



Initiation of Coverage

SECURITIES BROKERAGE

17 July 2007

Abu Dhabi Commercial Bank (ADCB)

Hold

General Information

RIC	ADCB.AD
Bloomberg Code	ADCB UH
Market Cap	AED29,080 Mil
Shares Outstanding	4,000 Mil
Free Float	35.2%

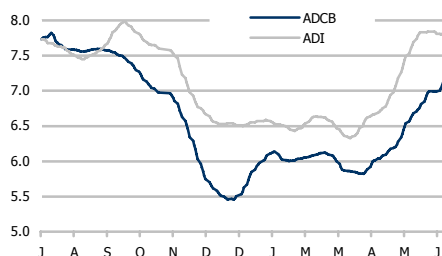
Valuation

Target Price	AED7.40
Market Price	AED7.27
Upside Potential	1.8%

Share Price Information

	Absolute	Relative*
YTD Δ	28.6%	8.6%
1M Δ	8.0%	4.9%
3M Δ	17.9%	1.1%
12M Δ	-7.9%	-8.9%
52-Wk Range	AED5.46-7.82	

* Relative Performance Based on ADI



Reaching a Bottleneck

Summary

ADCB in Overview

Abu Dhabi Commercial Bank (ADCB) was formed in 1985 as a result of the merger between Khalij Commercial Bank with Emirates Commercial Bank and Federal Commercial Bank. The bank currently has a network of 42 branches in the UAE and two branches in India. The bank is majority owned by the Abu Dhabi Investment Council, which has a 64.8% stake. In 2006, ADCB had a market share of 11.8% in terms of loans, 8.3% in terms of deposits and 9.4% in terms of total assets in 2006.

1H07 Results: Absence of Stock Market Related Earnings Plunges Bottom Line

ADCB booked a bottom line of AED945.8 million in 1H07, down 17.8% YoY impacted primarily by a 57.4% decline in fees and commissions due to the absence of IPO related income. This comes in spite of solid net interest income growth and a decline in provisioning charges.

We Forecast ADCB to Book a Net Income of AED1.9 Billion in FY07

We forecast that ADCB will book a bottom line of AED1.9 billion in FY07, down 6.9% YoY from AED2.1 billion in FY06. The decline is due to an estimated 33.0% YoY decline in the bank's fees and commissions to AED756.4 million due to the absence of the IPO related income that amounted to AED547.2 million in FY06. Falling fees and commissions are to overshadow a strong expected net interest income growth of 21.7% YoY.

We Recommend "Hold" on ADCB

We initiate our coverage on ADCB with a "Hold" recommendation based on a target price of AED7.40, which offers a 1.8% premium to the current market price of AED7.27.

Key Performance Indicators

AED Millions	06A	07E	08E	09F	10F	11F
Net Interest Income	1,774	2,159	2,406	2,733	3,072	3,505
Net Fees & Commissions	1,129	756	866	994	1,141	1,319
Operating Expenses	(754)	(959)	(1,166)	(1,426)	(1,691)	(2,026)
Pre-Provisions Income	2,343	2,162	2,350	2,570	2,824	3,139
NPL Provisions	(193)	(161)	(193)	(243)	(309)	(395)
Net Income Before Appropriations	2,082	1,938	2,090	2,255	2,437	2,660
P/E (x)	13.97x	15.00x	13.91x	12.90x	11.93x	10.93x
Unadjusted P/BV (x)	3.06x	2.76x	2.50x	2.26x	2.06x	1.87x
Adjusted P/BV (x)	3.10x	2.81x	2.54x	2.30x	2.08x	1.87x
Dividend Yield	4.2%	3.3%	3.6%	3.9%	4.2%	4.5%

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I. Investment Summary

Beginning in 2003, ADCB underwent a major restructuring plan with new management brought on board. The restructuring paid off as over the period from FY03 to FY05, the bank's loan portfolio grew at a CAGR of 44.5%, deposits at 30.9%, assets at 41.3% and net income at 72.6%. Additionally, NPLs to Gross Loans dropped from 18.0% in FY03 to 1.8% in 2006.

Table 1: ADCB in Comparison to Local Peers (FY06)

	ADCB	CBD	EBI	FGB	MB	NBAD	NBD	UNB
Gross Loans (AED Millions)	63,408	12,899	66,644	25,628	30,325	58,403	43,530	28,037
Deposits (AED Millions)	43,397	13,756	50,288	34,434	34,656	70,738	45,408	30,046
Total Assets (AED Millions)	81,088	18,705	95,878	47,759	56,745	100,966	69,276	41,539
Net Income (AED Millions)	2,082	601	1,888	1,536	1,571	2,106	1,106	1,008
Market Share (%)								
Gross Loans	11.8%	2.4%	12.4%	4.8%	5.6%	10.9%	8.1%	5.2%
Deposits	8.3%	2.6%	9.6%	6.6%	6.6%	13.5%	8.7%	5.7%
Total Assets	9.4%	2.2%	11.2%	5.6%	6.6%	11.7%	8.1%	4.8%
Key Ratios								
Loans-to-Deposits	146.1%	93.8%	132.5%	74.4%	87.5%	82.6%	95.9%	93.3%
NPLs-to-Gross Loans	1.8%	2.3%	0.7%	1.4%	1.3%	1.6%	1.1%	1.5%
Coverage Ratio	88.4%	87.6%	164.1%	129.6%	243.8%	96.7%	64.6%	130.8%
Interest Spread	2.19%	3.80%	2.24%	2.40%	2.49%	2.14%	2.14%	1.84%
Change YoY in bps	(51)	7	(34)	(35)	(32)	(26)	(24)	(19)
Net Interest Margin	2.69%	4.20%	2.27%	2.99%	2.66%	2.39%	2.19%	2.46%
Change YoY in bps	(32)	25	(48)	(7)	(35)	(24)	(27)	2
Cost-to-Income	24.3%	30.9%	35.7%	19.4%	36.5%	23.7%	36.5%	25.2%
Capital Adequacy	14.7%	20.2%	15.6%	21.3%	17.5%	20.9%	N/A	18.2%

Source: Banks' Financials, HC Brokerage

ADCB's 1H07 Bottom Line Plunges 17.8% YoY

ADCB's net interest income advanced by 19.9% YoY to reach AED1.0 billion in 1H07. Net interest margin declined from 3.12% to 2.70% and interest spreads from 2.66% to 2.28% primarily due to a greater increase in ADCB's cost of funding due to accelerated growth in funding base as a result of greater deposits' growth as well as the increased reliance on short and medium-term borrowings.

In spite of solid growth in net interest income, and a 76.7% YoY drop in provisioning charges, net income declined by 17.8% YoY to book AED945.8 million in 1H07, impacted primarily by the severe drop in net fees and commissions.

Growth Constraint

We believe that, given the status quo, ADCB will not be able to grow its loan portfolio at its historical levels as the bank is operating at a loans-to-deposits above 100%, and at an advances-to-stable resources near the maximum of 100% mandated by the Central Bank. Additionally, the bank has a high exposure to loans on its balance sheet, which entails that any substantial growth in loans would hurt the bank's capital adequacy, which currently fares below peers. ADCB had a capital adequacy of 14.7% in FY06, below the sector's 16.7%. Accordingly, we forecast ADCB's loans to grow at a CAGR of 17.0% over our forecast horizon.

Funding Gap to Hurt Spreads

We expect that ADCB is to focus on growing its funding base to resolve its funding gap through growing its deposits base and raising alternative sources of funds such as Euro Medium Term Notes (EMTNs). In 1H07, the bank raised a USD1.5 billion syndicated loan. Accordingly, we forecast that over our forecast horizon, deposits and borrowings are to grow at CAGRs of 22.1% and 12.8%, respectively.

Given a rising cost of funding from a growing funding base, a cap on loans' growth, increased sector competitiveness and the potential of a rise in interest rates, we forecast that ADCB will

exhibit declining interest spreads over the coming two years.

We Forecast ADCB's FY07 Net Income to Decline 6.9% YoY

We forecast that ADCB will book a bottom line of AED1.9 billion in FY07, down from AED2.1 billion in FY06. The decline is due to an estimated 33.0% YoY decline in the bank's fees and commissions to AED756.4 million due to the absence of IPO related income that amounted to AED547.2 million in FY06. Also, we expect the bank's cost-to-income to rise from 24.3% to 30.7% with an expected increase in operating expenses of 27.2% YoY due to rising staff costs. On the plus side, we expect solid net interest income growth in FY07 of 21.7% YoY but with a decline in spreads of 12 bps to 2.07%.

A DCF Target Price of AED7.40 Per Share

Our DCF target price for ADCB dictates a "Hold" recommendation. The recommendation is based on a DCF of AED7.40, which offers a 1.8% premium to the current market price of AED7.27. We have conducted 5-year forecasts, applied a single WACC of 11.0%, a perpetual growth rate of 6.0% and assumed a dividend payout of 50%.

ADCB is currently trading at a P/E (07) of 15.00x and a P/BV (07) of 2.76x, which is above the sector average of 11.96x and 2.45x, respectively.

Table 2: Multiples of ADCB Versus Local Peer Group

	P/E (07)	P/BV (07)
Commercial Bank of Dubai	11.57x	2.34x
Emirates Bank International	11.67x	2.87x
First Gulf Bank	11.47x	2.08x
Mashreq Bank	11.69x	2.26x
National Bank of Abu Dhabi	13.56x	3.26x
National Bank of Dubai	11.47x	2.26x
Union National Bank	12.30x	2.06x
Average	11.96x	2.45x
ADCB	15.00x	2.76x

Source: HC Brokerage

II. UAE Banking Sector Overview

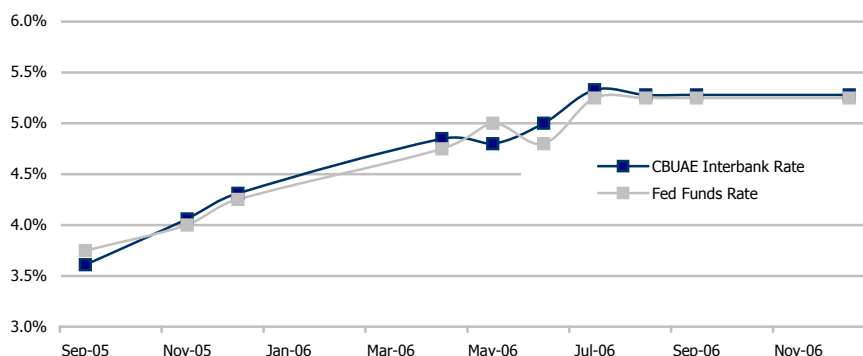
An Over-Populated Sector?

The UAE has a total of 46 banks, which are divided into 21 national banks and 25 branches of foreign banks. Given that the UAE has a population of around 5 million, the number of banks seems too high. This is partially due to the fact that most banks were in existence before the creation of the current central bank. It is important to note that foreign banks are particularly small as they cannot have more than eight branches. Also, a tax rate of 20% is imposed on foreign banks as opposed to the non-taxation of local banks, which reduces foreign banks' overall level of competitiveness. In March 2007, foreign banks collectively had 123 branches compared to 536 branches for the national banks. The market share of national banks in terms of total assets is around 78%.

