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Abu Dhabi Commercial Bank PJSC

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Abu Dhabi Commercial Bank PJSC

SACP: bbb → **Support: +3** → **Additional factors: 0**

SACP: bbb		
Anchor	bbb-	
Business position	Strong	+1
Capital and earnings	Strong	+1
Risk position	Moderate	-1
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

Support: +3	
ALAC support	0
GRE support	+3
Group support	0
Sovereign support	0

Issuer credit rating
A/Stable/A-1

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Issuer Credit Rating
A/Stable/A-1

Overview

Key strengths	Key risks
Entrenched relationships with Abu Dhabi-based government-related entities (GREs).	Reducing but still sizable lending exposure in real estate and construction sectors.
Majority ownership by the government of Abu Dhabi.	High concentration risk on both sides of the balance sheet.
Strong capitalization.	

Improving operating environment will support higher profitability. Abu Dhabi Commercial Bank PJSC's (ADCB's) profitability bounced back to near its pre-pandemic level in 2021, thanks to the improving economic environment in the United Arab Emirates (UAE) and central bank support measures. ADCB's return on average equity (RoAE) improved to 11.3% in first-quarter 2022, compared with 7.6% in 2020. Amid the more supportive economic environment in 2022-2023, we expect ADCB's profitability to stabilize or slightly improve. In addition, we believe the overall impact of increasing interest rates will be positive for the bank's profitability.

Strong capitalization will continue to buffer large exposures to weaker sectors. With a stable risk-adjusted capital (RAC) ratio forecast at 12.0%-12.5% through 2022-2023, as compared with 11.8% at year-end 2021, we expect improving income will support ADCB's capital base.

We anticipate that the continued de-risking of the lending portfolio will contain credit losses. Since the beginning of 2021, ADCB has moved to reduce its exposures to weaker sectors of the economy--particularly real estate and construction, which accounted for about 23% of the total exposure at end-March 2022, down from 29% at year-end 2020. At the same time, the focus has been to grow the lending book toward government and public sector entities. We expect this trend to continue in 2022-2023, which will help the bank reduce its credit losses toward pre-pandemic levels. In addition, the restructuring of NMC Group could offer some upside to its asset quality.

Outlook

The stable outlook stems from our view that ADCB's strong capital buffers and expected stable earnings performance can absorb operating risks and further credit losses from weaker sectors of the UAE economy over the next 12-24 months.

Downside scenario

We could take a negative rating action if faster-than-expected credit growth or an increased risk appetite were to erode ADCB's currently solid capitalization. We could also lower the ratings if ADCB's business performance were materially weaker than our expectations; for example, if revenue or profitability falls well below our forecasts, which could indicate a weakening business position, although we see a low likelihood of that scenario.

Upside scenario

A positive rating action over the next 12-24 months appears unlikely since it would require a two-notch strengthening of the bank's intrinsic creditworthiness, for example due to increased capitalization, with the RAC ratio exceeding 15%, and strong improvement of asset-quality indicators. We could also raise the rating on ADCB if either of these scenarios materializes and, at the same time, there is an upgrade of Abu Dhabi.

Key Metrics

Abu Dhabi Commercial Bank PJSC--Key Ratios And Forecasts

	--Fiscal year ended Dec. 31 --				
(%)	**2020a**	**2021a**	**2022f**	**2023f**	**2024f**
Growth in operating revenue	6.4	(3.1)	1.6-1.9	4.1-5.0	4.7-5.8
Growth in customer loans	(1.8)	1.9	2.7-3.3	2.7-3.3	2.7-3.3
Net interest income/average earning assets (NIM)	2.7	2.4	2.2-2.5	2.3-2.5	2.3-2.6
Cost to income ratio	34.3	34.4	33.4-35.2	32.6-34.3	31.9-33.6
Return on assets	1.0	1.3	1.2-1.5	1.2-1.5	1.2-1.5
New loan loss provisions/average customer loans	1.6	1.0	0.8-0.9	0.8-0.9	0.8-0.9
Gross nonperforming assets/customer loans	8.0	7.4	7.5-8.0	7.5-8.0	7.0-7.5
Risk-adjusted capital ratio	12.8	11.8	11.8-12.4	12.0-12.5	12.0-12.5

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

Anchor: 'bbb-' For Banks Operating Only In The UAE

We use our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in the UAE is 'bbb-'.

