Banking

First Abu Dhabi Bank – Consistent Compounder

BUY: 12M TP @ 15.29

Valuation Summary (TTM)			
Price (AED)			13.7
PER TTM (x)			11.5
P/Book (x)			1.4
Dividend Yield (%)			3.8
Free Float (%)			45%
Shares O/S (mn)			11,048
YTD Return (%)			-20%
Beta			1.4
(bn)		**AED**	**USD**
Market Cap		151	41
Total assets		1,110	302
Price performance (%)	**1M**	**3M**	**12M**
First Abu Dhabi Bank PJSC	1%	2%	-31%
FTSE ADX GENERAL INDEX	2%	3%	-3%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (AED ,000	40,856	48,218	48,313
Avg Daily Volume (,000)	2,862	3,539	3,537
52 week	**High**	**Low**	**CTL***
Price (AED)	20	13	9.1
* CTL is % change in CMP to 52wk low			
Major shareholders			
Emirate of Abu Dhabi			38%
AL NAHYAN FAMILY			15.3%
Vanguard Group Inc/T			1.6%
Others			45.2%
Other details			
Exchange			Abu Dhabi
Sector			Banks
Index weight (%)			10.1%
Key ratios	**2020**	**2021**	**2022**
EPS (AED)	0.9	1.1	1.2
BVPS (AED)	8.9	9.2	9.4
DPS (AED)	0.73	0.73	0.49
Payout ratio (%)	80%	67%	42%

First Abu Dhabi Bank (FAB) is the largest financial institution in UAE, with a market share of 30% by assets domestically. The bank with presence in 20 countries offers products and solutions catering to all segments of customers, specifically offering investment banking, corporate and commercial banking, global banking services. The bank will be a prime beneficiary of growth in GDP of UAE, given its significant scale of operations. In 2022, while the GDP grew by 7.4%, the assets of FAB grew by 10.5%. With the expected growth in credit demand arising out of planned execution of mega projects in Abu Dhabi and higher cash flows at consumer level due to elevated oil prices, we expect the bank to continue to demonstrate industry leading growth. Given the leadership and diversified nature of operations (across customers, geographies, products), the bank will continue to ride the growth in demand for credit and for banking solutions. The share price has seen a significant correction from AED 23.86 in March 2022, to AED 13.70. We feel at current levels the stock is attractive, given the growth trajectory and risk reward scenario. We have accordingly initiated a BUY recommendation and 12M target price of AED 15.29/share, indicating an upside of 11.6% from current market price, besides a dividend yield of 3.8% 2023E

Investment highlights

- Market leader in UAE, second largest player by assets in MENA
- Consistent compounder CAGR (2018-22): Assets (+10.5%) Loans and advances (+6.8%), Investments (+18.3%), deposits (+10.8%), borrowings (+10.3%). We expect the bank will deliver a minimum of mid-single digit growth rate in profits over next 5 years, given the demonstrated industry leading growth in the past.
- Unparalleled domestic franchisee with international foothold (Loans - 27%, investments – 75% and deposits - 28% outside UAE)
- Play on fee driven investment banking theme, requiring relatively less capital. Within investment banking segment, the share of non-interest income was at 44% of investment operating income.
- Superior adjusted average returns ratios in the last five years (2022 RoE of 12.6%, RoA of 1.2% and RoRWA of 2.3%) across multiple cycles. We estimate these to stay at elevated levels.

At current price of AED 13.70/share, the stock is trading at a price to book value of 1.3x, 10.8x of 2023E earnings, and 3.8% 2023E dividend yield. The valuations are attractive, given the expected consistent growth over a long period of time. We have arrived at a blended DDM-Relative valuation target price of AED 15.29/share, which offers upside potential of 10%, besides dividend yield of 3.8% and recommend a BUY on the stock.

Valuations snapshot

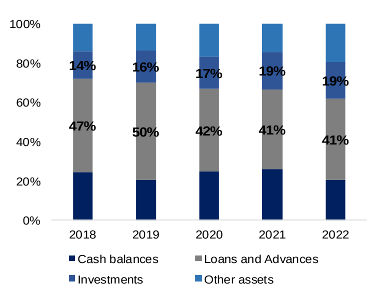
Amt in AED bn	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Loan Book	386.6	409.6	459.6	486.8	513.6	539.4	560.9	583.4
Gross NPL (%)	3.9%	4.0%	3.9%	3.8%	3.8%	3.5%	3.3%	3.0%
Deposits	540.9	614.7	700.6	735.6	772.4	811.0	851.6	894.1
NII	12.3	11.7	14.4	17.4	17.2	16.3	15.9	15.2
PAT	10.6	12.5	13.4	14.3	15.3	15.7	16.8	17.5
P/E	13.7	16.9	14.5	10.8	10.1	9.9	9.2	8.8
P/B	1.4	2.0	1.8	1.3	1.2	1.1	1.1	1.0
Dividend Yield	5.8%	2.6%	3.0%	3.8%	3.8%	3.8%	3.8%	3.8%

Asset mix change over the years in favour of investments…

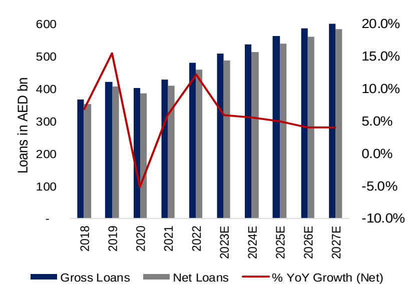
FAB has a significant market share of 30% of the total assets as of Dec 22. In terms of mix in assets, the share of loans and advances have declined from 47.5% in 2018 to 41.4% in 2022. Over the last five years, FAB's asset mix has shown a discernable trend in change in mix in favor of investments. The share of investments in the asset mix, which stood at 14.1% in 2018 has increased to 18.5% in 2022. The share was relatively higher in 2021 at 19.1%, however there was a significant sale of stake in a payment solutions subsidiary in Feb 2022. The growth is significant in the context of increase in the balance sheet size by +10.5% CAGR (2018-22) as compared to a growth in investment of +18.3% CAGR (2018-22) and loans and advances by +6.8% CAGR over similar period. The combined share of loans and advances and investments stood at 60% in 2022, as compared to 61.6% in 2018, indicating that while the mix has changed, the overall core business remains stable.

The share of investments at 18.5% of asset mix is high even when compared to large regional players – nearest domestic competitor, Emirates NBD has a share of 15.4%, and other regional players with the exception of SNB (27.3%) has a far lower share at 12.3%, 13.4%, 14.8% for Bank Muscat, QNB and NBK respectively. The high share indicates relatively higher opportunity for investment avenues as well as bank's focus on all-round growth in balance sheet. We expect the bank to maintain this composition and adopt an opportunistic approach to increase in investments going forward.

