Abu Dhabi Commercial Bank

Unduly Punished

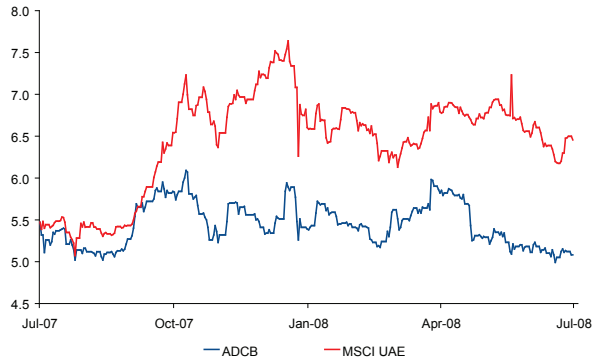
July 30, 2008

Key Data

Closing Price*	Avg. Value Traded per Day
AED 5.06	AED 18 million
52-Week High	**Market Cap**
AED 6.09	AED 24.4 billion
52-Week Low	**Shares Outstanding**
AED 4.99	4.81 billion
Reuters	**Bloomberg**
ADCB.AD	ADCB DH
Ownership Structure	
Closely Held: 78%	Public: 22%

** As of July, 29 2008. Sources: Reuters, Abu Dhabi Securities Exchange, and NBK Capital*

Rebased Performance



Sources: Reuters and NBK Capital

Key Ratios

	2007 a	2008 f	2009 f	2010 f	2011 f
P/B (latest)	2.1	1.8	1.6	1.4	1.0
P/E (latest)	11.5	10.7	9.5	7.8	6.8
Net Profit Growth	-4.5%	14.4%	12.3%	22.6%	14.5%
RoAE	18.1%	18.5%	17.9%	19.2%	16.9%
RoAA	2.1%	1.8%	1.6%	1.8%	1.9%
Net Interest Margin	2.6%	2.1%	2.1%	2.1%	2.2%
Dividend Payout	20.1%	31.7%	31.1%	27.9%	29.5%

2Q2008 Net Profit a	2Q2008 Net Profit f
AED 621 million	AED 639 million
3Q2008 Net Profit f	**4Q2008 Net Profit f**
AED 580 million	AED 613 million

a = actual, f = forecast. Sources: Reuters and NBK Capital

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Highlights

12-Month Fair Value: AED 6.20

Recommendation: Buy – Risk Level: 3**

Reason for Report: Second Quarter 2008 Update

- Our estimate of ADCB's 12-month fair value per share stands at AED 6.20, 22% above the share's closing price as of July 29; hence, our "Buy" recommendation. This value is 5% over our previous fair value of AED 5.90. The increase in fair value is mainly driven by a quicker lending growth than originally forecasted and a robust non-interest earning stream.

- ADCB achieved a net profit of AED 1,081 million in 1H2008, in line with our AED 1,099 million forecast (a difference of 1.6%). Net profit growth in 1H2008 stood at 14%, while operating income growth reached 45%. Net profit growth was much lower than operating income growth due to a 50% increase in the cost base and sizable provisions taken on the lending book (AED 167 million) and investment portfolio (AED 131 million).

- ADCB achieved a year-on-year net profit growth of 1% and 27% in 1Q2008 and 2Q2008, respectively. Net interest income picked up in 2Q2008 from a relatively weak 1Q2008, as the drop in asset yields was outweighed by a larger drop in funding costs on the back of a drop in interest rates. Fee income was robust in 1H2008, reaching AED 510 million, representing a growth rate of 45%. Provisions on securities affected by the meltdown in the US subprime mortgage market stood at AED 130.5 million in 1H2008. On the other hand, earnings were boosted by an AED 178 million gain on revaluation of investment property in 2Q2008.