The UAE has a wealthy economy with strong fiscal and external positions. We expect that higher oil prices, supportive government policies, and normalizing non-oil activity will help the economy to continue recovering from the pandemic's effects. We anticipate that further deterioration of banks' asset-quality indicators will be contained. During the highs of the pandemic, regulatory forbearance measures have helped the corporate sector deal with the negative effects, limiting the increase in nonperforming loans. We project that the banking sector's Stage 3 loans will reach 6.5% of systemwide loans by the end of 2022, compared with 6.1% by the end of 2021. The UAE banking sector is set to benefit from an interest rate hike, assuming no significant disruption of corporates' and retail clients' capacity to fulfill their financial obligations subsequently.

During the pandemic, the UAE Central Bank (CBUAE) implemented a Targeted Economic Support Scheme (TESS), which helped ease the pressure on corporate issuers and small and midsize enterprises (SMEs). Banks classified TESS exposures into two groups--Group 1 (exposures to clients that are temporarily and mildly affected); and Group 2 (exposures to clients that are significantly affected and could see potential stage migrations)--and they disclosed the information, which we view as positive. In our view, UAE banks enjoy sound funding profiles, with stable deposits from public-sector and government entities providing around 30% of total deposits.

Business Position: A Well-Established Franchise In The UAE

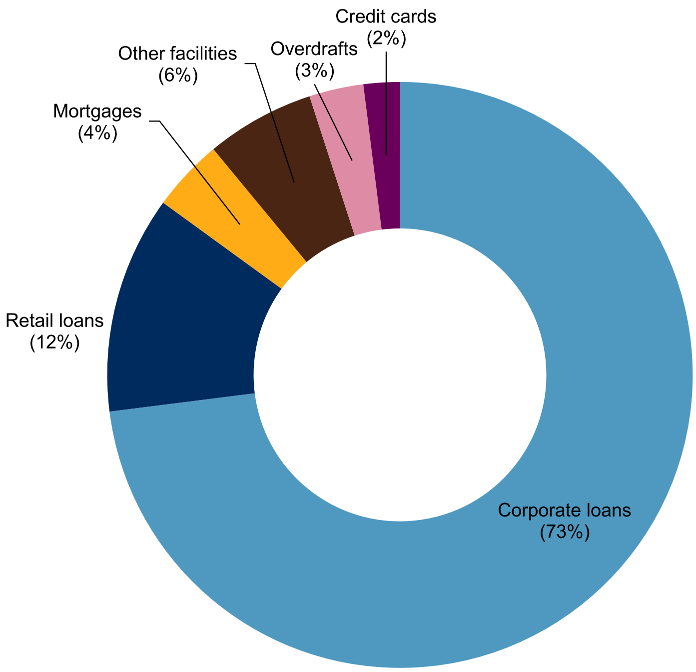
We consider that ADCB's business position benefits from a strong and established market position in the UAE, which helped the bank through tough operating conditions during the pandemic. ADCB is the third-largest bank in the UAE, with total assets of about UAE dirham (AED) 446 billion ($113 billion) on March 31, 2022.

We also base our assessment on structurally predictable and balanced earnings generation across different business segments, which will be further supported by interest rate hikes across 2022-2023.

While ADCB is predominantly a wholesale bank, it also has a good presence in retail banking. Its privileged relationship with the government of Abu Dhabi has resulted in lending opportunities to public sector entities during the period of relatively fragile non-oil private sector activity in 2020-2021. Lending to the government and GRE sectors increased by 25% in 2021. At the same time, the bank has been de-risking its exposure to real estate and construction sectors. On one hand, this has improved the underlying asset quality, but on the other it has reduced operating income, which declined by 3.1% in 2021. That said, we believe that lower revenue from the portfolio's de-risking will be balanced by higher income from interest rate hikes, which will help the bank to stabilize its operating income.