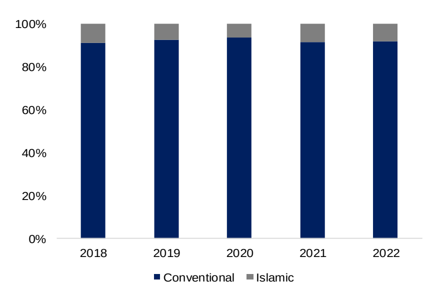
5 yr change in mix in favor of Investments



Loan growth ~7% CAGR (2018-22), to continue



No significant change in share of Islamic loans



Source: Company reports, US Research

Mid-single growth rate in Loans and advances to continue…

FAB's gross /net loan book stood at AED 479.7bn/459.6bn, a growth of 6.9% / 6.8% CAGR (2018-22), while there has been a volatility in YoY growth in line with the economic conditions, over a longer time frame. The bank has grown consistently at ~6% much above industry average, given the advantage it enjoys due to its size and relatively higher exposure to government and GRE segment. The net loan book YoY growth in 2022 was at 12%, much higher than industry average of 5.5%, driven mainly by increase in consumer demand and healthy demand from core customers. We expect the bank to continue to grow at 5% over the next five years.

The group conducts its Islamic banking activities through a 100% subsidiary First Abu Dhabi Islamic Finance PJSC and the gross exposure stands at AED 38.6bn, which is 8% of the gross loan book, the growth in the Islamic banking loans has been at a slower pace of 5.0% CAGR over 2018-2022, as compared to 6.9% overall growth in loans. The share of Islamic loans has been in the range of 6% - 9% in the last five years and we do not expect any material change going forward.

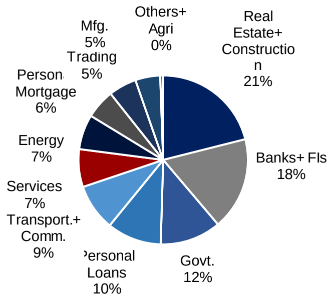
Sectorial composition moving towards quality …

In terms of sectorial exposure, the bank has done quite well in reducing the concentration towards real estate and construction over the years, the exposure which stood at 29% in 2018, has declined to 21% in 2022 on a growing loan book, a de-growth of -1.2% CAGR (2018-22). The exposure to the top six sectors stood at 61% in 2022, little changed from 2018, however within this the exposure to government has increased from a negligible 2% in 2018 to 12% in 2022. indicating that the quality of loan book has improved. Overall, the composition of sectoral mix has improved since 2018.

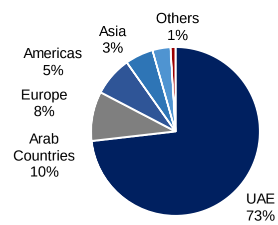
Despite international operations, the majority of the credit offtake takes place domestically. The share of loans of the domestic book grew from 63% in 2018 to 73% in 2022, while the exposure to Europe and Americas has reduced by 300bps each during the same period. The increase in share of domestic exposure augurs well as the bank has relatively better control over the book.

From an end user perspective, the corporate/private sector's exposure was at 52% in 2022, down by 300bps over five years, whereas the share of public sector has increased by 200bps over five years to stand at 19%. The personal/retail book has seen its share declining by 200bps from 18% in 2018 to 16% in 2022. Collectively the corporate/private exposure and the exposure to government stood at 64% in 2022 as compared to 57% in 2018, an increase of 700bps over the years.

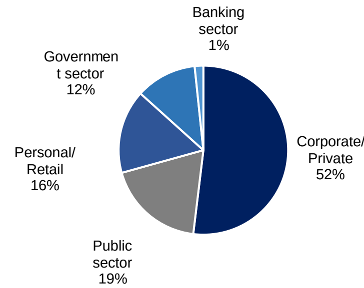
Top 6 sectors constitutes 61% of loan book



Domestic loans (UAE) up by 1000bps in 5 yrs



Exposure (Loan) to Govt + Public sector at 31%



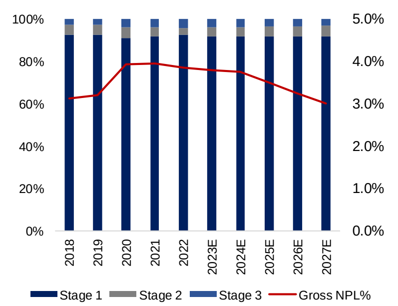
Source: Company reports, US Research

NPL at elevated levels since 2020 at 3.9%…

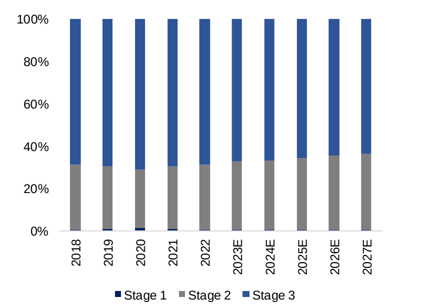
The bank's NPL as on 2022 stood at 3.86%, similar to levels witnessed in 2021. The NPL ratio which stood at 2.7% in 2016 has gradually deteriorated to 3.2% till 2020, post which it went up by 70bps and has been stable in the last three years. However, the NPL of 3.9% is better than the largest regional peer, which reported 6% NPL in 2022. In 2022, the NPL ratio of corporate book stood at 4.8%, whereas the retail NPL ratio stood at 3.7%, implying that ~76% of the total NPL was from corporate book and the remaining from retail book. The high NPL post 2020 was on account of slippages in real estate and construction sector. Out of the total NPL of AED 18.5bn in 1H23, around 44% was from real estate and construction sector, followed by loans to individuals which stood at 25% of the total NPLs. In our estimates, we have modeled for a gradual improvement in NPL ratio from 3.9% in 2022 to 3.0% by 2027E, due to higher cash flows buoyant by high oil prices and improved economic prospects.

Stagewise provisions coverage has decreased over the years, with stage 1 provision cover reducing from 0.4% to 0.3% from 2018 to 2022, while stage 2 provision cover has reduced from 23.6% to 19.4% over similar period. The purchased or originally impaired credit has reduced from AED 4.8b in 2018 to AED 4.0bn in 2022. The overall provision coverage has reduced from 103% in 2018 to 75% 2022, taking into account the provisions on funded loans, however as per the management's calculations, if the ECL on unfunded exposure and IFRS9 provisions are taken into account, the provision coverage stands at 98% in 2022. In our model, we have factored for an increase in the provision coverage ratio over the next few years to 86% by 2025E taking into consideration the estimated ECL on funded book.

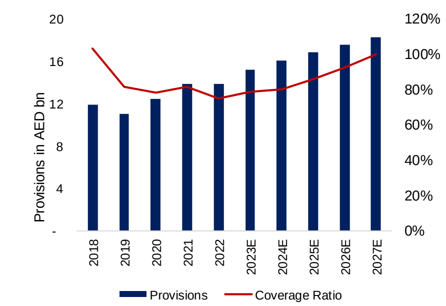
NPL ratio est. to improve to 3% by 2027E



Stage wise provisions have been declining



Coverage ratio to be improved going ahead



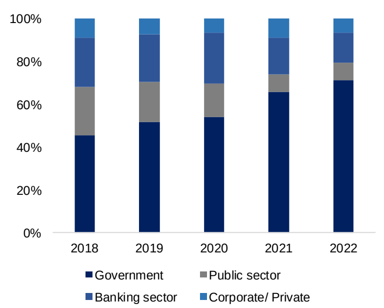
Source: Company reports, US Research

Investments, a vital cog in asset mix…

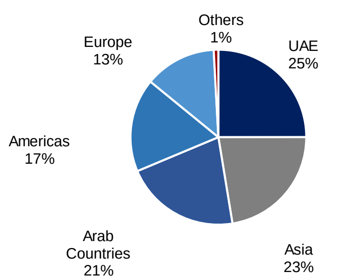
The bank's total investments as on 2022 stood at AED 205.7bn, which nearly doubled from AED 105.0bn in 2018. The investments comprise of non-trading investments (98% quoted and unquoted debt investments), investments at fair value through profit and loss (majority of which is debt securities, followed by investment in private equity, equities managed funds, private equity and investment in associate and JVs.) The significant increase in investments over the years, indicates that the management is keen on diversifying the asset mix. In Feb 2022, the bank divested its controlling stake of 60% in Magnati Sole Proprietorship LLC at a gain of AED 3.1bn, it continues to hold 40% in this payment solutions subsidiary. The investment book compliments the loan book and provides stability to the balance sheet, besides diversifying risks. We expect the management to run an active investment book going forward, however, we do not see a major increase in investments over the next few years, considering that the opportunity to lend is far higher domestically due to increased credit demand.