Interest Rates Mirror US Rates

With the UAE Dirham pegged to the US dollar, UAE interest rates move in tandem with US interest rates. Although the FOMC has not raised interest rates since June 2006, there are expectations for the Fed to raise the federal funds' rate in the short to medium term due to rising inflation.

Chart 1: CBUAE 1-Week Interbank Rate Versus US Federal Funds Rate



Source: CBUAE, FED, HC Brokerage

Banking Sector Balance Sheet and Financial Performance

Table 3: UAE's Banking Sector Aggregate Balance Sheet

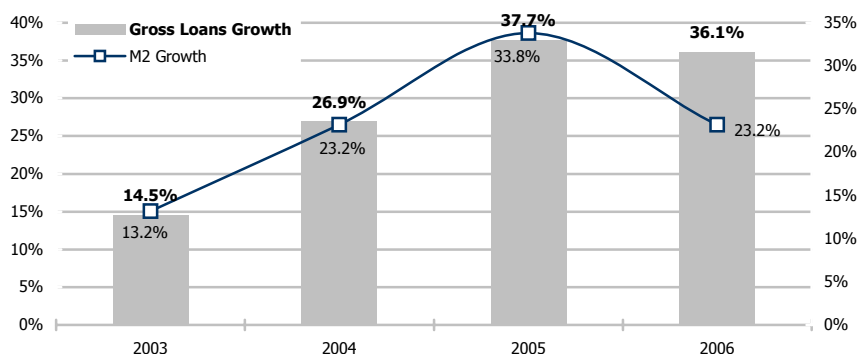
AED Billions	FY03	FY04	FY05	FY06
Cash in Hand	2.4	2.8	3.6	5.1
Deposits with CB	25.1	35.8	43.5	58.4
Dues from Banks	62.8	68.4	116.3	143.3
Foreign Securities and Other Foreign Assets	35.0	34.9	46.2	60.0
Gross Loans	226.0	286.7	394.9	537.4
Domestic Investments	6.9	10.0	19.2	32.1
Unclassified Assets	8.7	11.1	14.3	23.2
Total Assets	366.9	449.8	638.0	859.6
Deposits	233.4	291.3	411.1	522.6
Dues to Banks	40.1	53.0	87.9	158.2
Other Foreign Liabilities	0.5	0.5	0.6	5.3
Capital and Reserves	44.5	52.5	78.1	104.1
Provisions	33.3	31.1	32.3	34.5
Unclassified Liabilities	15.1	21.5	28.0	34.9
Total Liabilities & Equity	366.9	449.8	638.0	859.6
Total Contingent Liabilities	412.2	481.8	587.8	952.3

Source: CBUAE, HC Brokerage

Outstanding Loans Growth

The UAE banking sector has witnessed outstanding loans' growth at a CAGR of 33.5% over the period from 2003 to 2006. Loans growth was driven by phenomenal GDP growth with real GDP reaching around 8.9% in 2006 as well as an accommodative domestic liquidity environment with M2 growing at a CAGR of 26.7%. Another contributing factor to credit growth is the large number of big IPOs in FY05 and 1Q06, which have induced major lending activities to finance IPO subscriptions.

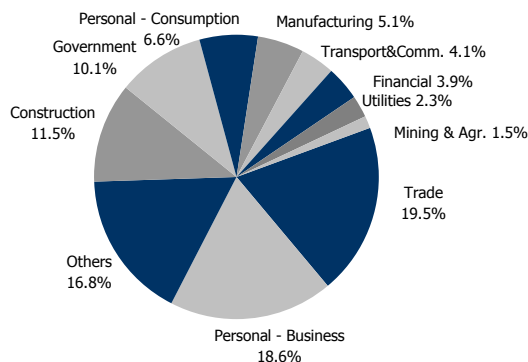
Chart 2: UAE Banks' Gross Loans Growth and UAE's M2 Growth



Source: CBUAE, HC Brokerage

Aggregate banking sector loans are somewhat diversified across different sectors. Personal loans (for both business and consumption purposes) dominate, constituting 25.2% of total loans. Trade follows constituting 19.5%.

Chart 3: Breakdown of Loans to Residents by Economic Activity in FY06

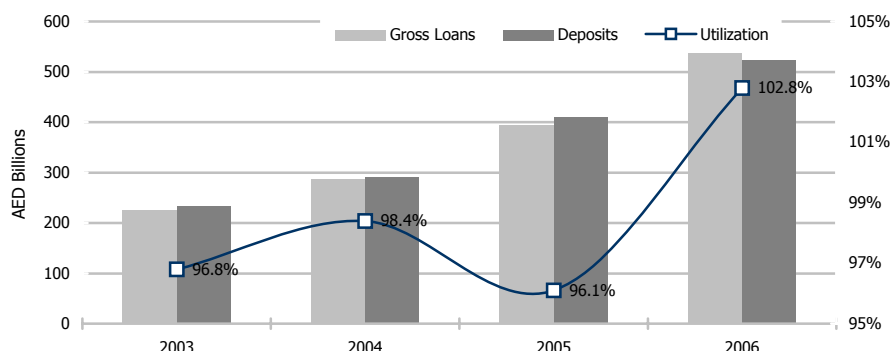


Source: CBUAE, HC Brokerage

An Over-Utilized Sector...

In spite of deposits growing at a positive CAGR of 30.8% over the period from 2003 to 2006, growth falls slightly short of the 33.5% CAGR for gross loans. The UAE banking sector had a loans-to-deposits ratio of 96.8% in 2003. The recent spurt in loans growth led sector loans-to-deposits to reach 102.8%. The slower deposits growth is partially due to the low deposit rates in the UAE, which make them a non-lucrative savings instrument. Deposit interest rates reached a maximum of 5.95% in 2006.

Chart 4: UAE's Banking Sector Aggregate Loans and Deposits



Source: CBUAE, HC Brokerage

...Encourages Banks to Seek Alternative Funding Sources

UAE banks are not required to maintain a loans-to-deposits ratio at a certain level; however, they are required to maintain an advances-to-stable resources of a maximum of 100% (see Appendix I for definition). Still, the funding gap in the sector entices banks to look for alternative funding sources through the issuance of Euro Commercial Paper (ECP) and Euro Medium Term Notes (EMTNs), syndicated loans and convertible debt. As long as deposit growth falls short of loans demand, we expect this trend to continue.

Table 4: Borrowings Outstanding by Selected UAE Banks as at March 31st, 2007

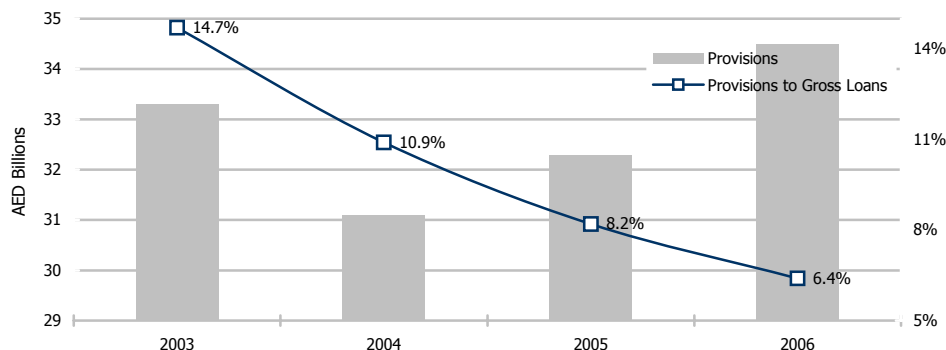
AED Billions	ECP	EMTNs	Sub. Debt	Syn. Loans
Abu Dhabi Commercial Bank	-	13.0	1.5	3.7
Emirates Bank Group	-	12.9	-	-
First Gulf Bank	-	-	-	3.4
Mashreq Bank	-	5.2	-	-
National Bank of Abu Dhabi	1.1	6.9	2.4	-
National Bank of Dubai	-	8.6	-	-
Union National Bank	-	2.0	-	3.7

Source: Banks' Financials, HC Brokerage

Low Provisioning Levels

Given a very positive economic environment, asset quality of most UAE banks is high, and accordingly, provisioning levels are particularly low. Provisions as a percentage of total sector loans declined from 14.7% in 2003 to 6.4% in 2006. The lurking question pertains to the sustainability of such low provisioning levels. Banks with a high exposure to the real estate sector and stock market in their loan portfolios have a higher susceptibility to see an escalation in their provisioning levels in the event of a crash in either market.

Chart 5: Banking Sector's Total NPL Provisions and Provisions as a % of Gross Loans

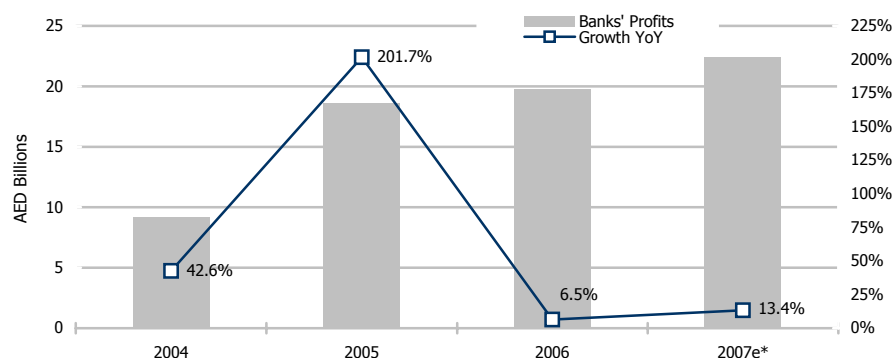


Source: CBUAE, HC Brokerage

Stock Market Earnings are History?

In 2005 and 1Q06, banks benefited from a booming stock market through gains from financing IPOs, brokerage fees, performance fees from assets under management, investment banking fees, trading gains and revaluation gains on available for sale and held to maturity investments. Aggregate banking sector profits grew by 202% in 2005, with growth rate plunging to 6.5% in 2006

Chart 6: Banking Sector Profits

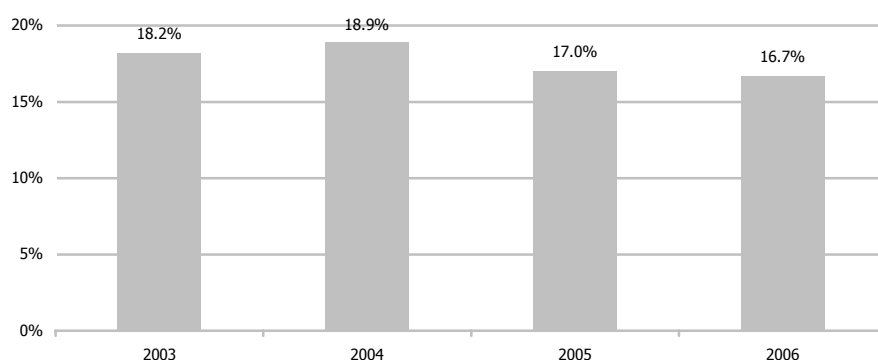


*1Q07 Profits Annualized
Source: CBUAE, HC Brokerage

UAE Banks' Capital Adequacy: On the Move to Basel II

The Central Bank of the UAE announced that it plans to implement the Basel II Accord in phases. Banks are expected to be compliant with at least the Standardized Approach for Credit Risk by December 31st 2007. Compliance to the Internal Ratings Based Approach for Credit Risk has to be at most by 2011. In the short term, we believe that UAE banks are well-prepared to implement Basel II given that they are over-capitalized with an aggregate capital adequacy of 16.7% in 2006. Additionally, the short-term pressure is with regards to compliance with the Standardized Approach, which is not very much different from the Basel I framework (it involves more risk-weighting categories and the use of credit ratings).

