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Abu Dhabi Commercial Bank PJSC

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Abu Dhabi Commercial Bank PJSC

SACP	bbb+

Anchor	bbb-	
Business Position	Strong	+1
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

+

Support	+2
ALAC Support	0
GRE Support	+2
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating

A/Stable/A-1

Major Rating Factors

Strengths:	Weaknesses:
• High systemic importance in the United Arab Emirates (UAE). • Strong business position with a good track record of earnings generation. • Majority ownership by, and privileged relationship with, the government of Abu Dhabi. • Strong levels of high-quality capital.	• High concentration risks on both sides of the balance sheet. • Sizable lending exposure in real estate and hospitality.

Outlook: Stable

The stable outlook on Abu Dhabi Commercial Bank (ADCB) reflects S&P Global Ratings' expectation that the bank's business and financial profiles will remain largely unchanged over the next two years.

A positive rating action over the next 24 months is unlikely. However, we could raise our ratings on ADCB if it strengthened its capital position, with our risk-adjusted capital (RAC) ratio sustainably exceeding 15%. This could be driven by a lower-than-expected dividend payout ratio, which we assume will remain stable at about 50%, as seen in the past three years.

A downgrade of ADCB is also unlikely in the next 24 months because it would require a simultaneous downgrade of the Emirate of Abu Dhabi and a weakening of our assessment of the bank's stand-alone credit profile (SACP). We could revise our assessment of ADCB's SACP downward if we saw a sharp drop in capitalization, with our RAC ratio falling below 10%, or a marked deterioration in asset quality metrics. This could follow higher-than-expected losses in real estate and hospitality exposures or an unexpected change in the bank's risk appetite in or outside the UAE.

Rationale

We base our ratings on ADCB on the bank's anchor of 'bbb-', since the bank's lending book is largely focused on the UAE. We also factor in ADCB's well-established franchise, stable management, and its predictable and balanced earnings generation across different business segments. We regard the bank's capital as a key strength for its credit profile, which is underpinned by strong and high-quality capital. We anticipate that ADCB's projected RAC ratio before concentration adjustments will remain in the 13.0%-13.5% range over our two-year outlook horizon. ADCB's asset quality is similar to that of its peers with a similar economic risk profile, supported by low nonperforming loans (NPLs) and healthy loan loss coverage. Although we expect some deterioration in asset quality indicators over the next 12-24 months, largely due to ongoing weakness in real estate, we think the impact on the bank's financial profile will be manageable. We view the bank's funding as comparable with the domestic banking average and its liquidity in line with global peers'. Overall, we assess ADCB's SACP, its intrinsic creditworthiness, at 'bbb+'.

We view ADCB as a government-related entity (GRE). We consider that there is a high likelihood that the government of the Emirate of Abu Dhabi would provide timely and sufficient extraordinary support to ADCB in the event of financial distress. Consequently, our long-term rating on the bank incorporates two notches of uplift from its SACP. In accordance with our criteria for rating GREs, we base our view of the high likelihood of extraordinary government support on our assessment of ADCB's very strong link with, and important role for, the Abu Dhabi government.

Anchor: 'bbb-' for banks operating in the UAE

We use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating in the UAE is 'bbb-'.

Regarding economic risk, we view the UAE's high income levels and its better economic diversification by Gulf standards as key strengths. We forecast a pickup in economic activity in 2018 and 2019 following a dip in real GDP growth last year. However, the country's real estate price market remains in a correction phase, which we expect will continue over the next two years. In addition, we are seeing deterioration in asset quality metrics in certain sectors such as retail expatriate and contracting, although under our base-case scenario, the deterioration will remain contained and we think credit losses will stabilize in 2019. Many banks are structurally exposed to high single-name concentrations and there is a fair level of restructured exposures in the system. Some government-owned entities' debt servicing capacities are vulnerable to volatility in commodity prices.

Regarding industry risk, the improving regulatory framework and banks' largely stable financial performance with healthy earnings generation underpin our assessment of the UAE banking industry. We note that the overall quality of banking regulation and supervision has grown closer to that of emerging market peers in recent years. Despite a very large number of banks in the system, the 10 largest institutions--mostly domestic banks that have had a stable total market share over the past decade--control more than 70% of the market. Core retail customer deposits are the main source of funding for banks and have proved resilient since 2015. Banks' funding costs benefit from high shares of non-interest-bearing deposits.