In terms of counterparty, majority of the investments is towards Government (71% in 2022 vs, 45% in 2018), followed by banking sector (14% in 2022 vs. 23% in 2018). The high investment exposure to government and banking sector indicates that the quality of investment book is quite high. The exposure to public sector reduced from a high of 23% in 2018 to 8% in 2022. In terms of end use industry, the investment in energy sector has reduced from 13% in 2018 to 3% in 2022, while investment in other sectors have reduced from 7% in 2018 to 5% in 2022. The investments are geographically well diversified with exposure to UAE at 1/4th of total investments in 2022 as compared to 37% in 2018. Exposure to Asia and Arab countries is at 44% in 2022 vs. 32% in 2018, while the exposure to America and Europe is little changed since 2018 at 30%. The spread of investments across geographies as well as majority of the investments in government and banking sector indicates that the risk is relatively low. Over 75% of the non-trade investments are externally rated above A to AAA, again indicating that the mix of investments are to relatively less risker counterparties.

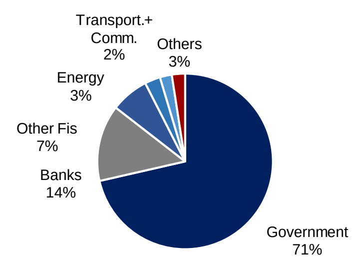
Investments-Govt/Banking ~86% in 2022…



… however, geographically well diversified



7% investments in non bank, non govt sector



Source: Company reports, US Research

Gradual improvement in CASA over last five years…

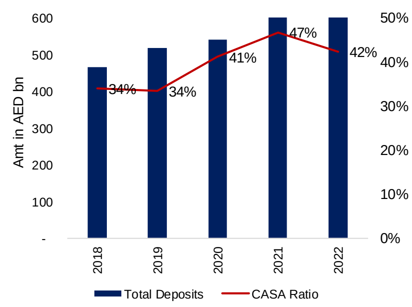
The bank has seen its CASA ratio improve by over 830bps over the last five years from 34.1% in 2018 to 42.4% in 2022. The increase in CASA with an increasing deposit book of 10.8% CAGR (2018-22) indicates that the bank's product offerings have been successful. While the current account grew at a faster pace at 17.4% CAGR (2018-22), the savings account grew at 10.5% over similar period, the term deposits grew at a relatively slower pace of 7.6% CAGR. Over the last five years, the share of time deposits de-grew from 58% in 2018 to 52% in 2022 alluding to the fact that the CASA growth is structural. The CASA ratio which stood at 46.4% in 2021 was down to 42.4% in 2022 mainly on account of migration of current account balances to time deposits, this can be corroborated from the fact that while current account grew by 3% YoY in 2022, the time deposits grew by 32.2% YoY, resulting in YoY deposit growth of 14.0%.

The CASA ratio however rebounded in 1H23 to 45% mainly on account of new client relationships and new cash management mandates in the investment banking division and higher growth of 21% YoY in consumer banking division. We expect that the bank will continue to maintain elevated CASA levels going forward in the range of 42%-45% over next five years.

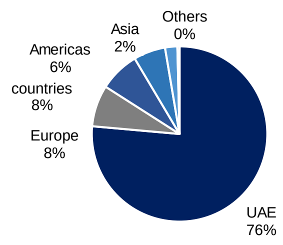
The domestic deposit book stood at 72% in 2022, at similar levels of 2018. While the mix in deposits from within other countries have not changed materially over the last five years. Deposits from Asia and Arab countries stood at 9% in 2022 (vs. 8% in 2018), while deposits from Europe and America stood at 13% in 2022 (vs. 15% in 2018). The 2022 YoY growth in domestic deposits has been superior at 20.9% as compared to the overall deposit book growth of 14%. The domestic growth over longer term trend of 5 years indicates that the domestic deposit and total deposits have strong co-relation, and the bank will continue to rely on domestic deposit book for growth. The Islamic deposits have a low share of 1.8% of total deposits as of 2022. In terms of maturity profile more than 98% of the deposits mature within 1 year as of 2022, indicating that majority of deposits are short term in nature.

From sourcing perspective, the deposits are fairly diversified with government deposits contributing around 32% in 2022 (vs. 30% in 2018), followed by corporates at 36% in 2022 (vs. 32% in 2018) and retail deposits stood at 14% in 2022. The fairly diversified source of deposits reduce risk associated with bulk deposits. The high sourcing of deposits from government indicates that FAB is the primary banker to the government of Abu Dhabi and its related entities. While the bank would continue to grow its deposits in the near future, we do see any significant change in the mix going forward given the wide spread franchise catering to both the corporate and retail segment. The bank's superior rating of AA-, one among the best in the region, makes it a natural choice for corporates and consumers alike from a safety perspective.

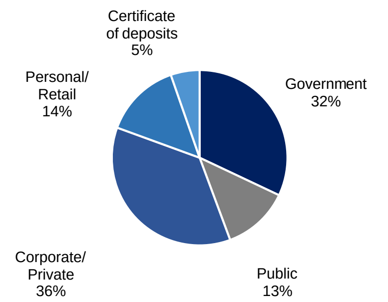
Deposits ~11%CAGR (18-22), CASA steady



Domestic deposits (Excl CDs) remains high



68% of deposits from Govt and Corporates



Source: Company reports, US Research

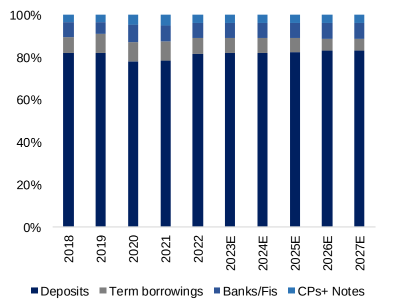
Multiple avenues for source of funds, bank well capitalised…

While the bank continues to rely heavily on deposits (70% of liabilities) it also has raised funds from other term borrowings (10.3% CAGR – 2018-22), banks and FIs (11.2% CAGR – 2018-22) and through CPs and subordinated notes (14.8% CAGR – 2018-22). The term borrowings are raised at both fixed and floating rates in multiple currencies, which are adequately hedged. Out of the total term borrowings of AED 62.6bn in 2022, ~43% of the repayments fall beyond three years, while 40% of the amount fall due for payment between 1-3 years. The long tenure loans coupled with a combination of both fixed and floating rates helps the bank raise funds at optimal cost.

