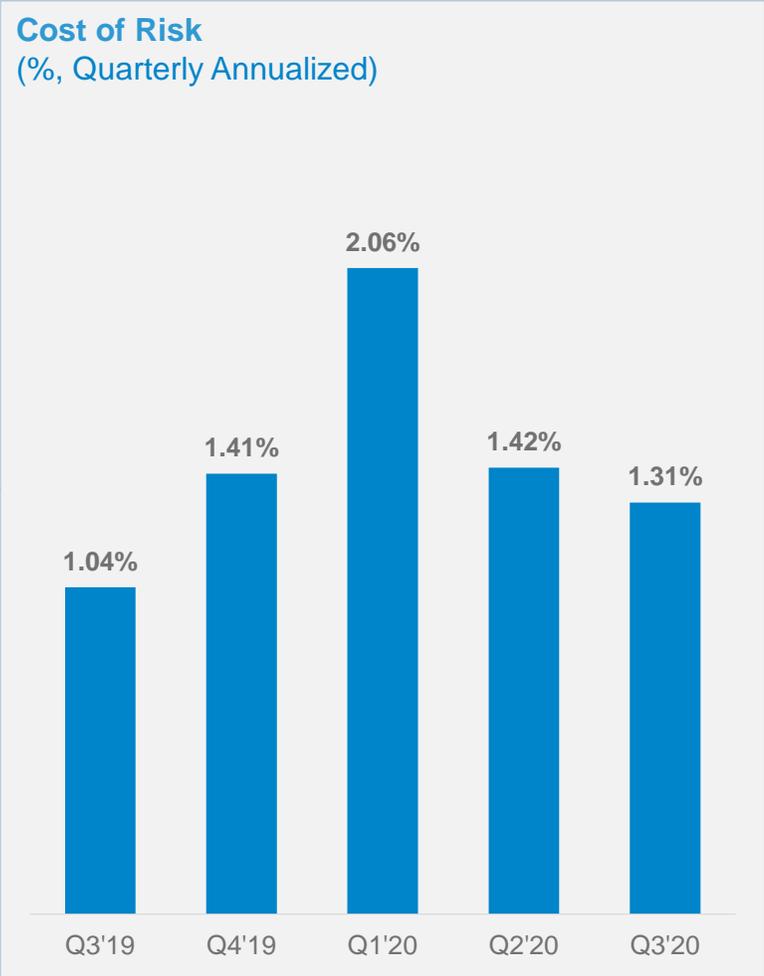
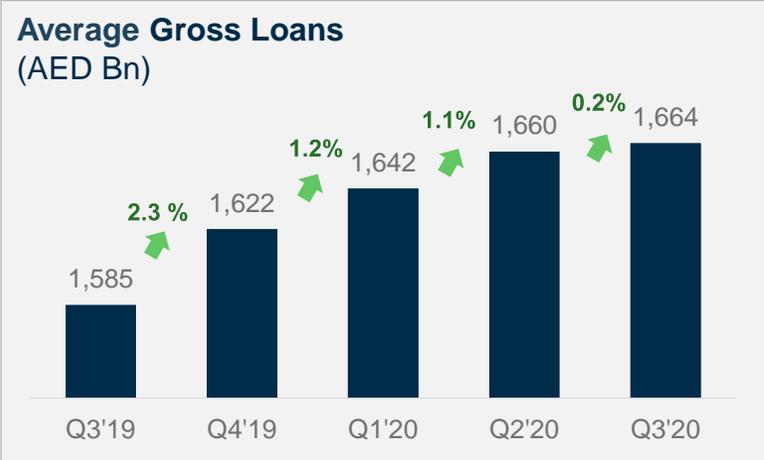
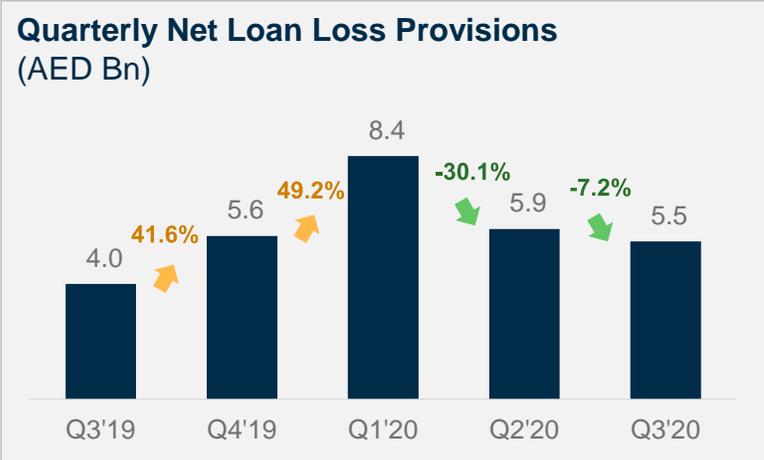
- Aggregate coverage ratio for the banks improved marginally to 90.3% in Q3'20 compared to 89.2% in Q2'20
- Coverage ratio of MSQ improved the most (~20% points), it declined the most for SIB (~5% points)
- Aggregate NPL / net loan ratio rose to 5.7% in Q3'20 from 5.5% in Q2'20, as NPLs increased ~4%
 - NBF saw the highest increase in the ratio (+1.1% points)