Table 1

Abu Dhabi Commercial Bank PJSC Key Figures					
		--Year-ended Dec. 31--			
(Mil. AED)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	271,703	264,984	258,270	228,248	203,984
Customer loans (gross)	172,727	169,189	164,400	152,426	138,540
Adjusted common equity	27,110	26,373	24,382	22,472	20,062
Operating revenues	4,648	8,905	8,503	8,262	7,529
Noninterest expenses	1,545	2,948	2,796	2,810	2,537
Core earnings	2,332	4,278	4,157	4,944	4,227

AED--United Arab Emirates dirham. *Data as of June 30.

Business position: A well-established franchise in the UAE

We regard ADCB's business position as strong, which reflects the bank's solid retail and corporate banking presence in the UAE, as well as its predictable and balanced earnings generation across different business segments. ADCB is the third-largest bank in the UAE, with total assets of about UAE dirham (AED) 272 billion ($74 billion) on June 30, 2018, and holds an 11% and 10% market share in loans and deposits, respectively. These have been growing steadily since 2014.

A purely UAE-centric approach has driven ADCB's growth strategy, which has enabled the bank to deliver strong customer service and achieve a sticky customer base. Retail banking, which accounts for about one-fifth of gross loans, posted average annual growth of about 12% from 2013 to 2017. This was coupled with visible efficiency gains as the number of branches declined to 47 from 50 during the same period. On the corporate banking side, the bank benefits from its banking relationship with the Abu Dhabi government and its public entities, which has strengthened materially. As a result, the share of government and GRE loans rose to about 20% compared to about 4% in 2010.

The bank's core lending activities largely drive its revenues, with net interest income accounting for about three-quarters of its operating revenues, one of the highest percentages among its peers in the Gulf Cooperation Council (GCC). ADCB's earning generation is still one of the highest in the GCC, with 15.6% return on equity and 1.6% return on assets in 2017. In our view, the bank's execution capabilities and stable management team are well reflected in the bank's key financial and business metrics.

On Sept. 3, 2018, ADCB confirmed that exploratory talks had commenced regarding a potential merger with two other UAE banks; Union National Bank and Al Hilal Bank. Our current ratings on ADCB do not factor in the potential merger, which we will have to assess depending on its potential terms.

Table 2

Abu Dhabi Commercial Bank PJSC Business Position					
		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Total revenues from business line (mil. AED)	4,648	8,905	8,503	8,262	7,529
Wholesale banking/total revenues from business line	31.9	30.7	30.3	30.2	26.4
Consumer banking/total revenues from business line	42.8	45.8	46.5	45.4	42.7
Wholesale and consumer banking/total revenues from business line	74.7	76.6	76.8	75.6	69.1
Return on average common equity	17.0	15.6	16.2	20.9	19.0

AED--United Arab Emirates dirham. *Data as of June 30.

Capital and earnings: ADCB operates with strong capitalization

We regard ADCB's capital and earnings as strong. This reflects the bank's high level of capital, its strong core earnings generation, and manageable dividend payout policy, which enables it to maintain its capitalization. On June 30, 2018, the bank's regulatory capital adequacy ratio stood at 16.7%, while its tier I ratio was 14.3%.

Although softer market conditions in 2017 challenged UAE banks' financial performances, ADCB's operating revenue and net income were resilient, with the bank posting 5% and 3% growth, respectively. ADCB has maintained its cost discipline with a flat cost-to-income ratio of about 33%. Lastly, ADCB's focus on non-interest-bearing deposit growth in recent years continues to deliver results, with the share of these deposits reaching 43% of total deposits.

The bank's RAC ratio before adjustments, based on 2017 financial statements, stood at 13.2%. We expect this ratio will remain between 13% and 13.5% over the next two years. Specifically, we expect:

- Gradual recovery in the UAE economy will drive annual loan growth of about 3%-5% in 2018 and 2019.
- A pickup in net interest margins, since we expect a positive impact from the repricing of the corporate loan book (mostly based on a floating rate), coupled with the benefits of a higher share of non-interest-bearing deposits.
- Mid-single-digit percentage fee income growth, in line with our loan growth projections.
- A relatively stable cost-to-income ratio of 33%-35%.
- A manageable increase in credit losses in 2018 given the soft real estate market, followed by a stabilization in 2019.
- Dividend payout to remain at about 50% of net income.

