

# Profitability remained weak

Results update – 4Q2015

Banks | UAE | 28 January 2016

National Bank of Abu Dhabi's (NBAD) reported profit at AED1.0bn was lower than our estimates (AED1.3bn). Underlying pre-provisioning profitability was weak due to subdued non-interest income and higher operating expenses. Further, credit costs spiked up, primarily due to a deterioration in SME credit quality. Margins (calc) were lower sequentially. Balance sheet growth remained muted. However, strong traction was witnessed in the international book. In particular, withdrawals in government deposits were partially offset by an increase in international deposits. NBAD has proposed a dividend of AED0.40 per share translating into a dividend yield of 5.7% at current market price. Going forward, we estimate profitability to remain weak, as we expect pressure on both the revenue and costs to continue. We have lowered our earnings estimates by 9% in 2016 and 7% in 2017 as we factor in lower business growth and higher credit costs. We maintain our Hold recommendation with a revised target price of AED7.74.

## ► Underlying profitability growth was weak

Pre-provisioning profit growth was weak (-8.2% YoY) due to lower income from other sources and higher operating expenses. Growth in fee based income declined 13% YoY. Besides muted commission income growth, growth was weak in the securities and asset management businesses. Cost-income ratio remained at the higher end at 41%. Margins (calc) were down sequentially (~5bps). However, we expect margins to stabilize around current levels and improve in 2017 supported by a highly liquid balance sheet (~28% of total assets).

## ► Credit costs spikes up

Credit costs (annualized) during the quarter spiked up 83bps (32bps in 3Q15 and 41bps in 4Q14). This was primarily due to an increase in delinquencies in the SME sector. As a result, the bank has discontinued its unsecured programmed lending in the commercial segment. During the quarter, NBAD has written off loans of AED852mn. Hence, growth in absolute NPLs was muted at 2% QoQ. Also, it has restructured one account amounting to AED1.4bn.

## ► Balance sheet growth was muted

Deposit growth was weak (-4% YoY) primarily due to a decline in deposits from the government (-62% YoY). Share of government deposits has dropped to 11% from 28% in 4Q14. In line with management strategy, growth in international deposits was strong at 46% YoY and now constitutes 37% of total deposits. Given management focuses more on flow based products over core lending, loan growth was lower than the total system loan growth (8% YoY) at 6% YoY.

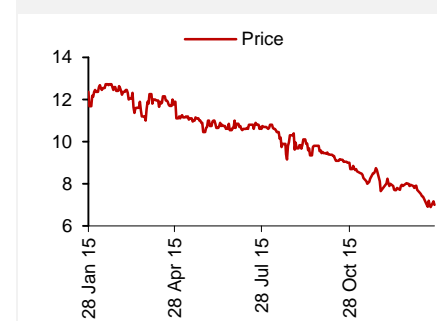
Key Financials	2014	2015	2016E	2017E	2018E
Net interest income (AEDm)	7,018	7,307	7,559	7,966	8,596
Total income (AEDm)	10,415	10,556	11,031	11,739	12,755
EPS (AED)	1.1	1.1	1.0	1.0	1.1
EPS (% Change)	19.4	(6.7)	(9.1)	4.3	6.5
P/E (x)	6.1	6.6	7.2	6.9	6.5
P/B (tangible)	1.0	1.0	0.9	0.9	0.8
Net NPL (% of Loans and advances)	2.2	2.1	1.6	1.2	0.8
Dividend yield	5.7	5.7	5.7	6.4	7.1
ROAA (%)	1.5	1.3	1.2	1.2	1.2
RoAE (%)	16.7	14.3	13.3	12.8	12.7

Source: ADCB Securities Equity Research

## Fundamentals

Recommendation	Hold
Target Price	AED 7.74
Price	AED 7.01
Price 12m High/Low	AED 12.73/6.90
Market Cap.	AED 36,442
Bloomberg	NBAD UH EQUITY
Bloomberg	

## Price Performance Chart



Source: Bloomberg

## Financials

Income Statement (Dec) (AEDmn)	2015	2016E	2017E	2018E
Net interest income	7,307	7,559	7,966	8,596
Total non interest income	3,249	3,473	3,774	4,160
Fee income	2,924	2,867	3,004	3,229
Trading income	254	384	517	633
Other income	71	222	252	299
Total income	10,556	11,031	11,739	12,755
Total operating expenses	4,083	4,238	4,481	4,860
Salaries and wages	2,774	2,885	3,058	3,302
Other operating expenses	1,309	1,353	1,423	1,558
Pre provision profit	6,473	6,794	7,258	7,895
Total provisions	943	1,126	1,342	1,603
Profit before tax and MI	5,530	5,667	5,916	6,292
Taxes	298	327	359	394
Minority interest	0	0	0	0
Reported net profit	5,232	5,340	5,557	5,898
Adjusted net profit	5,031	5,040	5,257	5,598

Source: ADCB Securities Equity Research

Balance Sheet (AEDmn)	2015	2016E	2017E	2018E
Loans and advances	205,914	216,666	232,638	252,174
Investments	76,085	77,607	81,487	87,191
Fixed assets	2,646	2,765	2,889	3,019
Other assets	34,455	37,234	40,489	44,061
Total assets	406,564	418,976	439,223	465,483
Total equity	36,356	39,429	42,459	45,571
Sub/hybrid/other debt	6,863	6,863	6,863	6,863
Minority interests	0	0	0	0
Deposits	233,815	238,491	250,415	267,944
Total borrowings	70,545	73,927	77,883	82,105
Total liabilities	363,346	372,684	389,901	413,050