Chart 7: UAE Banks' Aggregate Capital Adequacy Ratio



Source: CBUAE, HC Brokerage

Banking Sector Trends & Developments

NBD & EBI Merger – The Beginning of a Consolidation Wave?

In March 2007, Emirates Bank International Group (EBI) and National Bank of Dubai (NBD) announced that they agreed to merge to create the largest UAE bank with total assets of around AED178 billion (USD49 billion). This could be the beginning of a potential consolidation wave, especially given the large number of banks in the UAE.

Islamic Banking – A Growing Trend

With a huge Gulf and foreign appetite for Shariah compliant products, many banks are putting the issue of Islamic banking on the top of the priority list either through applying to an Islamic banking license or through offering Shariah compliant products.

New Banking Licenses

In July 2007, Sheikh Khalifa bin Zayed Al Nahyan issued a decree to establish a new bank, The Crescent Bank, which is to be a public joint stock company, fully owned by the Abu Dhabi Investment Council and will have an initial capital of AED4 billion. 10-20% of the bank may be offered through an IPO.

In July 2006, the Central Bank granted Saudi American Bank (SAMBA), and Doha-Bank Qatar, a license to carry out commercial banking activities in the UAE only to have representation from national banks of all GCC countries.

Mortgage Lending – Not as Hot as It Should Be?

With a booming real estate market in the UAE, mortgage loans have witnessed 80% YoY growth in 2006, up from 63% in 2005. Mortgage loans stood at AED31.5 billion as at 31 December 2006, which comprises a mere 6% of total sector loans. This can be primarily attributed to the lack of an efficient legal system.

Banks Permitted to Establish Real Estate Subsidiaries

The UAE Central Bank approved a regulation that allows banks to establish real estate subsidiaries to finance and manage real estate projects only. Housing finance companies that are jointly owned by banks are allowed to conduct the business of purchase, sale, development, financing and management of real-estate projects, provided that general shareholders own at least 60% of the company.

Emiratization of the Banking Sector

The Central Bank in cooperation with the National Human Resource Development and Employment Authority (TANMIA) conducts a semi-annual survey of banks operating in the UAE to enhance the participation of UAE nationals in the banking sector and their compliance to the requirement to employ nationals at a rate of 4% per annum.

III. ADCB Overview

Abu Dhabi Commercial Bank was formed in 1985 as a result of the merge between Khalij Commercial Bank with Emirates Commercial Bank and Federal Commercial Bank. The bank currently has a network of 42 branches in the UAE and two branches in India.

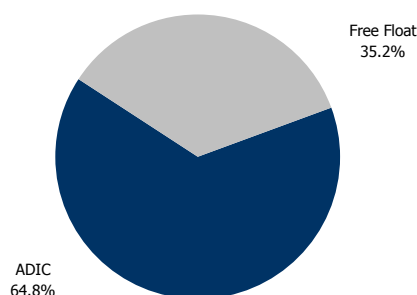
ADCB's Restructuring

The year 2003 marked the beginning of a major restructuring plan for ADCB. A new management team was brought on board to help the bank regain its market position. Eirvin Knox took over as the bank's CEO. The bank was structured into three main divisions: corporate, retail and treasury. A new corporate identity and brand image were introduced. Restructuring also involved centralization of back office operations and the installation of a new IT system.

Shareholders' Structure

ADCB is majority owned by the government of Abu Dhabi through the Abu Dhabi Investment Authority (ADIA), the investment arm of the Abu Dhabi government, which holds a 64.8% stake. A good share of government and related entities' deposits and business flows through the bank. The EGAM held on March 18th, 2007 approved the transfer of ADIA's stake to the Abu Dhabi Investment Council (ADIC). ADIC is an investment company, wholly-owned by the government of Abu Dhabi, with a corporate body that is responsible for Abu Dhabi-based investments that were previously managed by ADIA.

Chart 8: ADCB's Shareholders' Structure



Source: ADCB, HC Brokerage

Three Active Subsidiaries

ADCB has three active, consolidated subsidiaries: Al Dhabi Brokerage Services, Abu Dhabi Risk & Treasury Solutions and Abu Dhabi Commercial Properties. According to the agreement with shareholders, the bank shares 51% of profits in Abu Dhabi Risk & Treasury Solutions up to 2011. From 2012 to 2015, profit-sharing increases to 75%. Minority shareholders are not to share in any losses incurred by the subsidiary.

Table 5: ADCB's Consolidated Subsidiaries

Subsidiary	% Ownership	Description
Al Dhabi Brokerage Services	100%	Agent in trading of financial instruments and stocks
Abu Dhabi Risk & Treasury Solutions	51%	Providing computer software and design in relation with risk & treasury solutions
Abu Dhabi Commercial Properties	100%	Real estate property management and investments

Source: ADCB, HC Brokerage

Leveraging on Strategic Alliances

To better serve its clients all over the world and enhance its position as a banking institution, ADCB has been entering into a number of joint ventures and forming strategic alliances with a number of regional and international players. The most notable and wide-scoped is the joint venture with Australia's Macquarie Bank.

Table 6: ADCB's Alliances and Joint Ventures

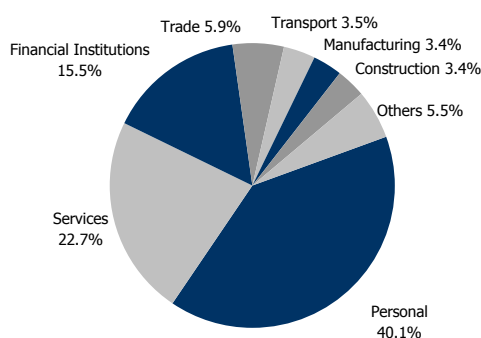
Partner	Date	Description
Commercial International Bank (Egypt)	September 2005	Strategic alliance to provide non-resident Egyptians with a one-stop banking solution in the UAE and Egypt.
Deutsche Bank (Germany)	May 2005	A Shariah compliant, principal-protected transaction for high net-worth clients linked to a basket of commodities.
Macquarie Bank (Australia)	April 2005	Joint venture between ADCB and Macquarie Bank's Treasury and Commodities Group.
	September 2005	An investment banking joint venture, with a focus on the infrastructure sector.
	May 2006	Joint venture between ADCB and Macquarie Real Estate.
Kuwait Finance & Investment Company [KFIC] (Kuwait)	November 2005	Al-Bashaer Shariah-compliant GCC equities fund with ADCB serving as the fund's exclusive distributor. KFIC, along with Bahrain's Gulf Finance House, undertake the Islamic filtration and stock selection.
	April 2007	ADCB and KFIC signed an MOU to establish & launch a USD155 million private equity fund with a 3-year term and 30% annual IRR. The fund offers both sector and country diversification.
UTI Bank (India)	April 2007	Strategic alliance to bring non-resident Indians with a one-stop banking solution both in the UAE and India.

Source: ADCB, HC Brokerage

A Retail Focus

ADCB's loan portfolio has a high proportion of personal loans representing 40.1% at June 2007, which subjects the bank to the risk of a crash in the real estate or capital markets. However, the bank's loans are well-secured and granted to high net-worth individuals. It is worthy to note that on an aggregate sector basis, personal loans also dominate but comprise a lesser 25.2%.

Chart 9: Breakdown of ADCB's Loan Portfolio by Sector at June 2007



Source: ADCB, HC Brokerage

Expertise in Project Financing

ADCB's corporate division specializes in financing projects of SMEs, big corporations, governments and public entities. The bank's ability to borrow long-term at low rates, due to its high credit ratings, enhances its ability to finance long-term projects.

Table 7: Recent Corporate Loans Provided by ADCB

Borrower	Date	Loan Amount
Gulf Energy Maritime PJSC	June 2006	AED367 Million
Etihad Towers	November 2006	AED2.4 Billion
International Capital Trading*	November 2006	AED1.5 Billion
Star Cement*	November 2006	AED 382 Million
GMR-Hyderabad International Airport – India*	March 2007	AED459 Million
RNA Resources Group Ltd.*	April 2007	AED624 Million
Union Properties*	June 2007	AED2.75 Billion

*Syndicated Loan

Source: ADCB, Khaleej Times, Zawya Dow Jones, HC Brokerage

An Indian Presence

ADCB has two branches in India. The choice of India is due to the large Indian expatriate population in the UAE and the high trade flows between the two countries.

Favorable Credit Ratings

In May 2006, Standard & Poors raised ADCB's credit rating from "A-/A-2" to "A/A-1" whilst maintaining a 'stable' outlook. In July 2006, Moody's Investor Services upgraded the bank's financial strength rating from "D" to "D+". The bank also received an "A1/Prime-1" rating for its foreign currency deposits (the country's ceiling), and an "Aa3" rating for its foreign currency senior unsecured debt rating.

Plans to Venture Into Islamic Banking?

ADCB's management has expressed interest in acquiring an Islamic banking license. The bank established an Islamic financial solutions unit called ADCB Meethaq. Under the umbrella of ADCB Meethaq, the bank offers Shariah compliant products, which currently are the Mudarabah Overdraft Facility and the Takaful & Savings Programme. The bank also offers, along with Kuwait Finance & Investment Company, Al-Bashaer Shariah-compliant GCC equities fund.

IV. ADCB in Comparison to Peers

In this section, we compare ADCB to seven other listed commercial banks: Commercial Bank of Dubai (CBD), Emirates Bank International (EBI), First Gulf Bank (FGB), Mashreq Bank (MB), National Bank of Abu Dhabi (NBAD), National Bank of Dubai (NBD) and Union National Bank (UNB).

Market Shares

ADCB booked a market share in terms of loans of 11.8% in FY06, surpassing Abu Dhabi based-giant NBAD due to its mediocre YoY loans growth in FY06. Only EBI dominates ADCB with a loans' market share of 12.4%. In terms of both deposits and assets, NBAD leads with a market share in FY06 of 13.5% and 11.7%, respectively. Among our selected peer group, ADCB ranks fourth in terms of deposits with a market share of 8.3% and third in terms of assets with a market share of 9.4%. Following the impending merger between EBI and NBD, the merged entity would lead with a market share of 20.5% in terms of loans, 18.3% in terms of deposits and 19.3% in terms of assets.