Chart 1

ADCB Is Predominantly A Corporate Bank

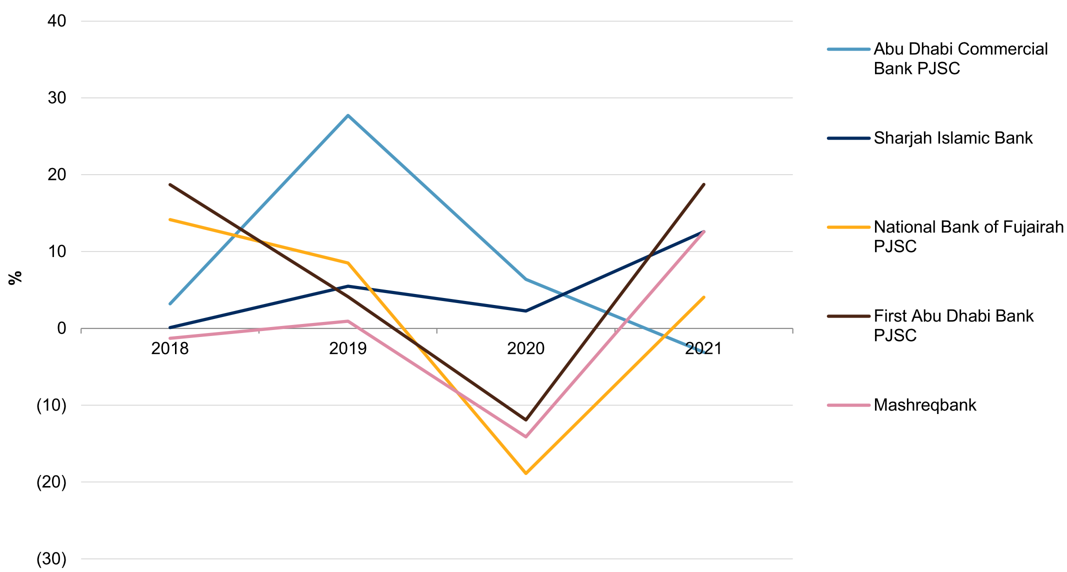


Note: As of March 31, 2022. Sources: ADCB financial statements, S&P Global Ratings.

We expect ADCB's strategy will remain UAE-focused. Most of the bank's operating revenue (97%) came from the UAE in 2021, and we do not expect this to change. In addition, the operating revenue is focused on net interest income, which we expect will account for about 70%-75% in 2022-2023.

Chart 2

ADCB's Operating Revenue Declined In 2021 Because Of A Change In Asset Mix
Year-on-year growth in operating revenue



Source: S&P Global Ratings.

Capital And Earnings: Expected To Remain Strong

We consider ADCB's capital and earnings to be strong, with a forecast RAC ratio of 12.0%-12.5%, compared with 11.8% at year-end 2021. This also reflects the bank's high level of capital, its typically strong core earnings generation, and adequate capital retention, which enables it to maintain strong capitalization levels.

Through 2021, net interest income contracted by 9% as the bank reduced its exposure to the high yield real-estate sector and maintained higher liquid assets, and interest rates remained low. With the improvement in consumer sentiment, transaction fee revenue increased in 2021, which partially offset lower interest income.