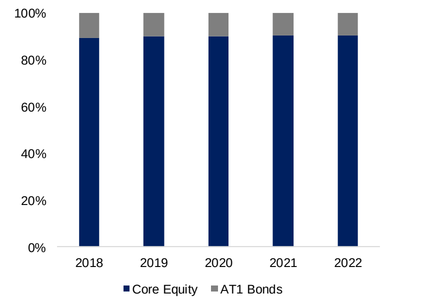
The bank has been prudent in not raising capital in the last five years, neither has it raised any tier 1 bonds. It has issued a stock dividend in 2022 for AED 128mn. The Tier 1 bonds are issued to Government of Abu Dhabi for AED 8bn, and it carries an interest rate of 6-month EIBOR plus 2.3% pa, while the rest of the bonds are issued are USD denominated and carry a fixed interest rate of 4.5% pa. Given the track record and the current interest regime, we do not see the company raising tier 1 bonds in near future.

The bank has maintained CAR well above the stipulated requirements at more than 15% in the last five years. The capital adequacy ratio reverted to 16.6% in 1H23, a level earlier seen in 2019, when it stood at 16.9%. We do not foresee any need for capital raise, given that the bank is well capitalized to fund its growth aspirations

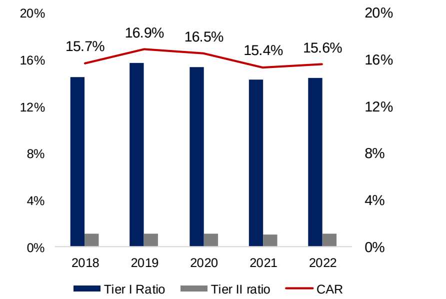
Deposits - major source of borrowings



Neither equity, nor bond raised in last 5 yrs



Bank adequately capitalised to fund growth



Source: Company reports, US Research

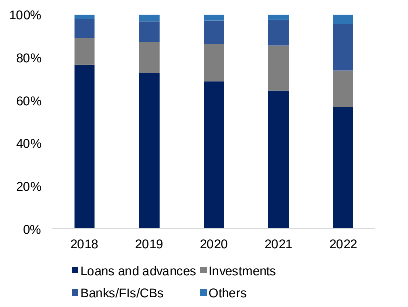
Interest income growth of 6.6% CAGR (2018-22) in line with growth in loan book…

The bank had reported an interest income of AED 28.2bn, a YoY growth of 73.9%, this is on account of a combination of current elevated interest rate environment, YoY growth in gross loan book by 11.9%, YoY growth in investment book by 7.7% in 2022. In 2022, the bank witnessed a growth of 53% YoY on interest from loans and advances, 40.5% YoY growth on interest from investments. The share of interest from loans and advances, which stood at 77% in 2018, has been declining over the years and stood at 57% in 2022. This is on account of change in mix in favor of interest yielding investments and, increase in income from placements with other banks and central banks. (9% in 2018 vs. 22% in 2022). Similar trend has continued in the first two quarters of 2023, with yields touching to record highs of 5.6% and 6.0% in 1Q23 and 2Q23. The loan book growth was at 9.1% and 5.5% in 1Q23, 2Q23 respectively, while the growth in investment book was at 9.3%, 13.8% in 1Q23, 2Q23 respectively

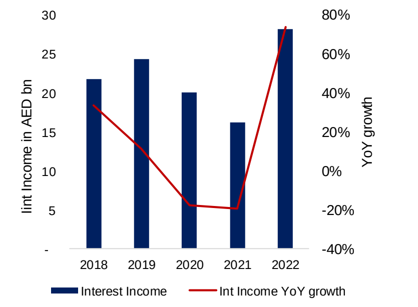
The 73.9% YoY growth in interest income in 2022 is an outlier and over a period of 5 years, the interest income growth (6.6% CAGR 2018-22) has been in line with the growth in loan book which was at 6.9% CAGR (2018-22). This long-term trend indicates that the bank has been able to manage the volatile interest rate environment quite well over the years.

The yield on assets over the years have moved broadly in line with the interest rate movements in the market. The average yield on assets, in 2022 was at 3.4%, back to levels seen in 2018, after a dip in 2020 and 2021 due to lowering of interest rates by central banks across the globe. In our model we have factored moderation in yield from 2024E onwards, due to likely decline in interest rates.

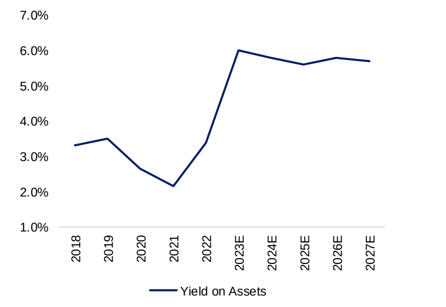
Change in Int Income mix significant in 5 yrs



73.9% YoY growth in 2022 an outlier



Yield on assets moving in line with interest rate



Source: Company reports, US Research

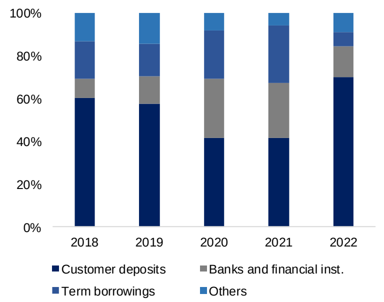
Interest expenses grow at a faster pace…

The bank had reported an interest expense of AED 14.8bn, a YoY growth of 166%, the increase is mainly attributable to increase in cost of funds from a low base of 90bps in 2021 to 190bps in 2022, the overall borrowings grew by 9.4% YoY, with deposits from customers going up by 14%, and borrowings from banks and banks/FI going up by 8%. The growth of interest expenses (13.8% CAGR – 2018-22) in general has been faster than the growth in interest income over the years (6.6% CAGR – 2018-22), suppressing the Net interest income growth to just 2.5% CAGR over similar period. The CASA ratio too declined from 46.8% in 2019 to 42.4% in 2022, resulting in higher cost of deposits, besides the general interest rate environment. We expect the interest expenses to reflect the growth in interest income going forward as the bank has demonstrated in the past its ability to pass on any hikes to customers.

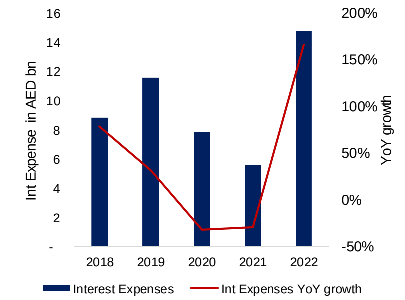
Interest on deposits, which constituted 60% of the total expenses in 2018, witnessed a decrease in 2021 to 42%, before increasing to 70% in 2022, reflecting the shortened cyclicality of interest rate. The share of term borrowings has however, been quite a contrast to interest on deposits mainly on account of a combination of fixed and floating rate of interest. Over a period of five years, the term borrowings grew by 10.3% CAGR (2018-22), while the interest expense on term borrowings witnessed a de-growth of 10.1% CAGR (2018-22), indicating the cushion available in the form of fixed rates. The term borrowings, which has a low base is not sticky unlike deposits and carry a re-finance risk.