Table 8: ADCB and Peers' Market Shares in FY05 and FY06

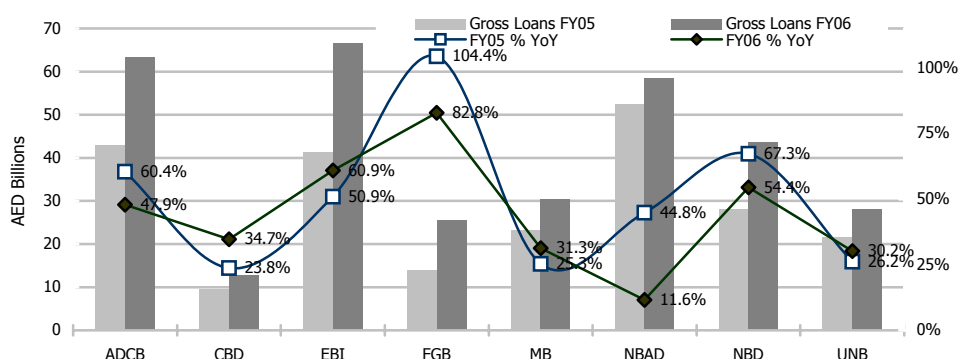
	ADCB	CBD	EBI	FGB	MB	NBAD	NBD	UNB
Loans Market Share (FY05)	10.9%	2.4%	10.5%	3.6%	5.8%	13.2%	7.1%	5.5%
Loans Market Share (FY06)	11.8%	2.4%	12.4%	4.8%	5.6%	10.9%	8.1%	5.2%
Deposits Market Share (FY05)	8.3%	2.6%	8.1%	4.2%	7.3%	14.5%	9.0%	6.3%
Deposits Market Share (FY06)	8.3%	2.6%	9.6%	6.6%	6.6%	13.5%	8.7%	5.7%
Assets Market Share (FY05)	9.0%	2.4%	9.3%	4.1%	7.3%	13.3%	8.1%	5.5%
Assets Market Share (FY06)	9.4%	2.2%	11.2%	5.6%	6.6%	11.7%	8.1%	4.8%

Source: Banks' Financials, CBUAE, HC Brokerage

Superior Loans Growth

FGB significantly stood out from among our selected peer group with a whopping loans growth of 104.4% and 82.8% in FY05 and FY06, respectively. This fares well above the sector loans growth of 37.7% and 36.1%. Other out-performers in terms of loans growth were EBI, ADCB and NBD. CBD, MB and UNB underperformed the sector. NBAD outperformed in FY05, but significantly underperformed in FY06 with a loans growth of 11.6% YoY – the lowest among our selected peer group. ADCB ranked third in terms of loans growth in FY05 surpassed by FGB and NBD, and fourth in FY06 surpassed by FGB, EBI and NBD.

Chart 10: ADCB and Peers' Gross Loans and Loans Growth in FY05 and FY06

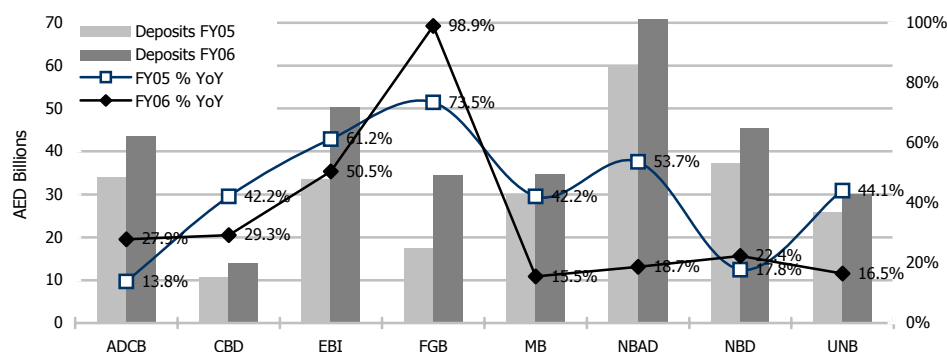


Source: Banks' Financials, HC Brokerage

Slowdown in Deposits Growth

FGB also significantly stood out among selected peers with a deposits growth of 73.5% and 98.9% in FY05 and FY06, respectively. This fares well above the sector's deposits' growth of 41.1% and 27.1%. Other out-performers, in terms of deposits growth, were EBI and CBD. NBD consistently underperformed in the sector. ADCB had 13.8% YoY growth in FY05, the lowest deposits growth, with a pick-up in FY06 to 27.9%, the fourth highest among our selected peer group.

Chart 11: ADCB and Peers' Deposits and Deposits Growth in FY05 and FY06

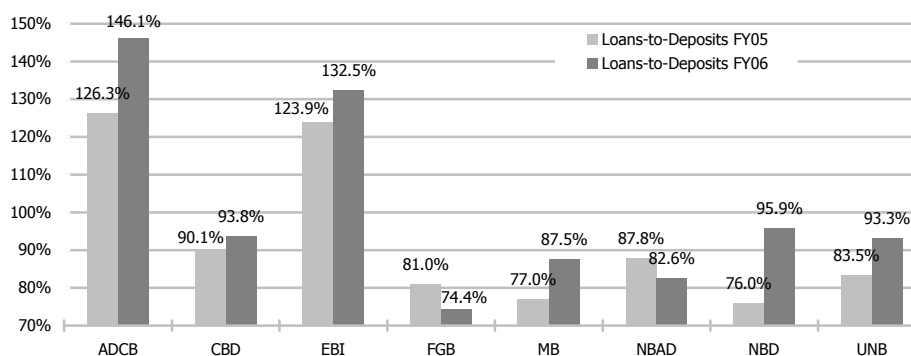


Source: Banks' Financials, HC Brokerage

Funding Gap - A Problem but Not For All

Only ADCB and EBI had a loans-to-deposits of above 100% in FY05 and FY06. The sector's loans-to-deposits reached 102.8%, and, accordingly, the six other banks in our selected peer group are operating below the sector average, and thus, have room for loans growth. Still, the loans-to-deposits of banks are mostly high standing above 70%, which enticed banks to search for alternative funding sources. All banks in our selected group, with the exception of CBD, utilize alternative funding sources in the form of loans, ECPs and/or EMTNs.

Chart 12: ADCB and Peers' Loans-to-Deposits in FY05 and FY06



Source: Banks' Financials, HC Brokerage

Low NPLs, High Coverage

The ratio of NPLs to gross loans is significantly low for our selected group ranging between 0.7% and 2.3% in FY06. ADCB, CBD, NBAD and NBD are the only ones that are under-provisioned with a coverage ratio below 100%. Still, under-provisioning is not significant and does not pose a major threat given the low levels of NPLs. NBD may be the single exception with a relatively low coverage ratio of 64.6%.

Table 9: ADCB and Peers NPLs to Gross Loans and Coverage Ratio in FY06

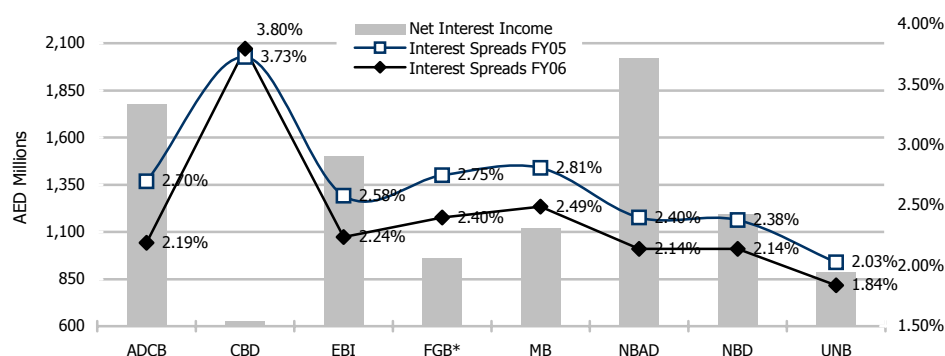
	NPLs to Gross Loans	Coverage
Abu Dhabi Commercial Bank	1.8%	88.4%
Commercial Bank of Dubai	2.3%	87.6%
Emirates Bank International	0.7%	164.1%
First Gulf Bank	1.4%	129.6%
Mashreq Bank	1.3%	243.8%
National Bank of Abu Dhabi	1.6%	96.7%
National Bank of Dubai	1.1%	64.6%
Union National Bank	1.5%	130.8%

Source: Banks' Financials, HC Brokerage

Declining Spreads

Interest spreads for our selected peer group have witnessed a significant decline in FY06; this was predominantly due to rising funding costs with an increase in deposits rates, as well as banks' embarking heavily on EMTNs and other funding programs. CBD is the only exception as its spreads witnessed a mild 7 bps increase YoY predominantly due to it being the sole bank in our selected peer group without sources of funds than deposits.

Chart 13: ADCB and Peers' Net Interest Income in FY06 and Interest Spreads



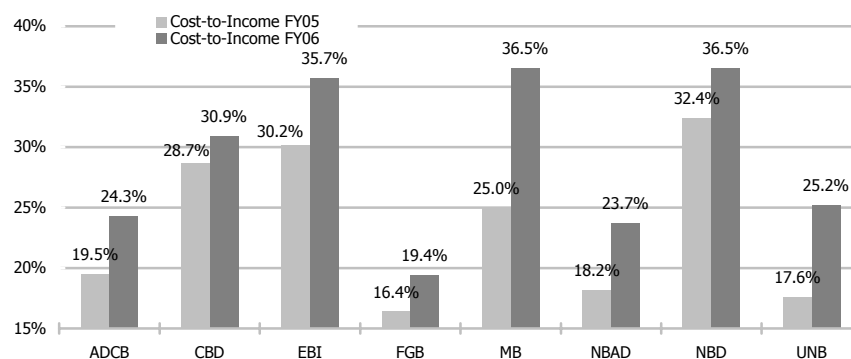
*FGB's Net Interest Income Excludes Net Interest Related to IPO Subscriptions

Source: Banks' Financials, HC Brokerage

Cost-to-Income On the Rise

Our selected banks have witnessed significant increases in their cost-to-income in FY06 as compared to FY05. However, FY05 cost-to-income ratios are misleadingly low due to the expansion of banks' income base from the exceptionally high, potentially non-recurring stock market related earnings. Based on FY06 numbers, FGB had the lowest cost-to-income of 19.4%. MB and NBD had the highest cost-to-income of 36.5%. ADCB had the third lowest cost-to-income of 24.3%.

Chart 14: ADCB and Peers' Cost-to-Income in FY05 and FY06



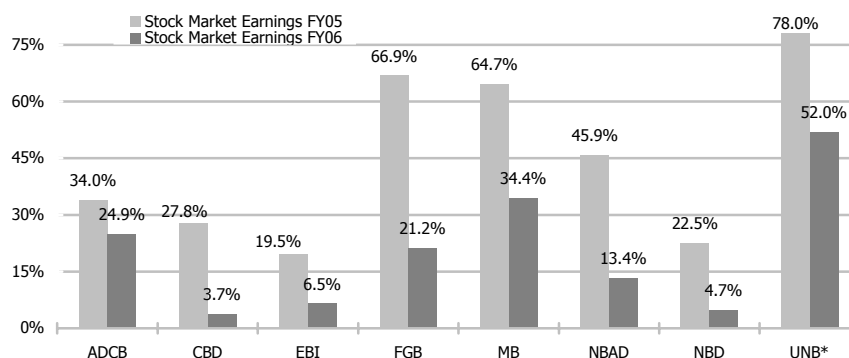
Source: Banks' Financials, HC Brokerage

Stock Market Earnings Witness an Adjustment in FY06...

In FY05, banks booked exceptionally high earnings from stock market related items (revenue from financing IPO subscriptions, fees from assets under management, investment income, brokerage fees, etc.). With the stock market slowdown and a reduction in the number of IPOs in FY06, a major adjustment occurred. ADCB, EBI and UNB witnessed the smallest adjustment in percentage terms in FY06.

It is important to note that stock market earnings are calculated as per the available disclosures in banks' financials. It is likely that some banks include a portion of IPO related income in net interest income without a separate disclosure, and hence, exposure to the stock market could be effectively higher than what is indicated below.