Source: ADCB Securities Equity Research

Valuation and leverage metrics	2015	2016E	2017E	2018E
P/E (x)	6.6	7.2	6.9	6.5
P/PPE (x)	5.6	5.4	5.0	4.6
P/B (tangible)	1.0	0.9	0.9	0.8
Dividend yield (%)	5.7	5.7	6.4	7.1
Tier I ratio	15.7	16.3	16.5	16.6
Core tier I ratio	13.2	13.9	14.3	14.5
CAR (%)	16.7	17.5	17.8	17.9
Average assets/Equity (x)	11.1	10.9	10.5	10.3
Loan to deposit ratio (%)	88.1	90.8	92.9	94.1

Source: ADCB Securities Equity Research

Key Ratios (%)	2015	2016E	2017E	2018E
ROAA	1.3	1.2	1.2	1.2
RoAE	14.3	13.3	12.8	12.7
Net interest margin	2.0	2.0	2.0	2.1
Cost-income	38.7	38.4	38.2	38.1
CASA	30.5	31.1	32.0	32.5
Gross NPL (% of Loans and advances)	3.1	3.2	3.1	3.2
Loan loss coverage	95.0	96.7	97.4	98.8
Credit costs (% of avg loans)	0.5	0.5	0.6	0.7

Source: ADCB Securities Equity Research

Per-share data (AED)	2015	2016E	2017E	2018E
EPS	1.1	1.0	1.0	1.1
DPS	0.4	0.4	0.5	0.5
BVPS	7.0	7.6	8.2	8.8
Total no. of outstanding shares (mn)	5,199	5,199	5,199	5,199

Source: ADCB Securities Equity Research

### Investment case

We recommend Hold on NBAD. Bank's valuation multiple is constrained by its weak profitability. Its pre-provisioning profitability is the lowest among its peers. Earnings to remain subdued as we expect pressure on both revenue and cost to continue.

### Upside case

AED10.7

Upside case for NBAD assumes pick-up in fee income growth. Bank has been investing in this area. Also, faster growth in retail book - an area which has been of less focus in the past. We value upside case at 1.4x P/BV 2016E.

### Downside case

AED6.1

Downside case assumes income growth not keeping up pace with cost growth as it builds up its franchise due to slower than expected economic growth. In this scenario, NBAD can trade at 0.8x P/BV 2016E.

## Results summary

**Fig. 1. Results review - 4Q2015**

<b>Income statement (AEDmn)</b>	<b>4Q14</b>	<b>3Q15</b>	<b>4Q15</b>	<b>% YoY</b>	<b>% QoQ</b>
Interest income	2,370	2,320	2,425	2.3	4.5
Interest expense	475	487	581	22.3	19.4
<b>Net Interest Income</b>	<b>1,895</b>	<b>1,834</b>	<b>1,844</b>	<b>(2.7)</b>	<b>0.5</b>
<b>Non-interest Income</b>	<b>862</b>	<b>763</b>	<b>713</b>	<b>(17.3)</b>	<b>(6.5)</b>
- Fee based income	619	492	537	(13.2)	9.2
- Trading revenue	231	270	168	(27.4)	(37.9)
<b>Total income</b>	<b>2,757</b>	<b>2,597</b>	<b>2,557</b>	<b>(7.2)</b>	<b>(1.5)</b>
Operating expenses	1,103	1,017	1,039	(5.8)	2.1
<b>Pre-provision profit</b>	<b>1,654</b>	<b>1,580</b>	<b>1,518</b>	<b>(8.2)</b>	<b>(3.9)</b>
Loan loss provisions	218	171	436	100.1	154.9
<b>Profit before tax</b>	<b>1,436</b>	<b>1,409</b>	<b>1,082</b>	<b>(24.7)</b>	<b>(23.2)</b>
Associate, taxes and minorities	74	82	46	(37.8)	(44.0)
<b>Net Income</b>	<b>1,362</b>	<b>1,326</b>	<b>1,036</b>	<b>(24.0)</b>	<b>(21.9)</b>
<b>Balance sheet (AEDbn)</b>					
Loans	194	212	206	6.0	(2.9)
Deposits	243	235	234	(3.9)	(0.5)
- CASA ratio	28.1	30.2	30.5		
<b>Ratios</b>					
Cost/income ratio (%)	40.0	39.2	40.6		
NIM (%)	2.0	2.0	2.0		
RoAA (%)	1.4	1.3	1.0		
Tier I (%)	15.0	15.6	15.7		
CAR (%)	16.4	16.5	16.7		
<b>Asset quality (AEDmn)</b>					
Gross NPA	6,160	5,725	5,847	(5.1)	2.1
Gross NPA (incl. loans overdue for more than 90 days)	7,322	7,173	6,450	(11.9)	(10.1)
Gross NPA (%)	3.8	3.4	3.1		
Coverage (%)	91.1	91.5	95.0		

Source: Company, ADCB Securities Equity Research.

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