- The major change in our forecast relates to quicker growth in ADCB's loan book than initially predicted, which is in turn driven by more rapid growth in the sector as a whole. We now forecast ADCB's loans to grow by a CAGR of 16% in the five years ending in 2012. We forecast operating income and net profit to grow by a CAGR of 15.1% and 15.8% during the same period as opposed to our earlier forecasts of 12.2% and 14.7%, respectively.

*** Please refer to the last page for recommendations and risk ratings.*

Valuation

Our estimate of ADCB's 12-month fair value per share stands at AED 6.20, 22% above the share's official closing price as of July 29, 2008; hence, our "Buy" recommendation. We had initiated coverage of ADCB with a fair value of AED 7.10 per share in March 2008. The issuance of a 20.25% bonus share in April 2008 led to a drop in the fair value per share to AED 5.90. Our new fair value (AED 6.20) is 5% higher. A stronger lending growth than originally forecasted and robust non-interest earnings are the main reasons behind the increase in our estimate of fair value.

Our 12-month fair value for ADCB is AED 6.20

Figure 1 Weighted Average Fair Value per Share

Valuation Method	Value (AED)	Weight (%)
Discounted Equity Cash Flow (DECF)	6.60	60%
Dividend Discount Model (DDM)	5.00	30%
Peer-Based Valuation	7.30	10%
Weighted Average Fair Value	**6.20**	**100%**

Source: NBK Capital

1Q2008 and 2Q2008 Performance

ADCB achieved a net profit of AED 1,081 million in 1H2008, in line with our AED 1,099 million forecast. Net interest income (NII) was weak in 1Q2008, dropping by 5% year-on-year and 16% quarter-on-quarter. However, NII rebounded in 2Q2008, growing by 28% year-on-year and 24% quarter-on-quarter as funding costs dropped more quickly than asset yields did. Income from fees and commissions was robust in both quarters. Income from fees and commissions reached AED 510 million in 1H2008 growing by 45% year-on-year, driven by both core-banking operations and the joint ventures that ADCB has with Australia's Macquarie Bank.

Income from foreign exchange (at AED 168 million in 1H2008) was a significant boost to earnings, accounting for 8% of total operating income. As already mentioned, ADCB booked an AED 178 million on revaluation of investment property in 2Q2008. This follows a similar gain of AED 295 million in 4Q2007. ADCB has recently been increasing its involvement in Abu Dhabi's booming real estate market. Costs were high in 1H2008, reaching AED 667 million, 50% over 1H2007.

Net profit growth was flat in 1Q2008 but jumped to 27% in 2Q2008

Figure 2 1Q2008 and 2Q2008 Performance – Income Statement

Income Statement ('000 AED)	1Q2008	2Q2008	1Q2008 Y-on-Y Change %	2Q2008 Y-on-Y Change %
Net Interest Income	506,223	629,917	-4.7%	27.8%
Net Fee and Commission Income	262,557	247,285	64.3%	28.4%
Net Foreign Exchnage Gain	79,345	88,732	699.3%	201.1%
Total Investment Income	60,292	239,086	511.2%	492.6%
Total Operating Income	921,018	1,221,824	28.4%	60.5%
Total Costs	(321,343)	(345,321)	57.2%	44.3%
Impairment of Investments	(71,730)	(58,773)	n/m	n/m
Net Profit	**459,887**	**621,249**	**0.7%**	**27.0%**

Sources: ADCB's financial statements and NBK Capital

Total assets stood at AED 128 billion at the end of June 2008, almost reaching our initial forecast of AED 131 billion for December 2008. Lending was quicker than initially forecasted as net loans expanded by 20% in 1H2008, coming close to our initial forecast of 23% for the whole year. Lending to the services sector was the most prominent, growing by 57% and accounting for 35% of the total increase in gross loans during 1H2008. Lending against securities expanded by 41% in 1H2008 and accounted for 23% of the total increase in gross loans. Retail loans and loans given for development and construction also witnessed robust growth during 1H2008.