Chart 15: ADCB and Peers' Stock Market Earnings as a % of Net Income in FY05 and FY06

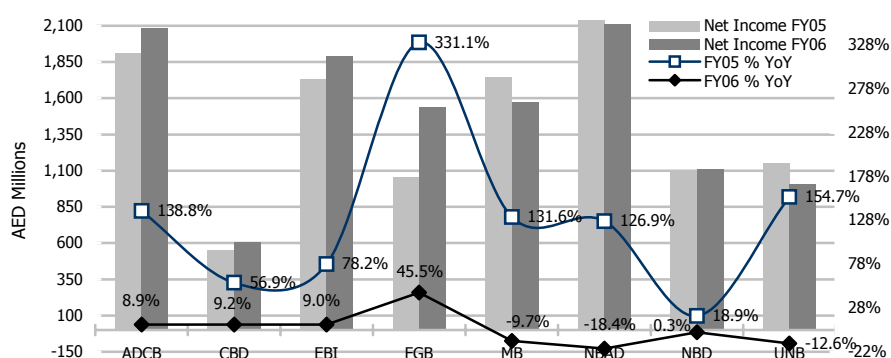


*UNB's Total Fees and Commissions Included as Stock Market Earnings Due to the Unavailability of a Breakdown for that Item
Source: Banks' Financials, HC Brokerage

...Causing a Slowdown in Bottom Line Growth

With significant reductions in stock market earnings, bottom line growth witnessed a severe blow in FY06. Our selected peer group averaged a bottom line growth of 4.0% in FY06 versus 129.6% in FY05. NBAD, UNB and MB's net incomes declined YoY in FY06 by 18.4%, 12.6% and 9.7%, respectively.

Chart 16: ADCB and Peers' Net Income and Net Income Growth in FY05 and FY06

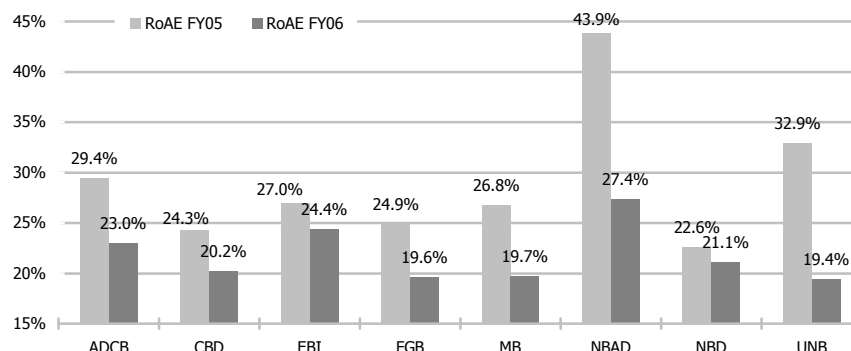


Source: Banks' Financials, HC Brokerage

Exceptional Return on Average Equity

Our selected banks averaged an RoAe of 29.0% in FY05 and 21.8% in FY06. The decline YoY is due to the slowdown in bottom line growth in FY06. NBAD stands out with the highest RoAe of 43.9% and 27.4% in FY05 and FY06, respectively.

Chart 17: ADCB and Peers' Return on Average Equity in FY05 and FY06

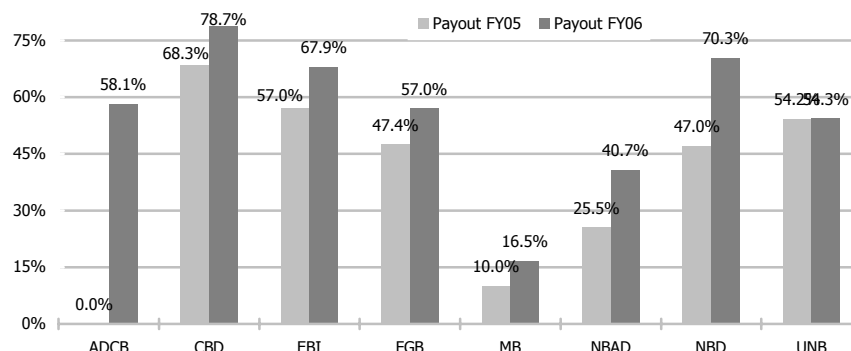


Source: Banks' Financials, HC Brokerage

High Dividend Payouts

In spite of the significant decline in bottom line growth in FY06, banks accelerated maintained their dividend payout in FY06, which indicates a high likelihood of maintaining such payouts going forward. ADCB, for instance, had a dividend payout of 58.1% in FY06 versus none in FY05. MB lags with a dividend payout of 16.5% in FY06.

Chart 18: ADCB and Peers' Dividend Payout Ratio* in FY05 and FY06

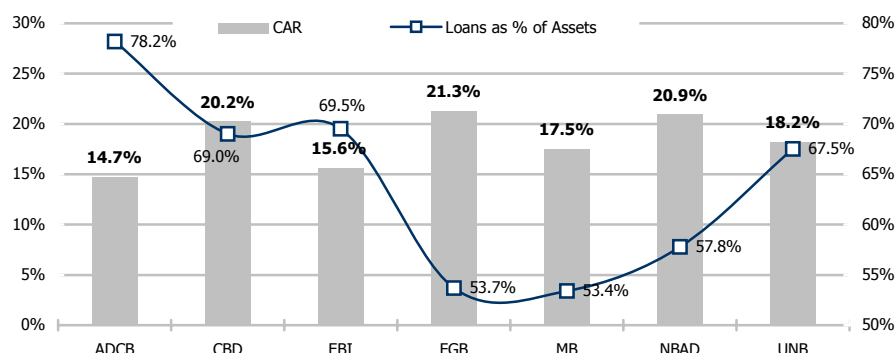


*Both cash and stock dividends
Source: Banks' Financials, HC Brokerage

High Capital Adequacy

Our selected group of banks all had a capital adequacy ratio significantly above the 10% mandated by the Central Bank in FY06. FGB, NBAD and CBD stand out with capital adequacy ratios of 21.3%, 20.9% and 20.2%, respectively. ADCB and EBI had the lowest capital adequacy ratios of 14.7% and 15.6%, respectively, which is partially due to their high loan exposure on the balance sheet. ADCB's loans constituted 78.2% of total assets in FY06, which entails that any massive increases in its loan portfolio will quickly erode its capital adequacy. This compares to sector loans representing 62.5% of total sector assets and an average of 64.0% for our selected peer group.

Chart 19: ADCB and Peers' CAR and Balance Sheet Loan Exposure in FY06



Source: Banks' Financials, HC Brokerage

Banks' 1Q07 Results

In this section, we compare ADCB's 1Q07 results to those of our selected peer group. We made the comparisons based on 1Q07 results since the majority of the peer group have not yet released their H07 financials.

Table 10: ADCB's 1Q07 Key Financial Indicators in Comparison to Local Peers

	ADCB	CBD	EBI	FGB	MB	NBAD	NBD	UNB
Net Loans (AED Millions)	64,295	13,007	70,551	28,465	29,772	61,381	46,669	28,636
YTD % Change	3.0%	2.9%	7.2%	14.8%	1.3%	6.8%	8.0%	4.2%
Deposits (AED Millions)	49,672	15,112	54,621	36,145	36,687	71,519	48,874	28,420
YTD % Change	14.5%	9.9%	8.6%	5.0%	5.9%	1.1%	7.6%	-5.4%
Assets (AED Millions)	87,901	20,105	104,112	51,051	61,658	111,877	73,605	41,453
YTD % Change	8.4%	7.5%	8.6%	6.9%	8.7%	10.8%	6.2%	-0.2%
NII (AED Millions)	531	192	485	275	332	540	360	236
YoY % Change	32.4%	45.1%	24.4%	-39.0%	38.9%	4.8%	21.5%	5.1%
Net Income (AED Millions)	457	218	575	406	445	601	302	254
YoY % Change	-23.7%	10.6%	-4.9%	7.7%	30.1%	-4.6%	17.5%	-40.0%
Loans-to-Deposits	131.4%	87.8%	131.0%	80.4%	83.4%	89.5%	95.5%	102.4%
Cost-to-Income	28.5%	27.6%	34.3%	18.8%	35.8%	26.8%	39.8%	29.6%
Interest Spread (Annualized)	2.37%	4.96%	1.73%	N/A	2.65%	1.96%	1.04%	2.32%
Change YoY in bps	-28	55	36	N/A	-32	-4	-7	-74
NIM (Annualized)	2.89%	5.04%	2.43%	N/A	2.87%	2.32%	1.98%	2.47%
Change YoY in bps	-14	55	-46	N/A	43	-55	-7	-55

Source: Banks' Financials, HC Brokerage

Loans Growth Slows Down, Deposits Growth Picks Up

1Q07 saw mild increases in loans YTD for many banks with far superior deposits growth as banks are, or approach, under-funding. ADCB net loans advanced 3.0% YTD versus 14.5% for deposits (the highest among our selected group), MB's 1.3% versus 5.9% and CBD's 2.9% versus 9.9%. FGB was a marked standout with loans growth of 14.8% YTD.

Spreads Continue to Decline

The trend of declining interest spreads witnessed in FY06 continued in 1Q07, predominantly due to banks' rising funding costs from a growing funding base. UNB saw the greatest decline in interest spreads of 74 bps. The two exceptions to the trend were CBD and EBI. We have intentionally not included interest spreads and NIM for FGB as the bank includes net interest from IPO subscriptions in net interest income, which explains the 39.0% YoY decline in its 1Q07 net interest income, with no quarterly breakdowns. Therefore, without the proper adjustments, its spreads and NIM would be distorted.

Cost-to-Income Continues to Rise

Banks in our selected peer group saw a rise in their cost-to-income in 1Q07, from rising staff costs and a decline in income base, particularly since 1Q06 still saw significant IPO related income for the majority of banks. UNB and ADCB exhibited the greatest increase in their cost-to-income.

Mediocre Bottom Line Performance

Banks that did not undergo the proper adjustment to stock market earnings in FY06, primarily due to still inflated 1Q06 figures, saw a downturn in to their 1Q07 net income. UNB's bottom line declined 40.0% YoY as its fees and commissions declined 76.1%. ADCB's bottom line declined 23.7% YoY due to a 71.4% YoY decline in its fees and commissions. MB was the best performer as it registered a bottom line growth of 30.1% YoY as the bank underwent a major adjustment to stock market related earnings in FY06. MB's FY06 net income declined 9.7% YoY and its stock market related earnings constituted 34.4% of FY06 net income versus 64.7% in FY05.

V. Financial Review of Results

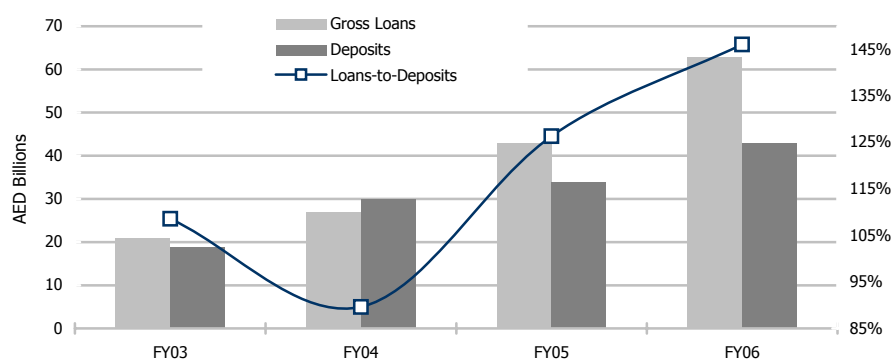
Historical Performance (FY03-FY06)

Higher Loans Growth As Compared to Deposits Creates a Funding Gap...