The cost of funds reflects the changes in yield on assets, however, the spreads have narrowed by 40bps over the last five years. We expect the cost of funds to moderate from 2024E onwards

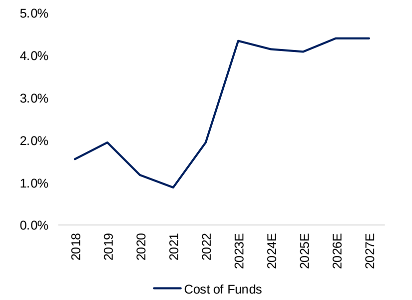
Inconsistent mix in Int expenses over 5 yrs



Growth in Int exp outpaced Int income in 2022



CoF change mirrors yield on assets change



Source: Company reports, US Research

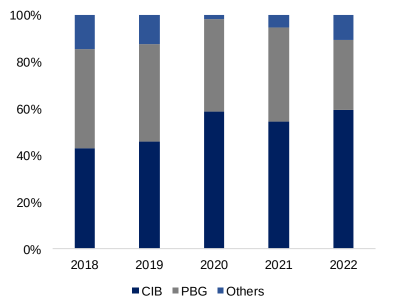
The bank had reported a Net Interest income (NII) of AED 14.4bn in 2022 vs. 11.7bn in 2021, a YoY growth of 23%, the growth in NII is attributable to increase in interest yielding assets, higher interest rates. The NII, however over a five-year cycle has seen a moderate growth of 2.5% CAGR (2018-22), due to relatively faster pace of growth in interest expenses as compared to interest income. The NIMs are back to pre-pandemic levels of 1.6%. (1.8% in 2019). The segmental NIIs indicate a faster growth from Investment Banking (+17% YoY) and Corporate and Commercial banking (+65% YoY) segment, and the share increased from 55% in 2021 to 59% in 2022. The bank's ability to pass on interest rate hike is superior in the corporate and commercial banking segment. We continue to see these two segments retain their share, given the higher ticket size of loans origination.

Share of non-interest income > 45% excl. one-offs over 5 years…

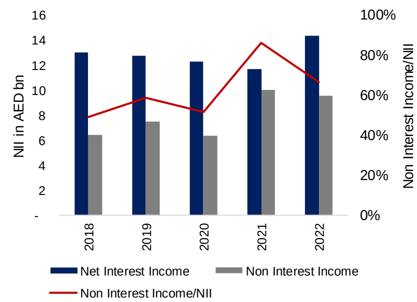
The contribution of non-interest income to the total income has been higher at more than 45% as compared to its nearest domestic peer (ENBD at 40%). The bank's investment gain in 2022, stood at AED 2.2bn (vs. 6.5bn in 2021), however, this is one off as the bank has reported less than AED 1.0bn investment gain in the three preceding years. The bank booked a profit of AED 3.1bn in 2022 on account of sale of 60% stake in its payment solution subsidiary. Adjusted for this one off in 2022, the share of non-interest income to operating income stood at 45%, which is a five-year low.

Within non-interest income, the fee income and net forex income has seen a de-growth of 4.9% CAGR (2018-22) and 3.4% CAGR (2018-22) respectively, the decline is compensated by higher growth in investment income at 27% CAGR (2018-22). We estimate the fee income to grow in mid-single digit going forward and other operating income at 30% of operating income.

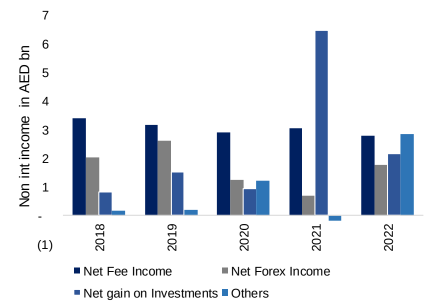
Segmental NII from CIB (IB/CCB) increasing



Investment gains 2021 and stake sale in 2022



Volatile net gain on investments over the years



Source: Company reports, US Research

Cost to income and impairment charge increase…

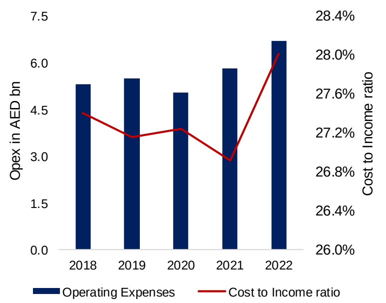
FAB's operating income was at AED 6.7bn in 2022 (vs. 5.8bn in 2021), an increase of 14.9% YoY, the increase was on account of one-off cost arising out of integration of operations in Egypt for the acquired entity (AED 198.0mn) and write-off of legacy systems in 4Q22 (AED 260.0mn). Excluding these one off the growth was at 8.2%, which was last seen in 2018. The staff cost increased by 5.6% YoY (13.3% of operating income), while operating costs increased by 27.5% YoY (11.2% of operating income, excluding one offs, the growth is 5% YoY). Consequently, the cost to income ratio increased to 28%, which is highest in last five years. The cost to income however, has moderated to in 25.1% and 25.3% in 1Q23 and 2Q23 respectively on account of faster pace of growth in operating income as compared to operating expenses. Going forward we see cost to income ratio to be in line with the historical trends of +27% and moderate over the next few years.

The impairment charge on loans and advances factoring in write back was at AED 2.73bn as compared to AED 2.59bn, a YoY growth of 5.4%, while the impairment charge on other financial assets stood at AED 100.0mn in 2022. The impairment charge on loans and advances has seen a spike in 2020 to AED 2.6bn due to pandemic driven stress, post a decrease in 2021, the impairment charged to P&L is back to 2.7bn, we do not see any significant charge going ahead in next two years. The credit costs, which saw an increase in 2020 at 65bps have now moderated to 57bps, which was last seen in 2018. In our model, we have factored credit costs of 55 bps in 2023E, which will moderate going forward.

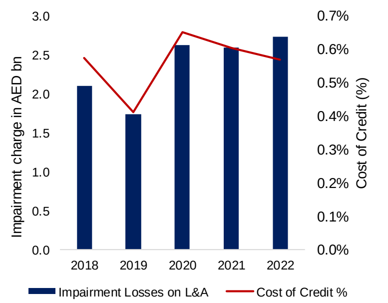
The bank reported an adjusted PAT of AED 13.3bn in 2022 (vs. 12.2bn, +7.1% YoY), however, adjusted for pre-tax one-off subsidiary stake sale of AED 3.1bn, there has been a decrease of 16.7% (AED 10.8bn) on YoY.

The decrease of PAT is on a higher base, since the investment gains were high at AED 6.7bn in 2021 and the effective tax rate was higher at 6.7% in 2022 as compared to 4.9% in 2021. Despite a global presence, the bank derives 90% of its profits domestically. We estimate the adjusted PAT to grow by 5.6% CAGR (2022-2027E) based on the normalized growth going forward.