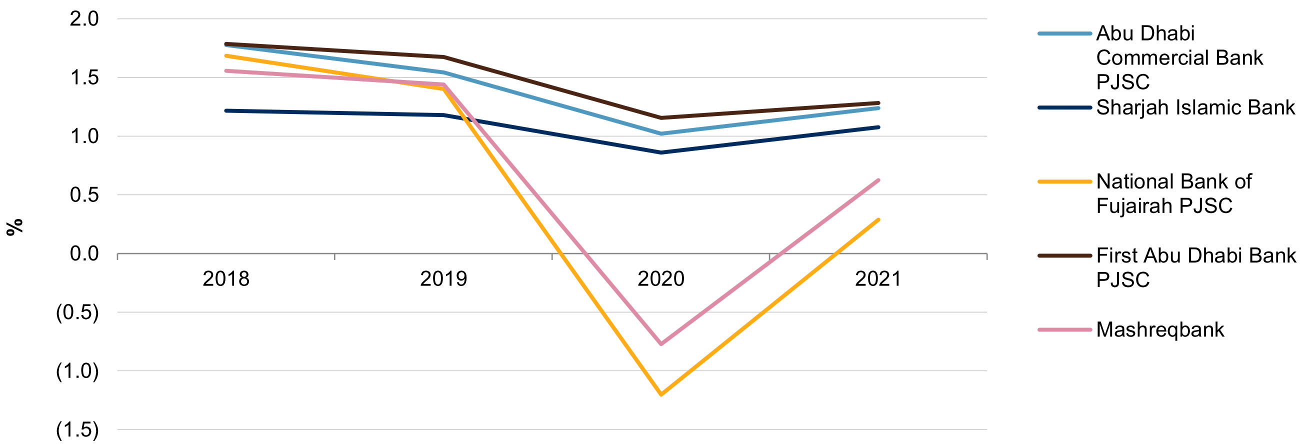
Our forecast factors in:

- 3%-4% loan growth, primarily driven by lending towards government and GRE sectors;
- Slightly higher net interest income in the higher interest rate environment, partially offset by lower yield on less risky assets; and
- Dividend payout of 50% of net income.

ADCB continues to enjoy a strong and positive earnings buffer (capacity to cover normalized losses through earnings), which we estimate at about 110 basis points (bps) in 2022-2023.

Chart 3

ADCB Is Reaching Its Pre-Pandemic Profitability Levels
Core earnings/average adjusted assets



Source: S&P Global Ratings.

Risk Position: Portfolio De-risking Will Help Contain Credit Costs

In our view, ADCB's significant but reducing exposure to the cyclical real estate sector, along with high concentration risks on its balance sheet, weighs on its overall risk position.

ADCB's asset quality metrics have remained weaker than the system average for the past two years, primarily because of the bank's significant exposure to NMC Healthcare and related entities, and higher-than-industry-average exposure to weaker sectors of the economy, including real estate and construction. Although the conclusion of NMC's restructuring offers some upside to the overall asset quality, we believe the nonperforming loan (NPL) ratio will remain higher than the industry average until NMC's exit instruments are repaid following monetization of the business, which may take three to four years. That said, we believe that provisions already recorded against NMC exposure are sufficient to cover the losses.

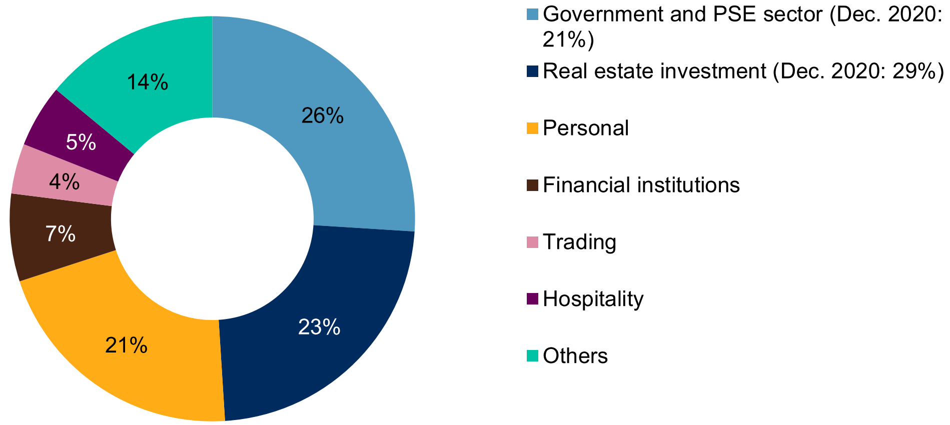
On March 31, 2022, the bank's Stage 3 loans stood at 7.7% of gross loans, including purchased and originated credit impaired loans. We expect this ratio to remain high, at about 7.5%-8% of gross loans in 2022-2023, as we believe some customers might face difficulties in their debt-repaying capacity once we see a meaningful increase in interest rates through 2022-2023. On the flipside, the bank has been de-risking its portfolio by reducing its exposure to weaker sectors of the economy, particularly the real estate and construction sectors, and focusing on government and GRE sectors since the beginning of 2021. This will help to reduce new NPL generation and reduce cost of risk to the tune of

80 bps-90 bps in 2022-2023.