ADCB's gross loans grew at a CAGR of 44.5% versus 30.9% for deposits over the period from 2003 to 2006. Thus, the bank mimics the sector in terms of higher historical growth for loans than deposits. Accordingly, and like the sector, ADCB is over-utilized with a loans-to-deposits ratio of 146.1% in FY06. With ADCB's deposits being predominantly short-term, the funding problem is slightly escalated. In FY06, around 85% of ADCB's deposits had a maturity of less than 3 months versus 34.1% for loans.

We estimate that ADCB's advances-to-stable resources reached around 94% in FY06, which, albeit being below the 100% mandated by the Central Bank, is relatively high and caps the bank's potential for loans growth.

Chart 20: ADCB's Historical Gross Loans, Deposits & Utilization



Source: ADCB, HC Brokerage

...And Leads ADCB to Resort to Alternative Funding Sources

To resolve its funding shortage, the bank started to raise funds from alternative sources. In 2005, the bank launched a USD2.5 billion EMTN programme that was later raised to USD6.0 billion. EMTNs outstanding stood at AED13.2 billion at June 30th, 2007.

In 1H07, ADCB launched a USD1.0 billion 5-year syndicated loan that closed at USD1.5 billion from 35 international banks with record low pricing of LIBOR+25 basis points. Bank of Tokyo-Mitsubishi UFJ served as lead arranger. The bank already has another USD1.0 billion outstanding syndicated.

In FY06, the bank raised a subordinated loan of AED1.5 billion from financial institutions outside the UAE. The loan is to qualify as Tier II capital up until 2011 and is to be amortized at 20% per annum until 2016 for capital adequacy calculation purposes if not redeemed during 2011.

Additionally, the bank has an unsecured standby facility of USD1.15 billion from a consortium of banks with a 1-year drawdown period.

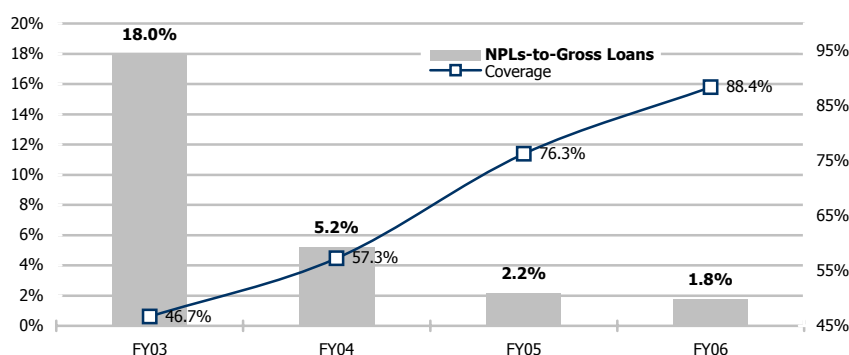
In addition to providing the bank with a solution to its funding problem, the long tenor of these borrowings enhances the bank's ability to provide loans with a long maturity.

Asset Quality Improves

ADCB's NPLs-to-gross loans decreased from 18.0% in FY03 to 1.8% in FY06, and accordingly, coverage improved from 46.7% to 88.4%.

The improvement in asset quality can be attributed to the bank's superior loan portfolio growth. Additionally, during 2004, the government of Abu Dhabi acquired AED1.2 billion of NPLs dating back to the merger that created ADCB that were previously secured through a guarantee. The guaranteed portion (AED438 million) was repaid by the bank with the remaining balance converted into a deposit.

Chart 21: ADCB's Historical NPLs-to-Gross Loans & Coverage

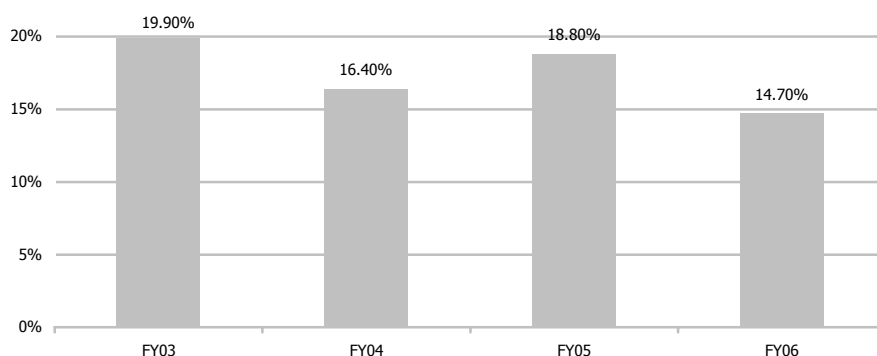


Source: ADCB, HC Brokerage

Adequate Capitalization

ADCB's capital adequacy got a boost in FY05 to 18.8% thanks to a capital increase of AED2.0 billion and the decision to retain all FY05 earnings. Capital adequacy dropped to 14.7% in FY06 as the bank paid out around 58% of its net income as dividends, which still stands adequately above the minimum 10% mandated by the Central Bank. However, this stands below the sector's 16.7% and is a threat given the bank's high loan exposure on the balance sheet.

Chart 22: ADCB's Historical Capital Adequacy Ratio

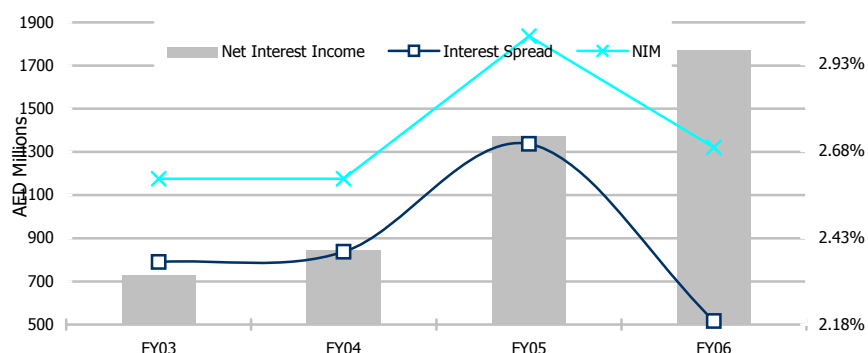


Source: ADCB, HC Brokerage

Slow Down in Net Interest Income Growth, Interest Spreads & NIM Decline

ADCB's net interest income grew at a CAGR of 34.6% over the period from FY03 to FY06. The peak in growth occurred in FY05 where the bank's net interest income witnessed 62.1% growth YoY, and interest spreads and NIM advanced by 31 and 41 basis points to 2.70% and 3.01%, respectively. Net interest income growth slowed down in FY06 growing by 29.2% YoY with interest spreads and NIM declining by 51 and 32 basis points to 2.19% and 2.69%, respectively. The decline is primarily due to the bank's efforts to raise its funding base rising funding costs through EMTNs and other borrowings as well as a pick-up in deposits growth to 27.9% YoY versus 13.8% in FY05.

Chart 23: ADCB's Historical Net Interest Income, Interest Spreads & NIM

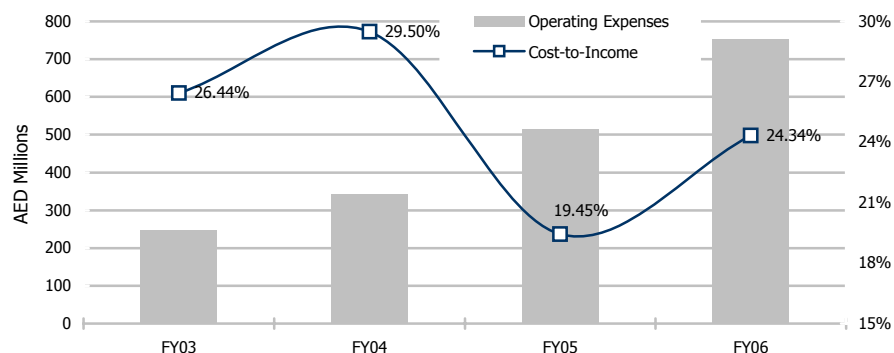


Source: ADCB, HC Brokerage

High Cost Efficiency?

ADCB's SG&A expenses grew at a CAGR of 44.8% over the period from FY03 to FY06. Cost-to-income witnessed a major drop in FY05 to reach 19.5%, which can be attributed to the massive increase in income due to stock market-related earnings. We do not view the FY05 level of cost-to-income as sustainable. Cost-to-income got a boost to 24.3% in FY06.

Chart 24: ADCB's Historical Operating Expenses and Cost-to-Income



Source: ADCB, HC Brokerage

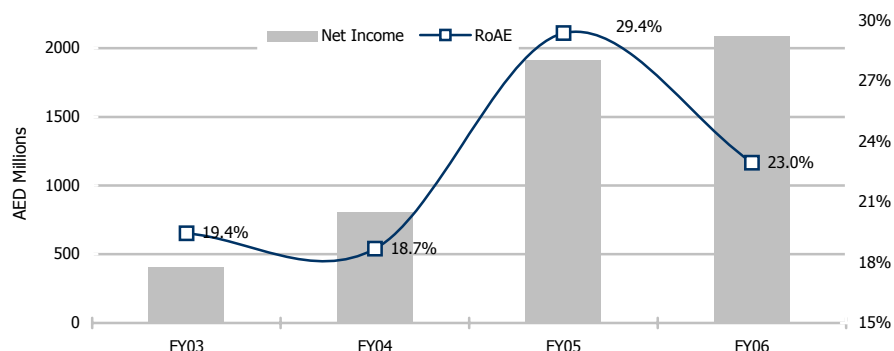
ADCB's Net Income Grew at a CAGR of 72.6% Helped by a Booming Stock Market

Like its peers, ADCB benefited from a booming stock market in FY05 as it registered an increase in bottom line of 138.8% YoY. In FY05, ADCB booked AED650.8 million in stock-market related earnings, which dropped 20.3% YoY to AED519.0 million in FY06, and hence, bottom line growth was reduced to 8.9%. Still, ADCB managed to yield an outstanding 23.0% RoAE in FY06, albeit down from a remarkable 29.4% in FY05.