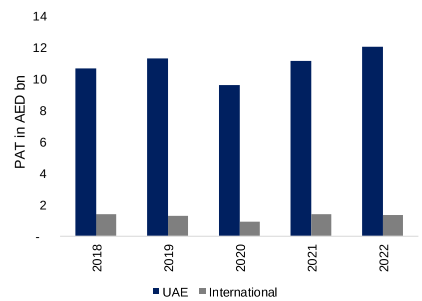
Operating exp and C/I ratio increase in 2022



Cost of credit spiked in 2020, now declining



Domestic operations contribute 90% of PAT



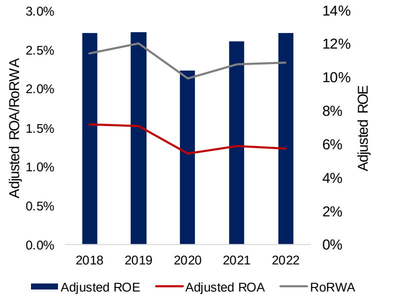
Source: Company reports, US Research

Return ratios improve, dividend payout reduced

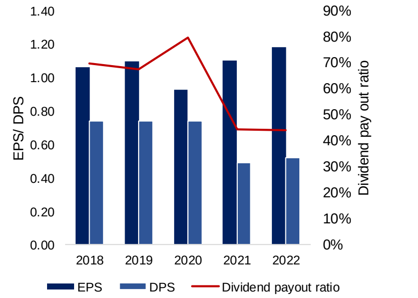
Return ratios, adjusted for interest on tier 1 bonds have reverted back to 2018 levels (Adjusted ROE 12.6% in 2022 vs. 12.7% 2018, Adjusted ROA 1.2% vs. 1.5% and RoRWA at 2.3% vs. 2.5% in 2018), post a pandemic driven decrease in 2020, when the adjusted ROE witnessed a decrease 10.4%. We expect the bank to maintain similar returns profile over the next few years, given the superior execution and efficient capital allocation.

Over the years, FAB has distributed a consistent dividend per share of AED 0.74/share from 2018-2020, however, the dividend per share was reduced to AED 0.49/share and AED 0.52/share in 2021 and 2022 to preserve capital, resulting in decrease in payout ratio from a high of 80% in 2020 to 44% in subsequent years. The decreased dividend per share and increase in the share price resulted in a lower dividend yield. The bank still trades at an attractive yield of 3.8% based on current market price. We expect FAB to continue maintaining the current dividend per share of AED 0.52/share going forward, implying a payout ratio in the range of 37%-44% over next three years.

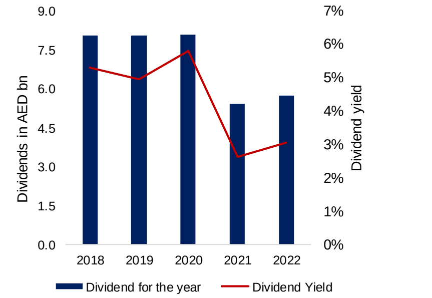
Returns ratio reverted to 2018 levels



Dividend payout reduced in 2021, 2022



Yield reduced due to decrease in dividends



Source: Company reports, US Research

Valuation

We have valued FAB based on blended DDM-Relative valuation method. FAB is one of the leading franchises in UAE, a regional leader with operations across 20 countries. The bank has witnessed various business cycles across many years and has emerged unscathed and much stronger, making it a fit case for a consistent compounder. After touching a peak of AED 23.86/share in Mar 22, the share price has corrected significantly to AED 13.70/share on account of concerns around possible inorganic growth. The bank is trading at attractive valuations after the correction. We arrived at target price of AED 15.29/share, implying ~11.6% upside potential from the current market price along with a dividend yield of ~3.8%. We have valued First Abu Dhabi Bank using the blended valuation approach, with 50% weight to intrinsic valuation based on DDM, 25% weight to relative valuation using P/E, and 25% weight to relative valuation using P/B.

Valuation parameters	
Risk free rate	5.00%
Equity risk premium	5.75%
Beta	0.74
Cost of equity	**9.3%**
Terminal growth rate	3.5%

Residual valuation of FAB	2022	2023E	2024E	2025E	2026E	2027E
Equity at beginning of year	101,893	104,295	112,895	122,473	132,464	143,546
Equity at end of year	104,295	112,895	122,473	132,464	143,546	155,326
Net income attributable to shareholders	13,411	14,330	15,309	15,721	16,813	17,511
Cost of equity	9,653	10,448	11,335	12,260	13,285	14,375
Residual income	3,759	3,881	3,974	3,461	3,528	3,135
PV of residual income	3,551	3,760	3,523	2,808	2,620	2,131
PV of Terminal value residual income						53,167
Current equity value						104,295
Fair value of equity						157,462
Shares outstanding						11,041
Fair value per share (AED)						**14.26**
CMP (AED)						13.70
Upside/downside (%)						4.1%

Valuation parameters	
5 Year earnings CAGR	5.48%
Risk free rate	5.00%
Equity risk premium	5.75%
Beta	0.74
Cost of equity	**9.3%**
Terminal growth	3.5%
Terminal year ROE (%)	12.0%
Justified P/B	**1.48x**

Relative Valuation - First Abu Dhabi	
EPS 2024e (AED)	1.35
BVPS 2024e (AED)	11.09
Target Price/Earnings Multiple for 2024E (x)	**12.0x**
Target Price/Book multiple for 2024E (x)	**1.48x**
Fair value per share (AED) - P/E Multiple	**16.23**
Fair value per share (AED) - P/B Multiple	**16.41**

Blended Weighted Average Fair Value

Valuation Method	Fair Value per share (AED)	Weight	Upside/downside
Relative Valuation - P/E	16.23	25.0%	18.5%
Relative Valuation - P/B	16.41	25.0%	19.8%
Intrinsic valuation - Excess ROE	14.26	50.0%	4.1%
Target Price (AED)		**15.29**	**11.6%**
CMP (AED)		13.70	0.0%
Forward Dividend Yield 2024E			3.8%
Total return Including dividend			**15.4%**

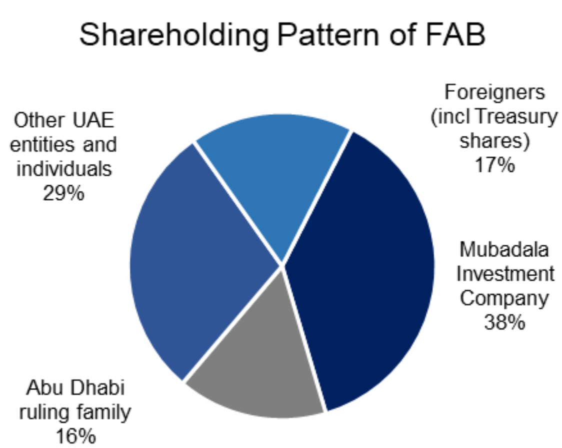
<u>Key risks to our investment thesis:</u>

- Volatility in Oil price, significant global credit event and consequently de-growth in UAE. Due to its sheer size, FAB is relatively more sensitive to these events.
- Exposure to real estate and construction is at 21% in 2022, from a high of 29% in 2018, this is still significant and any adverse cash flows in these sectors would result in increase in NPAs. Real estate and construction sector NPAs is at 44% of total NPA as on June 23. 71% of investment book and 12% of loan book or ~18% of the assets is exposed to Government and GRE sector, a significant concentration risk.
- FAB has indicated that it is likely to pursue inorganic growth, this could suppress near term returns ratios.
- Faster than expected reversal of interest rates due to actions by central banks around the world, affecting yield on assets and cost of funds.