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

Cost of Risk Continued to Fall for Second Consecutive Quarter

➔ Improved ↔ Stable ➔ Worsened



KEY TAKEAWAYS

- Aggregate cost of risk eased by 11 bps QoQ, as total provisioning dropped ~7% to AED 5.5bn
- Out of the top 4 banks, FAB (-52.5%), ADCB (-24.6%) and DIB (-16.7%) reported a decrease in total provisions
 - FAB's provision declined as the bank reached a partial resolution for a large corporate account
- On the other hand, ENBD (+30.1%) reported the highest increase in provisioning

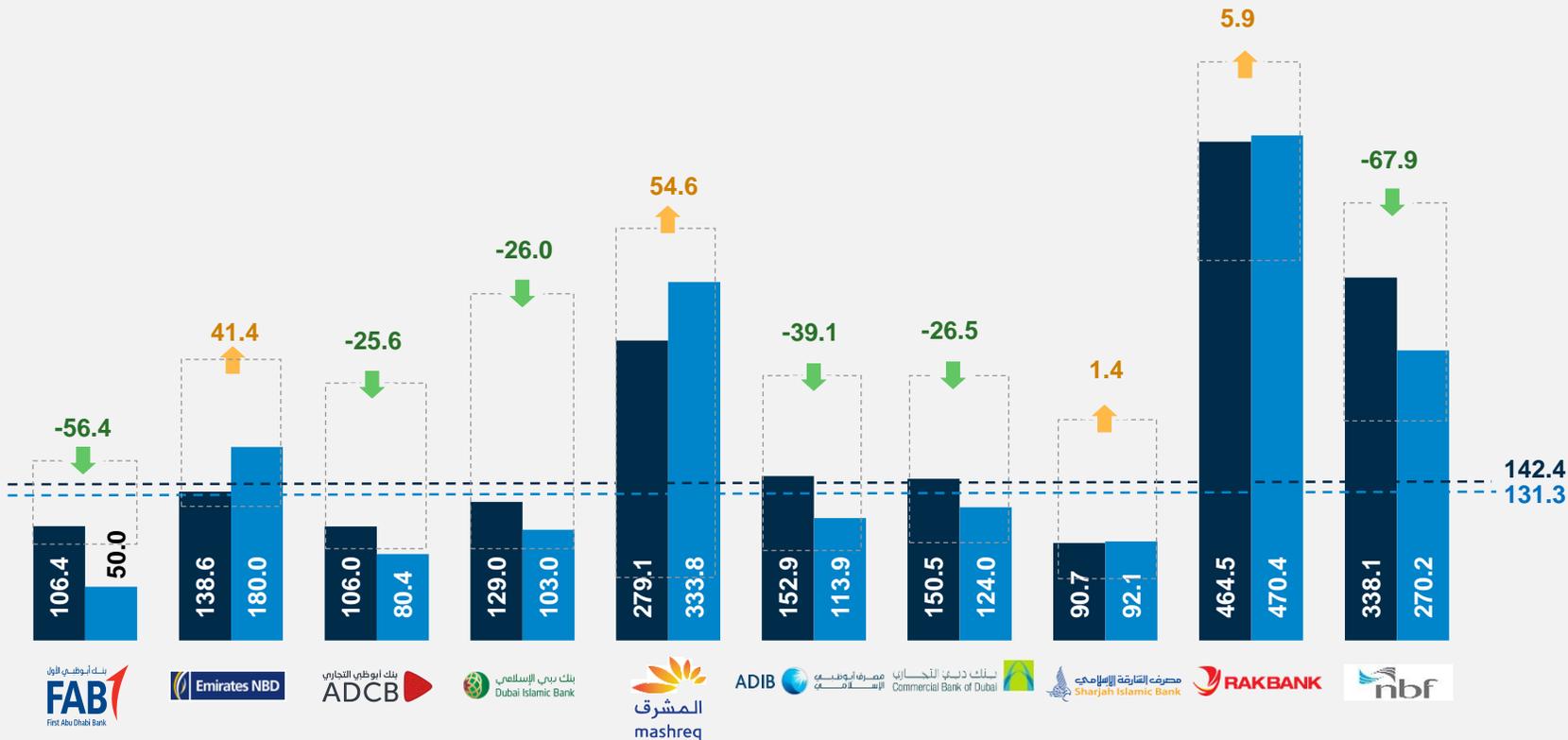
Note: Scaling and some numbers might not add up due to rounding
 Source: Financial statements, investor presentations, A&M analysis