Chart 4

ADCB Has Been De-Risking Its Portfolio

Gross loans by economic sector

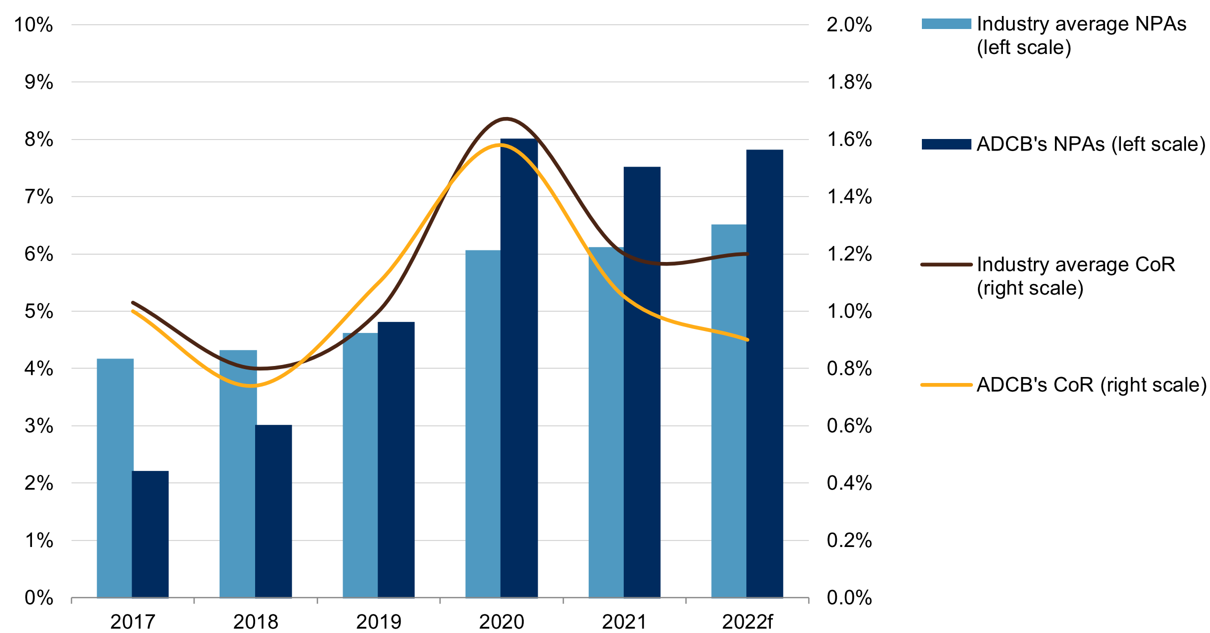


As of March 31, 2022. Sources: ADCB financial statements, S&P Global Ratings.

Phase 1 of the CBUAE's TESS, including the deferral program, ended in December 2021, and ADCB has reverted to its usual staging rules as per International Financial Reporting Standard (IFRS) 9 requirements. Under the TESS recovery program, the bank has minimal exposure, and we do not expect it to result in a significant increase in problem loans after the recovery phase ends in June 2022.

Chart 5

ADCB's Asset Quality Versus UAE Banking Industry Average*



*UAE banking industry- based on a sample of the 10 largest banks. CoR--Cost of risk. NPAs--Nonperforming assets. Source: S&P Global Ratings.