About First Abu Dhabi Bank and FAB group

First Abu Dhabi Bank (FAB) traces its origin to the merger of National Bank of Abu Dhabi (commenced operations in 1968) and First Gulf Bank (commenced operations in 1979) in April 2017. Since the merger, the FAB group has grown to become the leading bank in UAE, rated amongst the safest bank and is currently number 2 bank in Middle East on the basis of asset size. The banking behemoth has derived majority of its operating income from Investment banking (39%), followed by corporate and commercial banking (25%), consumer banking (12%) and global private banking (4%). It offers full range of banking services to Government, GREs, SWFs, financial institutions, large conglomerates, large corporates, SMEs across conventional and Islamic banking. Launched in 2018, it offered UAE's first all-in one digital wallet under the brand Payit. In Feb 2022, the bank divested 60% stake in Magnati, which offers payment solutions and services to various industries. The bank has a 30% domestic market share by assets (catering to 3mn customers) as on Dec 2022.

The bank derives 23% of its operating revenue from outside UAE (17% from MENA) and it has operations in 20 countries, across 5 continents, with 6737 employees across 88 nationalities. The bank is rated as Aa3/AA-/AA- by Moody's, S&P and Fitch respectively, the best among banks in Middle East region. The bank is majority owned by Mubadala Investment company (38%), followed by Abu Dhabi ruling family (16%)



Source: Company reports, Bloomberg, US Research

BOARD OF DIRECTORS

S.NO	NAME	POSITION
1	H.H. Sheikh Tahnoon Bin Zayed Al Nahyan	Chairman
2	H.E. Sheikh Mohamed bin Saif Al Nahyan	Deputy Chairman
3	H.E. Jassem Mohammed Bu Ataba Al Zaabi	Director
4	H.E. Dr. Sultan Ahmed Al Jaber	Director
5	H.E. Mariam bint Mohammed Saeed Hareb Almheiri	Director
6	H.E. Sheikh Ahmed Mohammed Sultan S. Aldhaheri	Director
7	H.E. Mohamed Thani Murshed Ghannam Alrumaithi	Director
8	H.E. Mohamed Saif Al Suwaidi	Director
9	H.E. Waleed Al Mokarrab Al Muhairi	Director
10	H.E. Homaid Abdulla Al Shimmari	Director
11	H.E. Khalifa Ateeq Al Mazrouei	Director

KEY MANAGEMENT PERSONNEL

S.NO	NAME	POSITION
1	Hana Al Rostamani	Group Chief Executive officer
2	Lars Kramer	Chief Financial Officer
3	Suhail BinTarraf	Group Chief Operating Officer
4	Futoon Al Mazrouei	Group Head of Consumer Banking UAE
5	Martin Tricaud	Group Head of Investment Banking
6	Michel Longhini	Group Head of Global Private Banking
7	Sara Al-Binali	Group Head of Corporate and Acting Group Head of IB
8	Sameh AlQubaisi	Group Head of Global Markets
9	Eric Shehadeh	Group Head of Mergers & Acquisitions
10	Gareth Powell	Group Chief Human Resources Officer
11	Nurendra Pereira	Group Chief Audit Officer
12	Pradeep Rana	Group Chief Risk Officer
13	Tracy S. Faulkner	Group Chief Communications and External Relations Officer
14	Nizar Qaiser Luqman	Acting Chief Compliance Officer
15	Rajesh Deshpande	Acting Group Chief Credit Officer
16	Karim Karoui	Advisor

Source: Company reports, Bloomberg, US Research

Income Statement (AED Mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Interest Income	24,369	20,100	18,084	30,273	55,485	55,382	55,884	60,186	61,375
Interest Expense	11,594	7,844	6,426	15,887	38,119	38,140	39,536	44,266	46,192
Net Interest Income	**12,775**	**12,256**	**11,658**	**14,386**	**17,366**	**17,242**	**16,348**	**15,920**	**15,183**
Non Interest Income	7,474	6,317	10,023	9,548	7,726	9,141	10,643	12,239	14,132
Net Operating Income	**20,249**	**18,574**	**21,681**	**23,934**	**25,092**	**26,383**	**26,991**	**28,159**	**29,315**
Operating Expenses	-5,499	-5,060	-5,836	-6,705	-6,775	-6,860	-7,018	-7,040	-7,329
Impairment charge	-1,843	-2,620	-2,658	-2,839	-2,897	-3,051	-3,057	-3,029	-3,146
Profit Before Taxation	**12,907**	**10,894**	**13,187**	**14,390**	**15,420**	**16,473**	**16,916**	**18,090**	**18,840**
Tax expense	-314	-341	-644	-968	-1,079	-1,153	-1,184	-1,266	-1,319
Profit for the year	**12,593**	**10,553**	**12,542**	**13,422**	**14,341**	**15,320**	**15,732**	**16,824**	**17,521**

Balance sheet (AED Mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Cash and balances with Central Bank	169,702	227,873	258,733	228,369	230,742	241,138	252,316	263,703	282,071
Due from banks	17,027	27,358	19,319	24,887	26,131	27,438	28,810	30,250	31,763
Loans & advances to customers	407,903	386,644	409,590	459,593	486,751	513,620	539,369	560,944	583,381
Investment securities/associates	134,744	152,840	191,060	205,726	221,155	237,742	252,007	267,127	283,155
Property and Equipment/Intangibles	24,117	24,164	26,500	26,127	25,899	25,629	25,338	25,009	24,641
Other Assets	68,476	100,182	95,894	165,354	173,621	182,302	191,418	200,988	211,038
Total Assets	**821,968**	**919,061**	**1,001,096**	**1,110,056**	**1,164,301**	**1,227,869**	**1,289,256**	**1,348,022**	**1,416,049**
LIABILITIES AND SHAREHOLDER'S EQUITY									
Due to banks	36,008	57,632	56,985	61,560	64,638	67,870	71,264	74,827	78,568
Customers' deposits	519,162	540,882	614,670	700,573	735,602	772,382	811,001	851,551	894,129
Term Borrowings	55,752	62,437	71,644	62,635	61,662	66,702	66,702	60,418	60,000
Commerical Paper	21,237	31,174	39,664	31,738	33,325	34,992	36,741	38,578	40,507
Other Liabilities	81,772	117,895	105,486	138,499	145,424	152,695	160,330	168,346	176,763
Total Liabilities	**713,931**	**810,022**	**888,449**	**995,006**	**1,040,652**	**1,094,641**	**1,146,038**	**1,193,721**	**1,249,968**
Paid-up Capital	10,920	10,920	10,920	11,048	11,048	11,048	11,048	11,048	11,048
Other Reserves	67,059	67,582	68,290	66,050	66,050	66,050	66,050	66,050	66,050
Retained earnings	18,872	19,418	22,667	27,186	35,785	45,363	55,354	66,436	78,217
Shareholder's Equity	**96,852**	**97,920**	**101,877**	**104,283**	**112,882**	**122,461**	**132,451**	**143,534**	**155,314**
Non - Controlling Interests	430	364	15	12	12	12	12	12	12
Tier 1 Capital notes	10,755	10,755	10,755	10,755	10,755	10,755	10,755	10,755	10,755
Total Equity	**108,037**	**109,039**	**112,647**	**115,050**	**123,650**	**133,228**	**143,218**	**154,301**	**166,081**
Total Liabilities and Equity	**821,968**	**919,061**	**1,001,096**	**1,110,056**	**1,164,301**	**1,227,869**	**1,289,256**	**1,348,022**	**1,416,049**