6 NBF Reported the Highest Decline in Cost of Risk, but Increase in NPL Ratio

➔ Improved ➔ Stable ➔ Worsened

Cost of Risk (bps) – Net of Reversals

■ Q2'20 ■ Q3'20 - - - Q2'20 Av - - - Q3'20 Av



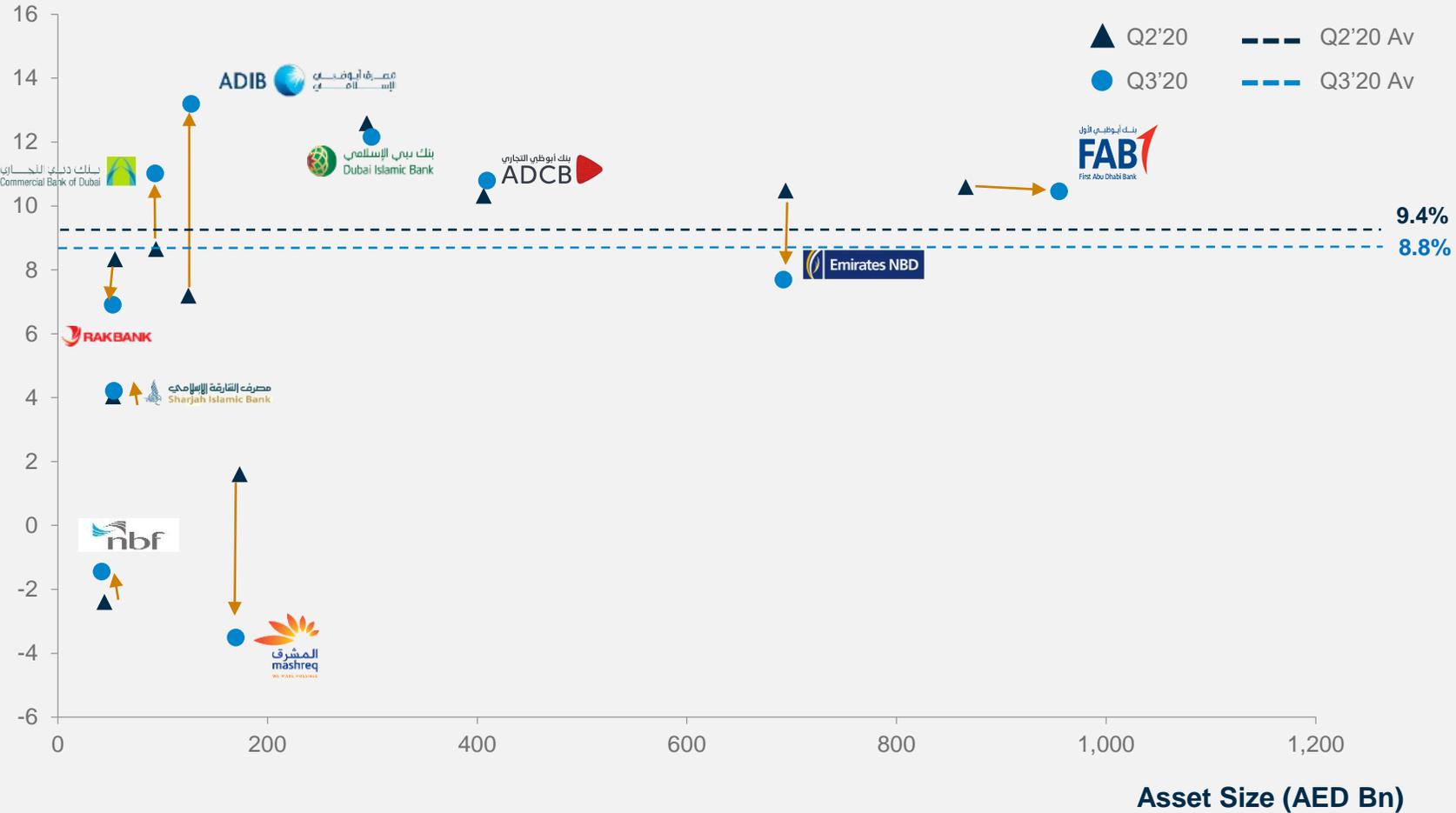
KEY TAKEAWAYS

- Six of the top ten banks reported lower cost of risk during the quarter
- NBF's cost of risk declined at the fastest pace (-67.9 bps QoQ), with the bank's provisions dropping ~23%
- ADCB's cost of risk declined by ~25 bps, as the bank reported increased recoveries and releases
- ENBD saw the highest rise in cost of risk by 41.4 bps, on account of increased provisions in its domestic and Turkish operations

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

RoE Dropped after Rising in the Preceding Quarter

Return on Equity (%)

