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Fitch Affirms Abu Dhabi Commercial Bank at 'A+'; Outlook Stable

Fitch Ratings - London - 10 Nov 2021: Fitch Ratings has affirmed Abu Dhabi Commercial Bank PJSC's (ADCB) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'bb+'.

Key Rating Drivers

IDRS, SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

ADCB's IDRs reflect an extremely high probability of support available to the bank from both the United Arab Emirates (AA-/Stable) and Abu Dhabi (AA/Stable) authorities, as reflected in its 'A+' SRF.

Fitch's assessment of potential state support, in case of need, factors in the sovereign's strong ability to support the banking system, underpinned by its solid net external asset position, still-strong fiscal metrics and recurring hydrocarbon revenue. It also reflects the authorities' very strong, timely and predictable record of supporting its domestic banks and strategic ownership of a number of banks, including ADCB (60%-owned by Mubadala Investment Company, an Abu Dhabi sovereign wealth fund).

ADCB's 'A+' SRF is at the Abu Dhabi domestic systemically important banks (D-SIB) SRF level, reflecting its high systemic importance and government ownership. The Abu Dhabi D-SIB SRF is one notch above that of other UAE banks, given Abu Dhabi's superior financial flexibility.

ADCB's Short-Term IDR of 'F1' is the lower of the two options corresponding to an 'A+' Long-Term IDR as described in our rating criteria. This is because a significant proportion of UAE banking-sector funding is related to the government and stress on banks would likely come at a time when the sovereign itself is experiencing some form of stress.

DEBT RATINGS

The ratings of the bank's unsecured debt (programmes and notes), including that issued by ADCB's special purpose vehicles (SPVs) ADCB Finance (Cayman) Limited and AHB Sukuk Company Ltd, are in line with the bank's Long- and Short-Term IDRs, reflecting Fitch's view that the likelihood of default of these obligations is the same as the likelihood of default of the bank.

ADCB's 'A-' subordinated notes, issued under ADCB Finance (Cayman) Limited, are rated two notches below ADCB's 'A+' Long-Term IDR, reflecting Fitch's view of a heightened likelihood of poor recoveries in the event of default. We do not notch the notes for non-performance, as in our opinion, this risk is low relative to the risk captured by the bank's LT IDR.

VR

ADCB's VR reflects its strong domestic franchise (end-3Q21: 13% of sector assets; 14% of loans), which was strengthened by the merger with Union National Bank and acquisition of Al Hilal Bank in 2019, and good funding and liquidity profile. It also reflects the bank's historically fairly high risk appetite and weaker-than-peers' asset quality.

We now believe that the challenges to the UAE economy from the Covid-19 pandemic have subsided sufficiently to remove the negative outlook on the UAE operating environment score. Government support measures, higher oil prices and eased restrictions have resulted in increasing economic activity and improved economic growth prospects (Fitch UAE GDP growth forecast: 1.8% for 2021 (non-oil: 3.5%); 5.8% (3.7%) for 2022).

These factors should be supportive of UAE banks' operations in the short-to-medium term. ADCB's loan book is concentrated by sector and borrower and this weighs on our assessment of the bank's risk appetite, as does slow amortisation of its largest exposures and high related-party lending (19% of gross loans at end-3Q21). Nevertheless, the latter also reflects the bank's government ownership. The bank's exposure to the real-estate sector has declined materially (end-3Q21: 25% of gross loans; 39% at end-2018) and further significant reductions of credit concentrations could support our risk appetite assessment. Low-risk government lending has also risen to 24% of gross loans (end-3Q19: 19%).

ADCB's asset quality is weaker than peers'. Reported Stage 3 loans (excluding interest in suspense) accounted for 6.1% of gross loans (excluding loans to banks) at end-3Q21, down from 6.3% at end-2020, due primarily to large write-offs (equivalent to 1.5% of end-3Q21 loans). In addition, Fitch calculates that ADCB's impaired loans (including Stage 3 and loans purchased or originated credit impaired (POCI)) would be a higher 7.5% of gross loans (end-2020: 8.0%).

Impaired loans are materially higher than at end-2019 (4.7%) primarily due to large corporate defaults (including NMC Healthcare) in 2020. ADCB's reported Stage 2 loans fell to 7.7% at end-3Q21, from 8.6% at end-2020, reflecting the more benign economic outlook.