Funding And Liquidity: Diversified Funding Profile And Adequate Liquidity

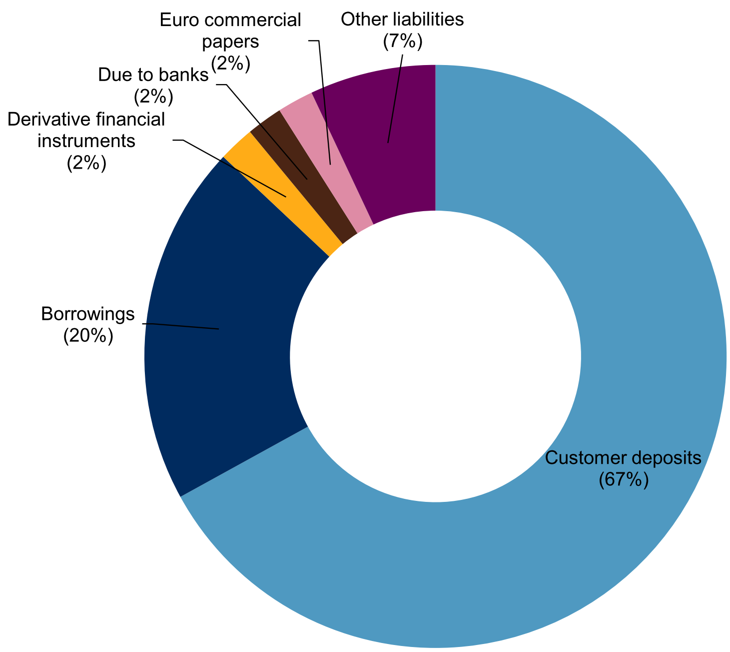
ADCB's funding and liquidity profile is in line with that of its domestic peers.

Our assessment of ADCB's adequate funding reflects the bank's solid base of core customer deposits, on the back of its well-established retail branch network. Although the bank's short-term funding has been increasing since 2019, it accounts for only 15% of the funding base as of March 2022. ADCB has access to long-term funding and strong capital, and its stable funding ratio stood at 124%. During the low interest rate environment, ADCB increased its current account savings accounts (CASA) deposits significantly, reaching 58% of total customer deposits at end-March 2022, compared with 51% at year-end 2020. During this period, CASA deposits increased by 18%, while time deposits declined by 10%. As the interest rates increase further through 2022-2023, we expect this trend to reverse and some of the CASA deposits to inevitably flow back to interest-bearing deposits. That said, we expect the overall impact of increasing interest rates will be positive for ADCB.

ADCB is one of the few banks in the region that has well-established, long-term funding programs and access to hard currency, overseas funding. It will likely maintain a stable proportion of liquid assets as cash, bank placements, and domestic sovereign bond holdings. We also understand that the bank, through its privileged relationship with the government, could reinforce its liquidity stability by drawing on bilateral lines if needed.

Chart 6

ADCB Has A Well-Diversified Liability Mix



Note: As of March 31, 2022. Sources: ADCB financial statements, S&P Global Ratings.

We expect ADCB's liquidity to remain adequate over the next two years. Its broad liquid assets to short-term wholesale funding stood at a healthy 2.5x as of end-March 2022. The bank has kept 13.8% of its assets in cash, central bank reserves, and interbank deposits. In addition, it has about 22.2% of assets as investment securities, which primarily includes highly rated UAE and Gulf Cooperation Council bonds.

Support: ADCB's GRE status will continue to support our rating on the bank

The issuer credit rating on ADCB includes three notches of uplift. This is underpinned by the bank's very strong link and important role for the Abu Dhabi government. We view ADCB as a GRE with a high likelihood of receiving timely and sufficient extraordinary support from the government of Abu Dhabi if needed. The Abu Dhabi government holds a 60.2% stake in ADCB, and other government entities own an additional 4.3%. It is the second-largest bank in Abu Dhabi and has a strong deposit and loan market share in the emirate's banking market. The bank also provides funds to certain Abu Dhabi-based GREs and key sectors in the emirate's overall business activities.

Environmental, Social, And Governance

ESG Credit Indicators

E-1 **E-2** E-3 E-4 E-5	S-1 **S-2** S-3 S-4 S-5	G-1 G-2 **G-3** G-4 G-5
- N/A	- N/A	- Risk management, culture, and oversight

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

We believe that environmental and social credit factors for ADCB are broadly in line with those of the bank's industry and domestic peers. Governance factors are a moderately negative consideration in our credit rating analysis of the bank.