Growth in deposits was slower than growth in loans in each of 1Q2008 and 2Q2008. Deposits expanded by 10.5% in 1H2008, driving up the loans-to-deposits ratio to 144% in June up from 132% at the end of 2007.

Figure 3 Growth in the Balance Sheet

Balance Sheet ('000 AED)	1Q2008 Change %	Mar-08	2Q2008 Change %	Jun-08
Cash and balances with central banks	-17.1%	12,976,923	-66.9%	4,301,758
Due from Banks	66.3%	10,027,964	72.9%	17,343,159
Net Loans and Advances	5.7%	80,002,245	13.7%	90,985,446
Investments	-7.9%	3,257,419	8.5%	3,535,407
Investment in Associate	n/m	-	n/m	4,420,672
Total Assets	7.3%	113,991,270	12.6%	128,345,687
Due to Banks	34.2%	7,514,171	-16.2%	6,294,950
Deposits	3.6%	59,226,689	6.6%	63,137,301
Other Purchased Funds	6.4%	29,122,001	36.3%	39,705,198
Shareholders' Equity	3.2%	11,664,597	1.7%	11,860,928

Sources: ADCB's financial statements and NBK Capital

Growth in the balance sheet was rapid, especially in 2Q2008

ADCB has relied significantly on borrowings to fund its asset growth. Total borrowings reached AED 35 billion at the end of June, versus AED 27 billion at the end of 2007. In addition, ADCB during 2Q2008 issued mandatory convertible securities worth AED 4.8 billion that will be converted into ordinary shares in three years. The securities were priced at EIBOR plus 1.5% and will be treated as Tier I capital under UAE capital adequacy regulations.

Outlook and Forecasts

One major change that we have made to our forecasts relates to quicker growth in the loan book of ADCB, primarily driven by quicker growth in the sector as a whole. We now forecast ADCB's loan book to grow by a CAGR of 16.4% between 2007 and 2012 as compared with our original forecast of 14.8%. The operating environment continues to be very strong, with oil prices at record highs. The amount of investment, through several massive infrastructure and tourism projects, which are currently under way or planned in Abu Dhabi, will continue to support the corporate banking books of UAE banks in general and Abu Dhabi-based ones in particular.

We increase our forecast for growth in operating income and net profit

Figure 4 Forecasts - Old and New

	2008 Forecasts ('000 AED)			2007 - 2012 CAGR %	
	Old	New	Change %	Old	New
Net Loans and Advances	93,440,052	102,000,089	9.2%	14.8%	16.4%
Deposits	74,142,589	73,652,971	-0.7%	18.1%	14.9%
Net Interest Income	2,436,452	2,408,053	-1.2%	9.7%	13.6%
Net Fee and Commission Income	1,167,527	1,143,957	-2.0%	19.3%	21.4%
Total Operating Income	4,296,002	4,417,114	2.8%	12.2%	15.1%
Total Costs	(1,230,964)	(1,487,624)	20.9%	17.8%	24.3%
Net Profit	2,227,755	2,274,515	2.1%	14.7%	15.8%

Sources: NBK Capital

ADCB has paid AED 4.4 billion for a 25% stake in RHB Capital Berhad, Malaysia's 4th largest bank. ADCB is looking for significant potential from that acquisition, as Malaysia has a large population and is considered the hub of Islamic banking. ADCB will also be launching an Islamic banking subsidiary before the end of the year which will support the expansion of ADCB's business, as Islamic banking is growing faster than conventional banking.

ADCB has some exposure to instruments that were affected by the meltdown in the US subprime mortgage market and the ensuing liquidity crisis. ADCB disclosed that its total exposure to such instruments stood at AED 953 million at the end of June 2008. Provisions amounting to AED 71.7 million and AED 58.8 million were taken in 1Q2008 and 2Q2008, respectively. We had initially forecasted a worst-case scenario of AED 460 million provisions to be taken in 2008. As provisioning so far has been lower than initially forecasted, we adjust downwards the amount of provisioning to be taken in 2H2008. We now assume an 80% loss on the remaining exposure that has not been provided for (AED 329 million), 50% to be taken in 2H2008 and the other 50% in 2009. This translates into an AED 123 million provision in each of 2H2008 and 2009.

