

Subject : Abu Dhabi Islamic Bank - Investment Update

Prepared by : Global Investment House “Global”

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- **Global** values Abu Dhabi Islamic Bank at **AED3.63** and reiterates a **BUY** on the stock

Global Investment House – Kuwait – Abu Dhabi Islamic Bank (ADIB) - ADIB posted a net profit of AED851.3mn in 2008, reporting a profitability growth of 11%YoY in the bank's bottom-line. The bank's earnings growth, though considerably over-shadowed by the 35%YoY growth in 2007 or the herculean 2004 – 2008 CAGR of over 62%, still signifies the resilience of the bank's bottom-line in troubled times. Albeit, the bank exhibited a tremendous growth in the top-line, erosion in net profits emanated from severe provisioning against non-performing loans and impairments in investments. We believe that profitability growth will remain relatively the same in 2009 (at 10%YoY) before the net profit embarks on an even healthier trajectory with a CAGR of 18.3% for the 2008 – 2012 period. The continuance of bottom-line growth is expected to be driven by a confluence of factors including sustainable though slower movement in net commission income (NCI) easily offsetting the expected 18%YoY decline in non-fund income. Net earnings will remain under pressure in 2009 owing to continuation of high provisions against loans complemented with slight impairments in investments. Higher profit growth is anticipated to kick in beyond 2009 as investment income improves and provisioning requirements ease off while the NCI follows a due sustainable course.

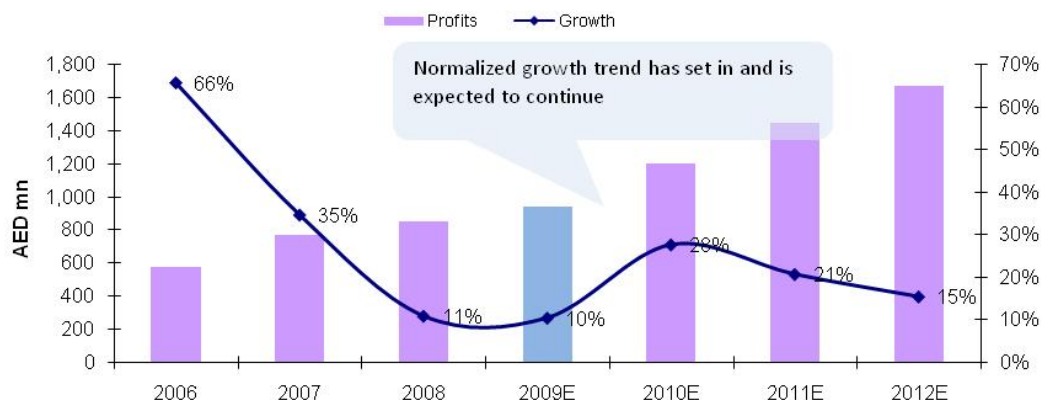
Based on the current market price of AED2.95/share (as on May 17, 2009), ADIB's shares are trading at a 2009E P/E and a 2009E P/BV multiple of 6.2x and 1.0x respectively. Our estimated value for this banking scrip is worked out to be AED3.63 based on DDM (80%) and adaptation of the Gordon Growth Model (20%). According to our fair value the banking scrip offers an upside of 23% over the closing price of AED2.95 per share. We therefore reiterate our **BUY** recommendation on the scrip.

Like any other bank in the UAE, ADIB is operating under challenging times and facing unprecedented conditions. A severe reduction in the risk appetite of banks, rising NPLs and that too amidst low oil prices coupled with production cuts are problems that will brutally undermine the asset growth trajectory of the banks in the UAE. Rating agencies like Moody's have already issued a medium-term negative outlook on the UAE banking system citing the adverse operating environment and weakening financial fundamentals as the deciding factors behind their assessment. Abu Dhabi however enjoys being in a favourable position to since its equity markets are one of the best performing YTD in the GCC, property prices have not been hit as severely as those in Dubai and analysts and property developers are not expecting any major pinch waiting to happen. Moreover the rich Abu Dhabi government has been more proactive in its attitude towards banks and provided them with the required assistance in whatever terms have been necessary to sustain them.

Albeit, the era of super-normal growth is a bygone and will remain a bygone, ADIB may still witness a very healthy growth going forward. The 4-yr CAGR of 42% in assets that we have witnessed till 2008,

may drop down to the early double-digits; for ADIB we see a 4-yr CAGR of 16% for the forecast period. That combined with range-bound spreads, is expected to keep net commission income (NCI) growth in check. We expect a modest growth of 15%YoY in the NCI in 2009, which is anticipated to maintain an average rise of 13% over the forecast period.

Figure 01: Profitability trends



Source: Annual reports, Global Research

Non-commission income generating from fees and commission income and capital gains from investments is expected to lay low over the forecast period given the prevalent and expected market conditions. Moreover, the management feels that increased focus on recurring, core-banking revenue streams is the need of the hour.

Asset quality maintenance will pose the biggest challenge to the bank which is already hovering at a very low coverage ratio. Even keeping the NPLs ratio maintained at around current levels and just providing enough to reach a 100% coverage in 4 yearly strides, will siphon-off a significant portion of the income. Exposure of investments to the stock market and the RE market may pose a threat the bottom line, however with the bank's focus on the Abu Dhabi markets combined with strict accounting practices does offer a certain cushion given the better performance exhibited by them. Attributable to the sheer magnitude and persistence of provisions, a modest growth in the net commission income and low capital gains on investments, we forecast a modest growth in the bottom-line of the bank in 2009 to the extent of 10%YoY. Better top-line performance supplemented with lower provisions is expected to provide the profitability with the necessary thrust in 2010 and onwards.

Investment Indicators

Price (May 17, 2009)	Shares in issue	Market Cap			52 - week price range			
2.95 AED	1970.6 mn	5931.5 AED mn			0.72 - 3.17 AED			
Year	Operating Income (AED mn)	Net Profit (AED mn)	EPS (fils)	BVPS (AED)	ROAA (%)	ROAE (%)	P/E (x)	P/BV (x)
2010F	1,955.7	1198.2	61	3.2	1.8%	20.0%	4.9	0.9
2009F	1,619.3	939.2	48	2.9	1.6%	17.3%	6.2	1.0
2008A	1,738.9	851.3	43	2.6	1.8%	16.5%	7.8	1.3
2007A	1,322.5	768.5	39	2.6	1.9%	20.0%	12.3	1.8

Source: Zawya, Global Research

Historical P/E & P/BV multiples pertain to respective year -end prices, while those for future years are based on closing prices as of May 17, 2009.