Table 3

Abu Dhabi Commercial Bank PJSC Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	14.3	15.9	15.7	16.3	17.0
S&P Global Ratings RAC ratio before diversification	N/A	13.2	13.2	13.8	14.7
S&P Global Ratings RAC ratio after diversification	N/A	10.4	11.1	11.7	11.5
Net interest income/operating revenues	77.7	75.2	72.9	75.1	74.2
Fee income/operating revenues	15.2	16.9	17.3	17.4	16.5
Noninterest expenses/operating revenues	33.2	33.1	32.9	34.0	33.7
Preprovision operating income/average assets	2.3	2.3	2.3	2.5	2.6
Core earnings/average managed assets	1.7	1.6	1.7	2.3	2.2

N/A--Not applicable. RAC--Risk-adjusted capital. *Data as of June 30.

Table 4

Abu Dhabi Commercial Bank PJSC Risk-Adjusted Capital Framework Data

(Thousand AED)	**Exposure***	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government and central banks	67,010,363	--	--	1,880,672	3
Of which regional governments and local authorities	0	--	--	0	0
Institutions and CCPs	51,113,184	--	--	17,996,998	35
Corporate	130,416,290	--	--	127,951,968	98
Retail	41,524,191	--	--	35,437,208	85
Of which mortgage	7,264,557	--	--	3,403,803	47
Securitization§	0	--	--	0	0
Other assets†	4,600,623	--	--	6,870,367	149
Total credit risk	294,664,651	--	--	190,137,213	65
Credit valuation adjustment					
Total credit valuation adjustment	--	--	--	0	--
Market risk					
Equity in the banking book	702,342	--	--	6,818,629	971
Trading book market risk	--	--	--	16,078,406	--
Total market risk	--	--	--	22,897,035	--
Operational risk					
Total operational risk	--	--	--	16,697,192	--

(Thousand AED)		**Basel III RWA**		**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification		298,044,238		229,731,440	100
Total diversification/concentration adjustments		--		61,426,201	27

Table 4

Abu Dhabi Commercial Bank PJSC Risk-Adjusted Capital Framework Data (cont.)				
RWA after diversification	298,044,238		291,157,641	127
(Thousand AED)	**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	32,149,499	15.9	30,373,445	13.2
Capital ratio after adjustments‡	32,149,499	15.9	30,373,445	10.4

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes deferred tax assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). AED--United Arab Emirates Dirham. CCP--Central counterparty. RAC--Risk-adjusted capital. RW--Risk weight. RWA--Risk-weighted assets. Sources: Company data as of Dec. 31, 2017, S&P Global Ratings.

Risk position: Adequate, although exposed to ongoing weakness in UAE real estate

We assess ADCB's risk position as adequate, which reflects its low level of NPLs and strong loan loss coverage. The bank had an NPL ratio of 2.8% on June 30, 2018, coupled with a healthy loan loss coverage of 145%, which benefits from AED1.5 billion provision taken under International Financial Reporting Standard 9.

A key risk for ADCB stems from the bank's large exposure in the real estate and hospitality segments, which accounted for 39% of its gross loans on June 30, 2018. UAE residential real estate prices have declined by an estimated 20%-25% since their recent peak in 2015, and we expect the market will remain soft in 2018 and 2019. While this will drive new NPL formation for UAE banks, we think they will be more resilient than in the last real estate cycle in 2002-2008 due to stronger regulation and more conservative lending practices to the real estate sector.

We believe ADCB's credit loss cycle bottomed out in 2015 and the weak real estate market in the UAE will be a negative factor for the bank's asset quality metrics. We also note that the volume of past-due but not impaired (PDNI) loans has increased, reaching 3.5% of gross loans on Dec. 31, 2017 compared to 1.8% a year earlier. Although most of these loans were in the 30-to-60-days PDNI bracket, they confirm our view of ongoing weakness in retail asset quality.

Nevertheless, we expect the bank's strong pre-provision earnings generation capacity will allow the bank to absorb mild credit losses without suffering any meaningful damage to its core profitability metrics. We expect the NPLs will increase over the next two years, without exceeding 3% by 2019, and NPL coverage by provisions will remain above 150% over the same period.

Table 5

Abu Dhabi Commercial Bank PJSC Risk Position					
		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans (gross)	2.1	2.9	7.9	3.5	6.4
Total managed assets/adjusted common equity (x)	10.0	10.0	10.6	10.2	10.2
New loan loss provisions/average customer loans	0.9	1.0	1.0	0.3	0.5
Net charge-offs/average customer loans	0.7	0.8	1.0	0.4	0.3
Gross nonperforming assets/customer loans + other real estate owned	2.8	2.2	2.8	3.2	3.1
Loan loss reserves/gross nonperforming assets	145.3	160.0	129.2	127.7	147.0

N/A--Not applicable. *Data as of June 30.