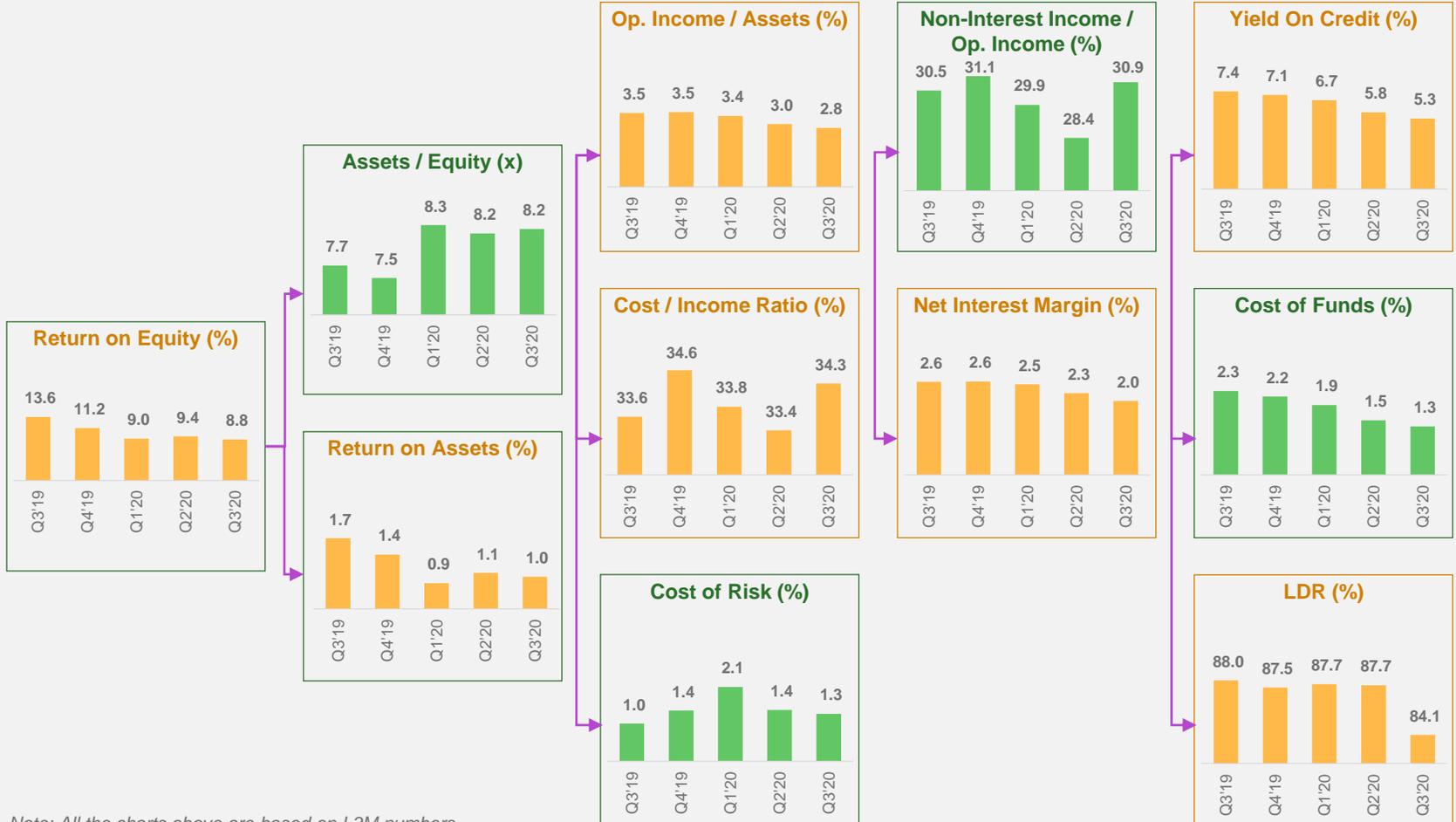


KEY TAKEAWAYS

- Reduced income stream impacted the overall RoE, which touched multi-period low levels
- ADIB reported the highest RoE at 13.2%, backed by a sizeable increase in the bank's net income
- MSQ swung into losses during the quarter. Consequently, the bank reported the lowest RoE (-3.5%)

Sluggish Economic Activity to Limit Lending and Earnings Growth of UAE Banks

■ 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

- Economic conditions in the UAE are expected to remain challenging in the near term, which would likely limit credit and earnings growth of the banks
- Sluggish economic activity coupled with exposure towards SMEs and IFRS 9 regulations could result in increased provisioning in the coming period
- The UAE's central bank would likely follow its US counterpart in maintaining rates at current levels, until the economy is back on track
 - This would put a cap on interest income growth
- In light of tough economic environment, banks would look for M&A opportunities and focus on technological integration in order to rationalize costs

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* |
|-------------------|--------------------------------|----------------|---|----------|------------------------|--------------|
| 16-Sep-20 | Ahli United Bank Egypt SAE | Egypt | Ahli United Bank BSC | 14.4% | 298 | Pending |
| 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



الإمارات
THE EMIRATES

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 | 955.1 | FAB | |
| Emirates NBD | 692.1 | ENBD | |
| Abu Dhabi Commercial Bank | 409.3 | ADCB | |
| Dubai Islamic Bank | 299.3 | DIB | |
| Mashreq Bank | 169.7 | MSQ | |
| Abu Dhabi Islamic Bank | 127.1 | ADIB | |
| Commercial Bank of Dubai | 92.8 | CBD | |
| Sharjah Islamic Bank | 53.3 | SIB | |
| National Bank of Ras Al-Khaimah | 52.3 | RAK | |
| National Bank of Fujairah | 41.8 | NBF | |

Note: Banks are sorted by assets size
* As on 30th September 2020