Quicker lending growth will result in a quicker growth in net interest income, which we now forecast to grow by a CAGR of 13.6% between 2007 and 2012. We increase our forecast slightly for fees and commissions and we also increase our forecast for the expansion in the cost base, translating to an increase in our net profit growth forecast to a CAGR of 15.8% (as compared to our earlier forecast of 14.7%) between 2007 and 2012.

FINANCIAL STATEMENTS

Balance Sheet (AED Thousands)			Forecast					
Fiscal Year Ends December	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
ASSETS								
Cash and Balances with Central Banks	1,898,457	15,657,588	9,743,792	10,972,099	11,376,518	15,417,916	16,251,169	18,368,689
Due from Banks	10,065,209	6,030,364	18,079,256	18,799,640	19,417,966	20,438,312	21,601,603	22,640,781
Investments	3,778,374	3,536,351	8,807,792	10,017,534	10,927,933	11,928,394	13,053,734	14,345,556
Net Loans and Advances	62,424,649	75,676,082	102,000,089	115,608,789	129,391,428	144,904,685	161,376,824	175,997,157
Net Fixed Assets	512,024	492,501	504,916	526,383	549,998	575,973	604,546	635,977
Other Assets	2,409,665	4,820,963	7,990,395	8,470,015	8,938,711	9,433,541	9,958,276	10,501,479
Total Assets	**81,088,378**	**106,213,849**	**147,126,240**	**164,394,461**	**180,602,554**	**202,698,822**	**222,846,152**	**242,489,639**
LIABILITIES & EQUITY								
Due to Banks	7,970,187	5,598,376	7,231,702	7,519,856	7,767,186	8,175,325	8,640,641	9,056,312
Customer Deposits	43,396,851	57,160,820	73,652,971	83,944,166	92,777,405	102,980,863	114,613,768	125,005,548
Other Purchased Funds	16,610,194	27,370,264	45,660,978	50,227,075	54,747,512	58,579,838	63,266,225	68,327,523
Other Liabilities	2,386,968	4,672,646	7,090,978	7,311,365	7,506,016	7,699,532	7,896,820	8,105,131
Total Liabilities	**70,364,200**	**94,802,106**	**133,636,628**	**149,002,462**	**162,798,119**	**177,435,557**	**194,417,454**	**210,494,515**
Minority Interest	65,800	114,231	177,853	253,285	333,618	430,018	520,168	647,416
Total Shareholders' Equity	**10,658,378**	**11,297,512**	**13,311,759**	**15,138,713**	**17,470,816**	**24,833,246**	**27,908,529**	**31,347,708**
Total Liabilities and Equity	**81,088,378**	**106,213,849**	**147,126,240**	**164,394,461**	**180,602,554**	**202,698,822**	**222,846,152**	**242,489,639**