Funding and liquidity: Well-established retail branch network and adequate liquidity

Our assessment of ADCB's funding reflects the bank's solid base of core customer deposits, on the back of its well-established retail branch network. The bulk of ADCB's deposit base comes from nonremunerated demand deposits, which accounted for 43% of total deposits on June 30, 2018 and help the bank to partly offset the increase in cost of funding caused by recent liquidity tightening. Although the bank's loan-to-deposit ratio of 102% on June 30, 2018 still looks higher than that of some of its GCC peers, we note that because of its access to long-term funding and strong capital, its stable funding ratio has stood at a healthy 110% over the past three years. We expect the bank will continue to enjoy sound access to long-term funding. ADCB is one of the few banks in the region with well-established, long-term funding programs and access to hard currency, overseas funding at strong rates.

We believe ADCB's liquidity will remain adequate over the next two years. Its broad liquid assets to short-term wholesale funding has stood at an average of 3.4x over the past three years. Furthermore, the ratio of net broad liquid assets to short-term core deposits has been improving every year since 2012 and reached 33% on June 30, 2018. The liquidity profile of ADCB's balance sheet is solid, with about 14% parked in cash, central bank reserves, or interbank deposits. Furthermore, the bank's large investment portfolio accounts for 18% of assets, which ADCB invests largely in highly rated UAE and GCC bonds.

Table 6

Abu Dhabi Commercial Bank PJSC Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	77.4	77.0	75.4	77.8	75.5
Customer loans (net)/customer deposits	96.6	100.1	101.9	101.9	111.5
Long term funding ratio	96.3	93.7	89.7	92.8	90.2
Stable funding ratio	122.5	115.6	110.5	110.3	108.1
Short-term wholesale funding/funding base	4.2	7.3	11.8	8.3	11.3
Broad liquid assets/short-term wholesale funding (x)	7.6	4.3	2.7	3.1	2.2
Short-term wholesale funding/total wholesale funding	17.3	29.2	44.4	34.3	42.3

*Data as of June 30.

Support: Two notches of government support

The issuer credit rating on ADCB includes two notches of uplift. This reflects our view of the bank as a GRE with a high likelihood of timely and sufficient extraordinary support from the government of Abu Dhabi if needed. We base our assessment on ADCB's:

- Very strong link with the Abu Dhabi government, because of its control and majority ownership by Abu Dhabi, and the latter's record of extraordinary support to ADCB. The Abu Dhabi government holds a 62.5% stake in ADCB through the Abu Dhabi Investment Council and therefore has a significant interest in, and business relationship with, the bank. The Abu Dhabi government appoints the majority of the bank's directors. In 2009, the government injected AED4 billion (about $1.1 billion) in tier I capital into the bank during a period of market stress.
- Important role for the Abu Dhabi government. ADCB is the second-largest bank in Abu Dhabi and has a strong deposit and loan market share in Abu Dhabi's banking market. The bank also provides funds to certain Abu Dhabi-based GREs and key sectors in the emirate's overall business activities.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Barring Oil Or Geopolitical Risks, Gulf Banks' Financial Profiles Should Stabilize In 2019, Oct. 1, 2018
- GCC Banks' Transition To IFRS 9 Yields No Surprises, May 28, 2018
- Banking Industry Country Risk Assessment: United Arab Emirates, March 14, 2018
- GCC Banks Should See A More Stable Financial Footing In 2018, Jan. 8, 2018
- The Overall Effect Of IFRS 9 On Rated Gulf Cooperation Council Banks' Financial Profiles Will Be Manageable, May 29, 2017

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	**5**	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	**bbb-**	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of October 3, 2018)

Abu Dhabi Commercial Bank PJSC		
Issuer Credit Rating		A/Stable/A-1
Commercial Paper		
Foreign Currency		A-1
Senior Unsecured		A
Issuer Credit Ratings History		
02-Apr-2015	*Foreign Currency*	A/Stable/A-1
30-Jul-2014		A/Positive/A-1
21-Jun-2011		A/Stable/A-1
02-Apr-2015	*Local Currency*	A/Stable/A-1
30-Jul-2014		A/Positive/A-1
21-Jun-2011		A/Stable/A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.