Cash Flow Statement (AED Mn)	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Cash flow from operating activities	-5,883	98,919	26,443	26,070	25,494	28,660	32,160	39,510	41,531
Cash flow from investing activities	-23,779	-17,373	-4,593	-31,055	-16,029	-17,187	-14,865	-15,720	-16,628
Cash flow from financing activities	5,330	6,298	11,775	-16,443	-7,091	-1,078	-6,118	-12,402	-6,536
Net change in cash	-24,332	87,844	33,625	-21,427	2,374	10,395	11,178	11,388	18,367
Cash at the end of period	**151,345**	**239,189**	**272,814**	**251,387**	**230,742**	**241,138**	**252,316**	**263,703**	**282,071**

Key ratios	2019	2020	2021	2022	2023E	2024E	2025E	2026E	2027E
Operating performance									
Yield on average earning assets	3.5%	2.6%	2.2%	3.4%	6.0%	5.8%	5.6%	5.8%	5.7%
Cost of funds	1.9%	1.2%	0.9%	1.9%	4.4%	4.2%	4.1%	4.4%	4.4%
Interest spread	1.6%	1.5%	1.3%	1.4%	1.7%	1.7%	1.5%	1.4%	1.3%
NIM	1.8%	1.5%	1.3%	1.6%	1.9%	1.8%	1.6%	1.5%	1.4%
Interest income/operating income	120.3%	108.2%	83.4%	126.5%	221.1%	209.9%	207.0%	213.7%	209.4%
Net interest income/operating income	63.1%	66.0%	53.8%	69.0%	69.2%	65.4%	60.6%	56.5%	51.8%
Non interest income/operating income	36.9%	34.0%	46.2%	45.8%	41.8%	37.0%	34.8%	32.3%	32.3%
Cost to income ratio	27.2%	27.2%	26.9%	28.0%	27.0%	26.0%	26.0%	25.0%	25.0%
Liquidity									
Net Loan to Deposit Ratio	73.5%	64.6%	61.0%	60.3%	60.8%	61.1%	61.1%	60.6%	60.0%
Customer deposits/total deposits	93.5%	90.4%	91.5%	91.9%	91.9%	91.9%	91.9%	91.9%	91.9%
Net loans to customer deposits	78.6%	71.5%	66.6%	65.6%	66.2%	66.5%	66.5%	65.9%	65.2%
Investments/total assets	16.4%	16.6%	19.1%	18.5%	19.0%	19.4%	19.5%	19.8%	20.0%
Asset quality									
Stage 1 loan ratio	91.4%	90.0%	90.5%	92.0%	91.0%	91.0%	91.0%	91.0%	91.0%
Stage 2 loan ratio	4.7%	5.0%	4.3%	2.8%	4.4%	4.5%	4.7%	5.0%	5.2%
Stage 3 loan ratio	2.8%	3.8%	3.9%	4.4%	3.8%	3.8%	3.5%	3.3%	3.0%
POCI ratio	1.1%	1.3%	1.3%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%
NPL ratio	3.2%	3.9%	4.0%	3.9%	3.8%	3.8%	3.5%	3.3%	3.0%
Provision as a % of gross loans	2.6%	3.1%	3.2%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%
NPL Coverage	81.5%	78.5%	81.6%	75.0%	78.9%	80.0%	85.7%	92.3%	100.0%
Cost of credit	0.4%	0.7%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%
Stage 1 coverage	0.5%	0.7%	0.5%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Stage 2 coverage	16.4%	15.5%	19.0%	19.4%	21.0%	21.2%	22.4%	23.5%	24.4%
Stage 3 coverage	38.9%	39.7%	44.8%	43.5%	43.5%	43.5%	43.5%	43.5%	43.5%
POCI Coverage	31.2%	13.7%	18.1%	18.6%	19.0%	19.0%	19.0%	19.0%	19.0%
Capital adequacy									
Tier I ratio	15.7%	15.4%	14.3%	14.5%	14.4%	15.0%	16.5%	18.0%	17.8%
Tier II ratio	1.2%	1.1%	1.1%	1.1%	1.1%	0.9%	0.9%	0.9%	0.8%
CAR	16.9%	16.5%	15.4%	15.6%	15.5%	15.9%	17.4%	18.9%	18.5%
Net Equity to Gross Loans	23.1%	24.4%	23.8%	21.7%	22.2%	22.8%	23.5%	24.5%	25.5%
Net Equity to Total Assets	11.8%	10.7%	10.2%	9.4%	9.7%	10.0%	10.3%	10.6%	11.0%
Return ratios									
Reported ROE	12.0%	9.7%	11.3%	11.8%	12.0%	11.9%	11.4%	11.3%	10.9%
Adjusted ROE	12.7%	10.4%	12.2%	12.6%	12.9%	12.7%	12.0%	11.9%	11.5%
ROA	1.5%	1.2%	1.3%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%
RoRWA	2.6%	2.1%	2.3%	2.3%	2.5%	2.4%	2.3%	2.3%	2.2%
Per share ratios									
EPS	1.10	0.93	1.10	1.18	1.26	1.35	1.39	1.49	1.55
BVPS	8.89	8.98	9.23	9.44	10.22	11.09	12.00	13.00	14.07
DPS	0.74	0.74	0.49	0.52	0.52	0.52	0.52	0.52	0.52
Valuation									
Price	14.98	12.75	18.62	17.10	13.70	13.70	13.70	13.70	13.70
P/E	13.7	13.7	16.9	14.5	10.8	10.1	9.9	9.2	8.8
P/B	1.7	1.4	2.0	1.8	1.3	1.2	1.1	1.1	1.0
Dividend Yield	4.9%	5.8%	2.6%	3.0%	3.8%	3.8%	3.8%	3.8%	3.8%

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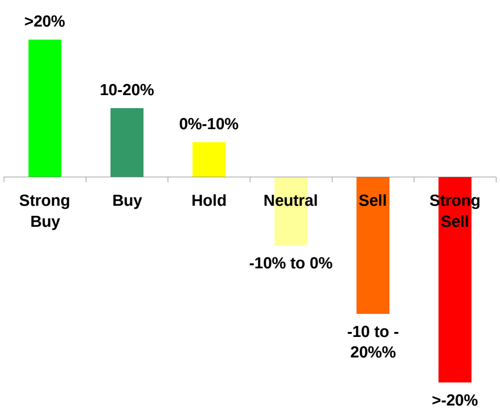
Rating Criteria and Definitions

Rating



Rating Definitions

Strong Buy	This recommendation is used for stocks whose current market price offers a deep discount to our 12-Month target price and has an upside potential in excess of 20%
Buy	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 10% to 20%
Hold	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 0% to 10%
Neutral	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between 0% to -10%
Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between -10% to -20%
Strong Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential in excess of 20%
Not rated	This recommendation used for stocks which does not form part of Coverage Universe

Disclaimer