Income Statement (AED Thousands)			Forecast					
Fiscal Year Ends December	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Net Interest Income	1,773,991	2,288,415	2,408,053	2,870,579	3,275,084	3,766,919	4,338,433	4,838,245
Income from Fees and Commissions	1,129,246	873,960	1,143,957	1,381,096	1,647,205	1,953,441	2,303,062	2,677,262
Other Operating Income	193,941	637,499	865,105	744,613	870,010	947,783	1,028,893	1,125,051
Total Operating Income	**3,097,178**	**3,799,874**	**4,417,114**	**4,996,288**	**5,792,299**	**6,668,142**	**7,670,387**	**8,640,558**
Provisions for Credit Losses	(193,470)	(143,363)	(256,297)	(211,448)	(214,151)	(241,041)	(255,940)	(227,167)
Salaries and Employee-Related Expenses	(440,218)	(543,743)	(810,177)	(1,053,230)	(1,221,747)	(1,417,227)	(1,643,983)	(1,907,020)
General and Administrative Expenses	(272,597)	(414,635)	(621,953)	(808,538)	(937,904)	(1,087,969)	(1,262,044)	(1,463,971)
Depreciation	(41,064)	(50,252)	(55,494)	(60,778)	(66,856)	(73,541)	(80,895)	(88,985)
Other Operating Expenses & Provisions	-	(559,595)	(253,913)	(123,410)	-	-	-	-
Total Operating Expenses	**(947,349)**	**(1,711,588)**	**(1,997,833)**	**(2,257,404)**	**(2,440,658)**	**(2,819,778)**	**(3,242,862)**	**(3,687,143)**
Net Operating Profit	**2,149,829**	**2,088,286**	**2,419,282**	**2,738,884**	**3,351,641**	**3,848,364**	**4,427,526**	**4,953,415**
Other Income / (Expenses)	(2,630)	(3,356)	(8,390)	(8,390)	(8,390)	(8,390)	(8,390)	(8,390)
Minority Interest	(65,582)	(97,412)	(136,377)	(177,290)	(212,748)	(255,297)	(280,827)	(336,993)
Net Profit	**2,081,617**	**1,987,518**	**2,274,515**	**2,553,204**	**3,130,503**	**3,584,677**	**4,138,308**	**4,608,033**

Key Ratios			Forecast					
Fiscal Year Ends December	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Growth in Loans	48.1%	21.2%	34.8%	13.3%	11.9%	12.0%	11.4%	9.1%
Growth in Deposits	27.9%	31.7%	28.9%	14.0%	10.5%	11.0%	11.3%	9.1%
Growth in Net Profit	8.9%	-4.5%	14.4%	12.3%	22.6%	14.5%	15.4%	11.4%
Growth in Operating Income	16.9%	22.7%	16.2%	13.1%	15.9%	15.1%	15.0%	12.6%
Loans-to-Assets	77.0%	71.2%	69.3%	70.3%	71.6%	71.5%	72.4%	72.6%
Loans-to-Deposits	143.8%	132.4%	138.5%	137.7%	139.5%	140.7%	140.8%	140.8%
NPLs-to-Gross Loans	1.9%	1.4%	1.4%	1.5%	1.5%	1.5%	1.6%	1.6%
NPL Coverage	83.4%	109.0%	97.3%	96.2%	95.1%	93.9%	92.7%	91.3%
Capital Adequacy	16.3%	13.5%	11.9%	11.5%	11.6%	11.5%	11.5%	11.7%
Growth in Costs	46.2%	33.8%	47.5%	29.2%	15.8%	15.8%	15.8%	15.8%
Non-Interest Expense-to-Average Assets	1.4%	1.8%	1.6%	1.4%	1.4%	1.5%	1.5%	1.6%
Cost-to-Income	24.3%	26.5%	33.7%	38.5%	38.4%	38.7%	38.9%	40.0%
Non-Interest Income-to-Operating Income	42.7%	39.8%	45.5%	42.5%	43.5%	43.5%	43.4%	44.0%
Dividend Payout	58.1%	20.1%	31.7%	31.1%	27.9%	29.5%	28.1%	31.5%
Net Interest Margin	2.7%	2.6%	2.1%	2.1%	2.1%	2.2%	2.3%	2.3%
RoAE	21.6%	18.1%	18.5%	17.9%	19.2%	16.9%	15.7%	15.6%
RoAA	3.0%	2.1%	1.8%	1.6%	1.8%	1.9%	1.9%	2.0%

Sources: ADCB's financial statements and NBK Capital

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Risk and Recommendation Guide

Recommendation	Upside (Downside) Potential
Buy	more than 20%
Accumulate	between 10% and 20%
Hold	between -5% and 10%
Reduce	between -10% and -5%
Sell	less than -10%

Risk Level				
1	2	3	4	5
Low Risk				High Risk

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