Table 11: ADCB's Stock Market Related Earnings in FY05 Vs. FY06

AED Millions	FY05	FY06
Underwriting Fees	584.6	547.2
Gains/Losses on Trading Investments	45.8	(39.7)
Gains/Losses from Sale of Non-Trading Investments	20.4	11.5
Total	650.8	519.0

Source: ADCB, HC Brokerage

Chart 25: ADCB's Historical Net Income and RoAE


Source: ADCB, HC Brokerage

1H07 Results

Table 12: ADCB's KPIs 1H07 vs. 1H06

AED Millions	1H07	1H06	% Δ
Income Statement			
Net Interest Income	1,024.3	854.0	19.9%
Net Fees & Commissions	352.3	827.4	-57.4%
Operating Income	1,478.9	1,771.1	-16.5%
Operating Expenses	(443.8)	(324.6)	36.7%
Provisions	(57.8)	(247.5)	-76.7%
Net Income	945.8	1,150.9	-17.8%
Balance Sheet			
Gross Loans	68,787.6	49,537.5	38.9%
Deposits	48,491.4	37,560.6	29.1%
Total Assets	96,098.3	68,402.8	40.5%

Source: ADCB, HC Brokerage

In Spite of NII Advancing, Spreads and NIM Decline

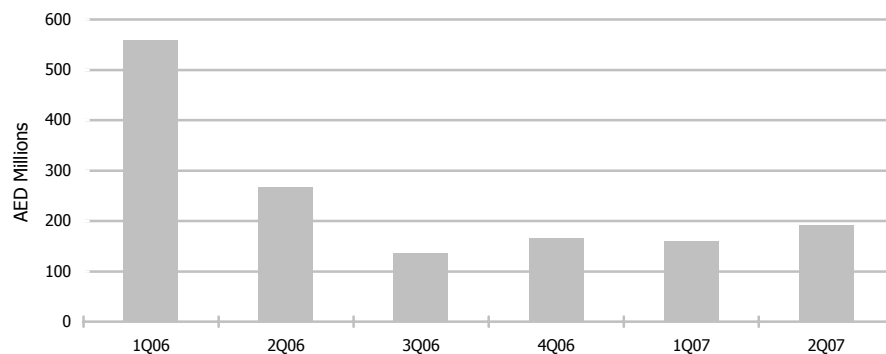
ADCB's net interest income advanced by 19.9% YoY to reach AED1.0 billion in 1H07. The robust interest income growth of 49.0% YoY was brought down by a 73.9% YoY growth in interest expense. Net interest margin declined from 3.12% to 2.70% and interest spreads from 2.66% to 2.28% primarily due to a greater increase in ADCB's cost of funding due to accelerated growth in funding base as a result of greater deposits' growth as well as the increased reliance on short and medium-term borrowings. ADCB's borrowings amounted to AED24.0 billion in 1H07 versus AED11.6 billion in 1H06.

Severe Decrease in Non-Interest Income; Operating Expenses Escalate

Non-interest income decreased by a hefty 50.4% YoY to AED454.6 million, impacted primarily by a 57.4% YoY drop in net fees and commissions to AED352.3 million, as 1H06 included around AED393 million in fees and commissions from IPOs.

Operating expenses witnessed a 36.7% YoY increase impacted by rising staff costs. Accompanied by the fall in the bank's income base, cost-to-income escalated to 30.0%, up from 18.3% in 1H06.

Chart 26: ADCB's Quarterly Net Fees and Commissions



Source: ADCB, HC Brokerage

Bottom Line Drops 17.8% YoY

In spite of solid growth in net interest income, and a 76.7% YoY drop in provisioning charges, net income declined by 17.8% YoY to book AED945.8 million in 1H07, down from AED1.2 billion in 1H06, impacted primarily by the severe drop in net fees and commissions.

VI. Financial Forecasts

We forecast that ADCB will book a bottom line of AED1.9 billion in FY07, down 6.9% from 2.1 billion in FY06. The decline is due to an estimated 33.0% YoY decline in the bank's fees and commissions to AED756.4 million due to the absence of IPO related income that amounted to AED547.2 million in FY06. The decline in bottom line is cushioned by a solid expected 21.7% YoY increase in net interest income to AED2.2 billion.

Table 13: ADCB's Key Forecast Indicators

AED Millions	FY06A	FY07E	%YoY	CAGR (06A-11E)
Net Interest Income	1,774.0	2,158.6	21.7%	14.6%
Net Fees & Commissions	1,129.2	756.4	-33.0%	3.2%
Operating Expenses	753.9	958.8	27.2%	21.9%
Net Income Before Appropriations	2,081.6	1,938.4	-6.9%	5.0%
Gross Loans	63,407.5	74,101.1	16.9%	17.0%
Deposits	43,396.9	52,987.6	22.1%	22.1%
Borrowings	16,610.2	24,915.3	50.0%	12.8%
Total Assets	81,088.4	101,626.7	25.3%	18.2%
Loans-to-Deposits	146.1%	139.8%		
NPLs/Gross Loans	1.8%	1.6%		
Coverage Ratio	88.4%	84.0%		
Interest Spread	2.19%	2.07%		
Net Interest Margin	2.69%	2.53%		
Cost-to-Income	24.3%	30.7%		

Source: ADCB, HC Brokerage

A Cap on Loans Growth...

We believe that ADCB will exhibit slower loans growth with loans growing at a CAGR of 17.0% over our forecast horizon due to the following reasons:

- (i) the bank currently operates near the maximum resources to stable funds of 100% mandated by the Central Bank;
- (ii) the bank has a high exposure to loans on its balance sheet with loans representing around 78% of ADCB's total assets in FY06. This means that any substantial growth in loans would hurt the bank's capital adequacy, which currently fares below peers, and hence, erode its value. ADCB had a capital adequacy of 14.7% in FY06, below the sector's 16.7%.

...and an Emphasis on Growth in Funding Base...

We expect that ADCB is to focus on growing its funding base to resolve its funding gap. The big question is whether the bank will be able to increase its funding base. The ability to grow funding base will depend on whether ADCB will increase its deposits through offering lucrative rates as well as its ability to raise EMTNs and other sources of borrowing. As noted earlier, the bank has a USD6.0 billion (AED22.0 billion) EMTNs program, of which it has utilized USD3.6 billion (AED13.2 billion) as of 1H07. The bank also raised in 1H07 a USD1.5 billion syndicated loan. We forecast that over our forecast horizons deposits and borrowings to grow at CAGRs of 22.1% and 12.8%, respectively.

...Are To Hurt Interest Spreads

We forecast that ADCB's interest spreads will decline by 12 bps in FY07 to 2.07% and 9 bps in FY08 to 1.98%. We have assumed constant spreads from FY08 onwards. The expected decline in the bank's spreads is due to:

- (i) the aforementioned cap on the bank's loans growth;

- (ii) increased reliance on EMTNs and other borrowings to resolve its funding gap;
- (iii) a pick-up in the bank's deposits growth;
- (iv) increased competition in the sector, which could entail a loan pricing war;
- (v) a potential rise in interest rates over the short to medium term if the Fed opts to raise the federal funds rate, which would hamper the spreads of the UAE banking sector at large. A rising interest rate environment would be particularly problematic for ADCB since its deposit base is predominantly short-term, and hence, has greater exposure to interest rate risk.

Focus on Fee Income From Core Operations

Although we estimate a major slowdown in fees and commissions in FY07, we forecast that ADCB's fees and commissions are to grow at a CAGR of 14.9% from FY07 onwards. The reason is greater emphasis on fee income from core operations, such as contingent liabilities. The bank also currently has four mutual funds that are to contribute positively to its fee income stream given the local appetite for mutual funds: (i) Al Nokhitha; (ii) Al Bashaer GCC Equities Fund; (iii) MSCI UAE Index Fund; (iv) Al Mada'en Real Estate Fund. Additionally, ADCB has a brokerage subsidiary and an investment banking platform bolstered by a strategic alliance with Macquarie Bank.

Rising Costs

We forecast ADCB's operating costs to rise by 27.2% YoY in FY07 and at a CAGR of 21.9% over our forecast horizon. Accordingly, we forecast a rise in cost-to-income to 30.7% in FY07, up from 24.3% in FY06, and to reach 39.2% by the end of our forecast horizon. The estimated increase in operating expenses and, hence cost-to-income, is primarily due to rising staff costs with increased competition over labor. It is important to note that the expected significant hike in cost-to-income in FY07 is due to the decline in income base from the absence of IPO related earnings.

Asset Quality Is Not a Major Concern

We forecast that ADCB will maintain a low NPLs/Gross Loan in the range 1.4-1.6% over our forecast horizon. Although the bank is not fully provisioned, we do not see that there are any pressures for it to achieve full coverage of its NPLs in the near term. We forecast that the bank is going to gradually build up provisioning to achieve full coverage by 2011. However, with the majority of the bank's portfolio comprised of personal loans, asset quality could become a concern in the event of a major downfall in the equities market and/or a correction in the real estate market.

VII. Valuation

Valuation Methodology

We have applied the Discounted Cash Flow method to value ADCB, which involves discounting the bank's free equity cash flows. Free equity cash flows are defined as the bank's net attributable income after making the necessary deductions to maintain the minimum capital adequacy ratio of 10% mandated by the Central Bank. We have conducted forecasts over 5-years and applied a perpetual growth rate going forward.

A DCF Target Price of AED7.40 Per Share

Our DCF target price for ADCB dictates a "Hold" recommendation. The recommendation is based on a DCF of AED7.40, which offers a 1.8% premium to the current market price of AED7.27. We have applied a single WACC of 11.0% and assumed a dividend payout of 50%.

We used a perpetual growth rate of 6.0% given that the UAE's expected real GDP growth is in the 7-8% range, as well as the increased competitiveness in the sector and ADCB's constrained growth due to its funding gap.

Table 14: WACC Sensitivity Analysis of Value Per Share (AED)

Perpetual Growth Rate	WACC (%)		
	10.0	11.0	12.0
5%	7.67	6.48	5.63
6%	9.12	7.40	6.26
7%	11.53	8.79	7.15

Source: HC Brokerage

ADCB is Not Lucrative from a Multiples Standpoint

ADCB is currently trading at a P/E (07e) of 15.11x and a P/BV (07) of 2.78x, which is above the UAE sector average of 11.96x and 2.45x, respectively.

Table 15: Multiples of ADCB Versus Local Peer Group

	P/E (07)	P/BV (07)
Commercial Bank of Dubai	11.57x	2.34x
Emirates Bank International	11.67x	2.87x
First Gulf Bank	11.47x	2.08x
Mashreq Bank	11.69x	2.26x
National Bank of Abu Dhabi	13.56x	3.26x
National Bank of Dubai	11.47x	2.26x
Union National Bank	12.30x	2.06x
Average	11.96x	2.45x
ADCB	15.00x	2.76x

Source: HC Brokerage

Valuing ADCB at the UAE sector average P/BV (07) of 2.45x would yield a value per share of **AED6.46**, which is 11.1% below the current market price.