High carbon-emitting industries constitute a significant portion of the UAE's economy and the majority of Abu Dhabi's. Although we estimate that the bank has relatively limited direct lending to sectors exposed to energy transition risk, the indirect exposure (via the overall dependence of the UAE economy on hydrocarbons) is higher.

The Abu Dhabi government holds a 60.2% stake in ADCB. The emirate appoints most of the bank's board of directors, and therefore has a strong influence on ADCB's strategy. At the same time, we assess the bank's risk appetite as higher than some domestic peers', given its large exposure to real estate and weaker asset quality metrics. This weighs on our assessment of the bank's risk position.

We consider bank regulation in the UAE less focused on consumer protection than in Europe or the U.S., meaning that the bank is less exposed to mis-selling penalties or other retail conduct risks.

Key Statistics

Table 1

Abu Dhabi Commercial Bank PJSC--Key Figures

	--Year-ended Dec. 31--				
(Mil. AED)	**2022***	**2021**	**2020**	**2019**	**2018**
Adjusted assets	438,424	432,984	403,766	397,620	279,812
Customer loans (gross)	256,621	255,113	250,453	255,166	173,153
Adjusted common equity	44,498	43,119	40,438	38,690	27,154
Operating revenues	2,938	12,101	12,489	11,740	9,192
Noninterest expenses	1,094	4,162	4,278	4,108	3,084
Core earnings	1,521	5,196	4,092	5,236	4,840

*Data as of March 31. AED--UAE dirham.

Table 2

Abu Dhabi Commercial Bank PJSC--Business Position

	--Year-ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (currency in millions)	2,938	12,267	12,489	11,740	9,192
Commercial banking/total revenues from business line	30.6	31.4	29.2	31.4	32.7
Retail banking/total revenues from business line	42.0	41.6	42.5	43.0	42.7
Commercial & retail banking/total revenues from business line	72.6	73.0	71.7	74.4	75.4
Trading and sales income/total revenues from business line	24.8	24.4	26.4	23.6	22.2
Asset management/total revenues from business line	2.5	2.5	1.9	2.0	2.4
Investment banking/total revenues from business line	24.8	24.4	26.4	23.6	22.2
Return on average common equity	11.3	10.1	7.6	12.2	16.9

*Data as of March 31.

Table 3

Abu Dhabi Commercial Bank PJSC--Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	14.8	14.8	15.9	14.8	15.3
S&P Global Ratings' RAC ratio before diversification	N/A	11.8	12.8	12.1	12.8
S&P Global Ratings' RAC ratio after diversification	N/A	10.5	11.2	10.6	10.2
Adjusted common equity/total adjusted capital	88.1	87.8	87.1	86.6	87.2
Net interest income/operating revenues	73.1	73.2	78.3	78.7	78.5
Fee income/operating revenues	16.6	15.7	12.4	15.5	15.2
Market-sensitive income/operating revenues	7.6	8.2	7.2	3.9	4.6
Cost to income ratio	37.2	34.4	34.3	35.0	33.5
Preprovision operating income/average assets	1.7	1.9	2.0	2.2	2.2
Core earnings/average managed assets	1.4	1.2	1.0	1.5	1.8

*Data as of March 31.

Table 4

Abu Dhabi Commercial Bank PJSC--Risk-Adjusted Capital Framework Data

(AED 000s)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Credit risk					
Government & central banks	125,078,322	--	--	4,012,465	3
Institutions and CCPs	69,261,157	--	--	26,722,375	39
Corporate	212,670,102	300,934,852	142	243,866,972	115
Retail	56,051,058	--	--	55,276,556	99
Of which mortgage	10,186,016	--	--	6,066,923	60
Other assets†	17,848,226	--	--	30,982,011	174
Total credit risk	480,908,865	300,934,852	63	360,860,379	75
Market Risk					
Equity in the banking book	1,018,022	--	--	9,365,760	920