Nevertheless, we expect loan quality to remain broadly stable in 2022 given the improving economic outlook and only modest level of remaining deferred payments (1.8% of loans; with about a third in group 2). The recently announced restructuring agreement for NMC could also yield recoveries, but we believe this will take time. We calculate that total loan loss allowances covered 73% of total stage 3 and POCI loans at end-3Q21 which is considered by Fitch as fairly low.

ADCB's operating profit-to-risk-weighted assets (RWAs) ratio is weaker than most peers but improved slightly to 1.5% in 9M21, from 1.3% in 2020, primarily due to lower impairment charges and higher fee and commission income. We expect profitability to gradually improve with economic recovery and rising rates. ADCB's cost efficiency could improve further as merger-related synergies are fully realised.

ADCB's Common Equity Tier 1 (CET1) ratio fell to 13.2% at end-3Q21 from 13.9% at end-2020, primarily due to regulatory changes in RWAs. Capitalisation is only adequate for the bank's risk profile, considering its weaker-than-peers' asset quality and profitability, high credit concentrations and moderate share of unreserved problem loans. The Tier 1 ratio was a higher 15.0%, supported by AED6 billion of additional Tier 1 capital, entirely issued to the Abu Dhabi government.

ADCB's funding and liquidity profile is a VR strength. The bank is largely funded by customer deposits (end-3Q21: 73% of total funding), a high share of which is derived of low-cost current and savings accounts (57%) reflecting its strong franchise. Government and public-sector deposits (42% of total) also underpin the funding base. Liquidity is comfortable and accounted for about 26% of total assets at end-3Q21, or 44% of customer deposits. The liquidity coverage ratio was 132% at end-3Q21, comfortably above minimum requirements.

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

IDRS, SR AND SRF
ADCB's IDRs and Outlook are sensitive to a change, in Fitch's view, of the ability and propensity of the UAE and Abu Dhabi authorities to support the banking system or the bank. Any negative rating action on the UAE or Abu Dhabi or a negative change in Fitch's assessment of the authorities' ability or propensity to provide support would result in a downward revision of the SRF and would lead to a downgrade of ACDB's Long-term IDR. However, this is not currently anticipated given the Stable Outlook on both sovereigns' ratings.

SPV AND DEBT RATINGS
Any downgrade of the bank's IDRs would lead to a corresponding change in the bank's debt ratings and the senior unsecured and subordinated debt ratings of its SPVs.

VR
ADCB's VR is primarily sensitive to our assessment of the bank's risk appetite and asset quality, given these are of high importance. A material deterioration of ADCB's asset-quality metrics or a prolonged weakening in operating profitability (below 1.5% of RWAs) would likely lead to a downgrade of the VR.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

IDRS, SR AND SRF
Given our already existing view of the high creditworthiness of the Abu Dhabi and UAE authorities and high propensity to support the banking system and the bank, positive rating action is unlikely.

SPV AND DEBT RATINGS
Any positive change in the bank's IDRs would lead to a corresponding change in the bank's debt ratings.

VR
Continued material reductions in credit concentrations, by sector and borrower, could improve our assessment of risk appetite and bring upside potential to the VR, in particular if this was accompanied by improvements in the bank's asset quality. In addition, significant improvements in core

capitalisation and problem loans reserve coverage would be positive for the VR.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

ADCB's IDRs, SR and SRF reflect an extremely high probability of support available to the bank from the UAE and Abu Dhabi authorities.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Abu Dhabi Commercial Bank PJSC	LT IDR	A+	Affirmed		A+
	ST IDR	F1	Affirmed		F1
	Viability	bb+	Affirmed		bb+
	Support	1	Affirmed		1
	Support Floor	A+	Affirmed		A+
• senior unsecured	LT	A+	Affirmed		A+
• senior unsecured	ST	F1	Affirmed		F1
ADCB Finance (Cayman) Limited					

ENTITY/DEBT		RATING		RECOVERY	PRIOR
• senior unsecured	LT	A+	Affirmed		A+
• subordinated	LT	A-	Affirmed		A-
AHB Sukuk Company Ltd					
• senior unsecured	LT	A+	Affirmed		A+
• senior unsecured	ST	F1	Affirmed		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	▣	

Applicable Criteria

Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Abu Dhabi Commercial Bank PJSC	UK Issued, EU Endorsed
ADCB Finance (Cayman) Limited	UK Issued, EU Endorsed
AHB Sukuk Company Ltd	UK Issued, EU Endorsed

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