Table 16: Multiples of ADCB Versus GCC Peer Group

	Country	P/E (07)	P/BV (07)
Al Ahli United Bank	Bahrain	12.94x	2.29x
Bank Muscat	Oman	19.74x	2.99x
National Bank of Kuwait	Kuwait	16.46x	3.98x
Qatar National Bank	Qatar	16.74x	3.85x
Al Rajhi Bank	KSA	14.23x	6.01x
SAMBA	KSA	14.49x	5.48x
Average		15.77x	4.10x
ADCB		15.00x	2.76x

Source: Bloomberg, HC Brokerage

VIII. Financial Statements and Ratios

AED Millions	05A	06A	07E	08F	09F	10F	11F
Income Statement							
Interest Income	2,449	4,128	6,042	7,908	9,197	10,694	12,526
Interest Expense	(1,077)	(2,354)	(3,883)	(5,502)	(6,464)	(7,622)	(9,020)
Net Interest Income	1,373	1,774	2,159	2,406	2,733	3,072	3,505
Fees & Commissions	1,093	1,129	756	866	994	1,141	1,319
FX Income	67	72	76	100	112	131	153
Investment Income	88	85	90	103	114	127	141
Other Income	30	37	40	42	43	44	46
Operating Income	2,650	3,097	3,120	3,516	3,996	4,514	5,165
Operating Expenses	(516)	(754)	(959)	(1,166)	(1,426)	(1,691)	(2,026)
Pre-Provisions Income	2,134	2,343	2,162	2,350	2,570	2,824	3,139
NPL Provisions	(212)	(193)	(161)	(193)	(243)	(309)	(395)
Pre-Tax Income	1,922	2,150	2,000	2,157	2,327	2,515	2,745
Income Taxes	(0)	(3)	(2)	(2)	(2)	(2)	(3)
Net Income After Tax	1,922	2,147	1,998	2,155	2,325	2,513	2,742
Minority Interest	(9)	(66)	(60)	(65)	(70)	(75)	(82)
Net Income Before Appropriations	1,912	2,082	1,938	2,090	2,255	2,437	2,660
Appropriations	(1)	(3)	(3)	(6)	(9)	(12)	(13)
Net Income	1,911	2,078	1,935	2,084	2,246	2,425	2,646
Balance Sheet							
Assets							
Cash & Due from Central Bank	1,702	1,898	4,239	5,144	6,303	7,711	9,418
Due from Banks	9,989	10,065	15,578	18,687	20,554	22,608	24,868
Investments	2,164	3,778	3,873	4,025	4,201	4,401	4,632
Gross Loans	42,878	63,408	74,101	86,759	100,297	117,950	138,906
NPL Provisions	(714)	(983)	(996)	(1,102)	(1,295)	(1,557)	(1,910)
Net Loans and Overdrafts	42,164	62,425	73,105	85,657	99,001	116,394	136,996
Other Assets	1,302	2,410	4,217	5,060	6,325	7,907	9,883
Net Fixed Assets	403	512	614	737	885	1,062	1,274
Total Assets	57,725	81,088	101,627	119,310	137,269	160,082	187,071
Liabilities							
Due to Banks	6,049	7,970	9,108	11,502	11,919	12,841	13,534
Deposits	33,937	43,397	52,988	64,295	78,787	96,388	117,729
Borrowings	7,749	16,610	24,915	26,161	27,469	28,843	30,285
Dividends Payable	-	1,210	971	1,048	1,132	1,225	1,336
Other Liabilities	1,371	2,387	3,103	4,655	5,120	6,656	8,653
Total Liabilities	49,107	71,574	91,085	107,661	124,428	145,953	171,537
Shareholders' Equity	8,618	9,514	10,542	11,649	12,841	14,129	15,535
Contingent Liabilities	25,280	39,233	44,153	47,215	51,256	56,971	64,003
Key Ratios							
Capital Adequacy	18.8%	14.7%	14.0%	13.0%	12.2%	11.2%	10.3%
Loans-to-Deposits	126.3%	146.1%	139.8%	134.9%	127.3%	122.4%	118.0%
NPLs-to-Gross Loans	2.2%	1.8%	1.6%	1.5%	1.5%	1.4%	1.4%
Coverage	76.3%	88.4%	84.0%	84.7%	86.1%	92.3%	100.0%
Interest Spread	2.70%	2.19%	2.07%	1.98%	1.98%	1.98%	1.98%
NIM	3.01%	2.69%	2.53%	2.37%	2.33%	2.28%	2.24%
Cost-to-Income	19.5%	24.3%	30.7%	33.2%	35.7%	37.4%	39.2%
Loans Growth (% YoY)	60.4%	47.9%	16.9%	17.1%	15.6%	17.6%	17.8%
Deposits Growth (% YoY)	13.8%	27.9%	22.1%	21.3%	22.5%	22.3%	22.1%
Net Income Growth (% YoY)	138.8%	8.9%	-6.9%	7.8%	7.9%	8.1%	9.1%

Appendix I: Key UAE Banking Sector Regulations

Regulation	Requirement
Asset Classification and Provisioning	Loans can fall into one of four categories: (i) unclassified (loans with normal risks); (ii) substandard; (iii) doubtful; (iv) loss. A bank should account in full for loans classified as loss, and the amount of expected losses on those loans classified as substandard and doubtful.
Capital Adequacy	Banks are obliged to maintain a ratio between their capital (both Tier I and Tier II) and risk-weighted assets of a minimum of 10%. Tier I capital must stand at a minimum of 6% of total risk weighted assets, while Tier II capital will only be considered up to a maximum of 67% of Tier I capital.
Advances-to-Stable Resources	Banks are required to maintain a ratio of loans and advances to stable resources of a maximum of 100%. The numerator includes: (i) banks' credit facilities net of provisions for doubtful debts and interest in suspense; (ii) interbank placements in any currency due from local and foreign banks with a remaining maturity of more than 3 months excluding Central Bank Certificates of Deposit. The denominator includes: (i) free capital and reserves, which should not include fixed assets, goodwill, non-marketable securities, investments in subsidiaries and affiliates, but should include subordinated debt; (ii) interbank deposits in any currency due to local and foreign banks with a remaining maturity of more than 6 months; (iii) 85% of customer deposits.
Minimum Reserve Requirement	The required reserves ratio for both local and foreign currencies is 14% on current, savings and call accounts, and only 1% on time deposits. Banks are also required to keep at the Central Bank 30% of their AED-denominated deposits abroad with non-resident banks (including head office and foreign branches). All bank reserves kept at the Central Bank are non-interest bearing. The average daily balance of each bank's account has to be maintained with the required reserves over each six-day period and at the end of each month.
Personal Loan Limit	The upper limit for personal loans is currently set at AED250,000 with personal loans defined as "loans given to individuals for specific purposes, secured by assigning salary and end-of-service benefits or any regular income from a well-defined source". Private property and guarantees from nationals cannot serve as collaterals. Credit cards are excluded from the personal loan limit.
Limits on Loans to Purchase Local Company Shares	(i) loans extended to founders against a pledge of shares should not exceed 50% of the nominal value of shares; (ii) loans extended to subscribe in public offerings of companies under establishment against a pledge of shares should not exceed 10% of the nominal value of shares. If the issuer or subscription bank undertakes to refund excess funds directly to the lending bank, lending can be up to five times the amount contributed by the subscriber of the IPO shares; (iii) extended loans against a pledge of shares of newly established companies should not exceed 70% of the book value of the shares. The limitation is valid up until the company has been in operations for 5 years; (iv) for companies in operation for more than 5 years, loans extended against a pledge of shares should not exceed 80% of the market value of the shares.
Large Exposure Limits	Credit exposure of a bank to a single borrower or a group of related borrowers should not exceed 8 times the bank's capital base.

Source: CBUAE, HC Brokerage

Appendix II: Foreign Ownership Restrictions on Listed Banks

Bank	Listing	Allow Foreign Ownership	Max. Foreign Ownership
Abu Dhabi Commercial Bank	ADSM	Yes	25%
Abu Dhabi Islamic Bank	ADSM	No	0%
Bank of Sharjah	ADSM	Yes	30%
Commercial Bank International	ADSM	Yes	20%
Commercial Bank of Dubai	DFM	No	0%
Dubai Islamic Bank	DFM	Yes	15%
Emirates Bank International	DFM	No	0%
Emirates Islamic Bank	DFM	No	0%
First Gulf Bank	ADSM	Yes	30%
Invest Bank	ADSM	Yes	20%
Mashreq Bank	DFM	No	0%
National Bank of Abu Dhabi	ADSM	Yes	25%
National Bank of Dubai	DFM	No	0%
National Bank of Fujairah	ADSM	No	0%
National Bank of Ras Al-Khaimah	ADSM	Yes	20%
National Bank of Umm Al-Qaiwain	ADSM	No	0%
Sharjah Islamic Bank	ADSM	Yes	20%*
United Arab Bank	ADSM	Yes	49%

*GCC Nationals Only

Source: ADSM, DFM, HC Brokerage

ADCB in Brief

Company Overview

ADCB was formed in 1985 as a result of the merger of Emirates Commercial Bank and Federal Commercial Bank with Khaleej Commercial Bank. ADCB is a diversified full service bank that offers corporate, retail and commercial banking services as well as treasury, derivatives, infrastructure finance, private banking and wealth management. The government of Abu Dhabi, through the Abu Dhabi Investment Council, owns 64.8% of ADCB. ADCB has three active, consolidated subsidiaries: Al Dhabi Brokerage Services, Abu Dhabi Risk & Treasury Solutions and Abu Dhabi Commercial Properties. The bank has a network of 42 branches in the UAE and two in India. The bank had a market share of 11.8% in terms of loans, 8.3% in terms of deposits and 9.4% in terms of total assets in 2006.

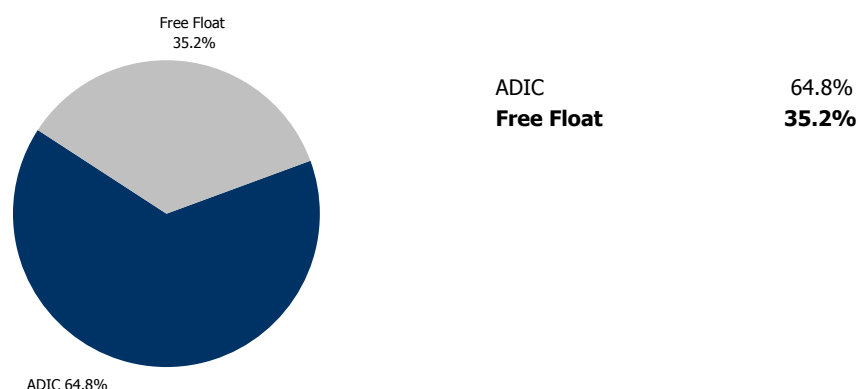
Key Attractions

- Majority ownership by the government of Abu Dhabi, which generates business for the bank
- Positive credit ratings
- Strategic alliances with numerous other financial institutions
- Foreign ownership allowed for up to 25% of the bank

Key Concerns

- High loan exposure on the balance sheet with loans being predominantly personal loans
- Rising cost-to-income ratio that is expected to keep growing
- Rising funding cost due to a growing funding base
- Threat of a rising interest rate environment especially with the bank's deposit base being predominantly short-term
- Increased competition in the sector
- Risk of downfall in the equities market and a correction in the real estate market

Shareholders' Structure



Investment Ratings

Stock Liquidity	Upside Potential					
High	>30%	30% to 20%	20% to 10%	10% to 0%	0% to -25%	Less than -25%
Mid	>35%	35% to 25%	25% to 15%	15% to 5%	5% to -20%	Less than -20%
Low	>40%	40% to 30%	30% to 20%	20% to 10%	10% to -20%	Less than -20%
Recommendation	Strong Buy	Buy	Accumulate	Hold	Reduce	Sell

HC Brokerage – Cairo, Egypt

HC Brokerage

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HC Securities & Investment – Cairo, Egypt

HC Securities & Investment

HC Securities & Investment, the holding company for HC group, owns HC Brokerage and Hussein Choucri Financial Advisors. Investment banking is engaged in raising capital and providing advice in the areas of corporate finance, mergers and acquisitions, restructuring, divestitures and spin-offs, capital market services, project finance and real estate. Asset management offers portfolio and mutual fund services.

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Al-Futtaim HC Securities – Dubai, UAE

Al-Futtaim HC Securities

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