Table 4

Abu Dhabi Commercial Bank PJSC--Risk-Adjusted Capital Framework Data (cont.)					
Trading book market risk	--	9,406,222	--	23,809,500	--
Total market risk	--	9,406,222	--	33,175,260	--
Operational risk					
Total operational risk	--	22,542,859	--	23,417,348	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	333,025,578	--	417,452,986	100
Total Diversification/ Concentration Adjustments	--	--	--	50,773,535	12
RWA after diversification	--	333,025,578	--	468,226,521	112
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		49,108,862	14.7	49,119,101	11.8
Capital ratio after adjustments‡		49,108,862	14.7	49,119,101	10.5

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. AED--United Arab Emirates dirham. Sources: Company data as of Dec. 31, 2021, S&P Global Ratings.

Table 5

Abu Dhabi Commercial Bank PJSC--Risk Position					
	--Year-ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	2.4	1.9	(1.8)	47.4	2.3
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	12.2	14.3	14.5	24.9
Total managed assets/adjusted common equity (x)	10.0	10.2	10.2	10.5	10.3
New loan loss provisions/average customer loans	0.5	1.0	1.6	1.1	0.7
Net charge-offs/average customer loans	0.3	1.4	0.5	0.7	0.8
Gross nonperforming assets/customer loans + other real estate owned	7.7	7.4	8.0	4.8	3.0
Loan loss reserves/gross nonperforming assets	54.8	57.1	57.1	60.1	128.7

*Data as of March 31. N/A--Not applicable.

Table 6

Abu Dhabi Commercial Bank PJSC--Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	70.1	72.1	74.6	81.5	78.2
Customer loans (net)/customer deposits	93.9	92.2	95.1	94.6	94.2
Long-term funding ratio	86.8	87.9	91.5	96.0	93.5
Stable funding ratio	124.1	125.6	127.8	119.4	120.7
Short-term wholesale funding/funding base	15.0	13.8	9.7	4.6	7.4

Table 6

Abu Dhabi Commercial Bank PJSC--Funding And Liquidity (cont.)					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Broad liquid assets/short-term wholesale funding (x)	2.5	2.7	3.7	6.6	4.6
Broad liquid assets/total assets	31.3	31.3	29.4	24.4	27.8
Broad liquid assets/customer deposits	53.3	52.0	48.0	37.7	44.1
Net broad liquid assets/short-term customer deposits	32.6	33.5	35.8	32.7	35.2
Short-term wholesale funding/total wholesale funding	47.4	46.7	35.8	22.7	31.5
Narrow liquid assets/3-month wholesale funding (x)	6.7	7.5	10.2	8.7	12.5

*Data as of March 31. N/A--Not applicable.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Middle East And African Banks: Varied Exposure To Russia-Ukraine Conflict, April 4, 2022
- UAE Banking Sector 2022 Outlook: On The Path To Recovery, March 3, 2022
- When Rates Rise: UAE Banks Will Benefit From Higher Interest Rates, Feb. 15, 2022
- Ratings On Five UAE Banks Affirmed Under Revised Criteria; Outlooks Stable, Jan. 20, 2022
- GCC Banking Sector Outlook: On The Recovery Path In 2022, Jan. 11, 2022

Ratings Detail (As Of June 3, 2022)*	
Abu Dhabi Commercial Bank PJSC	
Issuer Credit Rating	A/Stable/A-1

Ratings Detail (As Of June 3, 2022)*(cont.)		
Commercial Paper		
Foreign Currency		A-1
Senior Unsecured		A
Short-Term Debt		A-1
Subordinated		A-
Issuer Credit Ratings History		
25-Mar-2021	*Foreign Currency*	A/Stable/A-1
26-Mar-2020		A/Negative/A-1
02-Apr-2015		A/Stable/A-1
25-Mar-2021	*Local Currency*	A/Stable/A-1
26-Mar-2020		A/Negative/A-1
02-Apr-2015		A/Stable/A-1
Sovereign Rating		
Abu Dhabi (Emirate of)		AA/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.