

## CREDIT OPINION

23 May 2018

Update

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### RATINGS

#### Al Hilal Bank PJSC

Domicile	Abu Dhabi, United Arab Emirates
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Al Hilal Bank PJSC

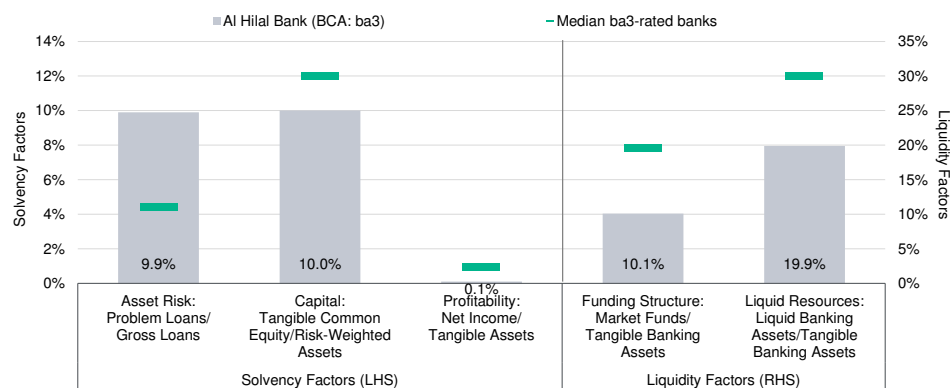
### Update to credit analysis

#### Summary

Al Hilal Bank PJSC's (AHB) A2/P-1 issuer ratings capture the bank's baseline credit assessment (BCA) of ba3 and seven notches of uplift from government support based on our view of a very high likelihood of support from the [Government of United Arab Emirates](#) (UAE, Aa2 stable) in case of need.

AHB's ba3 BCA reflects the bank's (1) significantly weakened asset quality and provision coverage levels; (2) modest capitalisation, coupled with relatively weak net profitability owing to high provisioning and operating costs; and (3) sound funding profile moderated by relatively low liquidity buffers.

Exhibit 1  
Rating Scorecard - Key financial ratios



Problem loan and profitability ratios are the weaker of the three-year averages and the latest reported figures; the capital ratio is the latest reported figure, and the funding structure and liquid asset ratios are latest year-end figures.

Source: Moody's Financial Metrics

## Credit strengths

- » Modest capitalisation
- » Sound funding profile
- » Very high likelihood of support from UAE authorities in case of need

## Credit challenges

- » Significantly weakened asset quality and provision coverage levels
- » Weak profitability
- » Relatively low liquidity buffers

## Rating outlook

The stable outlook reflects our view that AHB's financial fundamentals, in particular the bank's asset quality, capital and profitability, are expected to stabilise at their current, relatively weak levels over the next 12 months.

## Factors that could lead to an upgrade

Upward pressure on AHB's ratings could develop from a combination of (1) a significant improvement in the bank's asset quality, capitalisation and profitability; and (2) a significant reduction in its borrower and sector concentrations.

## Factors that could lead to a downgrade

Downward pressure on AHB's ratings could develop from (1) any weakening in the bank's asset quality or profitability metrics, or (2) decline in liquidity or capital buffers.

## Key indicators

Exhibit 2

### Al Hilal Bank PJSC (Consolidated Financials) [1]

	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (AED million)	44,788	43,427	43,091	41,291	38,705	3.7 <sup>4</sup>
Total Assets (USD million)	12,194	11,824	11,732	11,242	10,538	3.7 <sup>4</sup>
Tangible Common Equity (AED million)	3,692	3,650	3,626	3,745	3,906	-1.4 <sup>4</sup>
Tangible Common Equity (USD million)	1,005	994	987	1,020	1,063	-1.4 <sup>4</sup>
Problem Loans / Gross Loans (%)	9.7	10.9	8.9	5.4	3.7	7.7 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	10.0	9.4	10.0	10.9	12.9	10.6 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	56.2	62.1	50.8	32.7	21.6	44.7 <sup>5</sup>
Net Interest Margin (%)	2.6	2.5	3.1	3.4	3.7	3.1 <sup>5</sup>
PPI / Average RWA (%)	1.3	1.1	1.7	2.4	2.4	1.8 <sup>6</sup>
Net Income / Tangible Assets (%)	0.1	0.1	0.0	0.1	1.1	0.3 <sup>5</sup>
Cost / Income Ratio (%)	61.7	67.3	58.3	50.0	54.1	58.3 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	10.1	10.5	10.2	9.0	13.0	10.6 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	19.9	14.0	16.8	15.5	15.7	16.4 <sup>5</sup>
Gross Loans / Due to Customers (%)	99.0	107.9	100.9	103.6	99.3	102.2 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Profile

Established in Abu Dhabi in 2007, AHB is an Islamic bank that offers a wide range of Shariah-compliant corporate, retail, treasury and investment banking services, as well as Islamic insurance.

The bank is fully owned by the Abu Dhabi government through its investment vehicle, the Abu Dhabi Investment Council (ADIC). The bank operates primarily in the UAE and through one subsidiary in Kazakhstan. As of December 2017, AHB had a domestic market share of around 1.7% in terms of total assets.

The bank's concentration of activities in the UAE has resulted in a Strong- Macro Profile score, which is used to derive its ratings (see [United Arab Emirate's Macro Profile: Strong-](#)).

## Detailed credit considerations

### Significantly weakened asset quality and provision coverage levels

AHB's asset-quality metrics significantly weakened in recent years, with the adjusted non-performing financing (NPF) ratio (NPF analogous to NPL - non-performing loans - as defined by Moody's, includes all loans over 90 days past due) increasing to around 9.7% as of December 2017 (10.9% as of December 2016) from 5.4% as of December 2014.

Although the adjusted NPL ratio has slightly improved in the second half of 2017, such levels continue to compare unfavourably with the UAE average of around 5.1% and the median for global peers with a ba3 BCA of 4.4%. At the same time, AHB's coverage ratio declined to 64% as of December 2017 from 91% as of December 2014, which is lower than both the local average and the median for global peers with a ba3 BCA of around 97% and 86%, respectively. This weakening trend since 2014 is in contrast with a period of recovery observed in most UAE banks.

This deterioration in asset-quality metrics is owing to a sizeable increase in NPF mainly in the bank's financing portfolio for corporates, and small and medium-sized enterprises.

Following this weak asset-quality performance, a new CEO, CFO and CRO have been appointed, and the bank is taking steps to implement more stringent underwriting standards and governance practices. As a result, total financings contracted in the second half of 2017 reflecting the bank's renewed strategy on de-risking and refocusing its activities towards the core sectors of the economy.

Although management changes and ongoing improvements in risk management and controls are expected to be broadly beneficial for the bank's risk profile in the medium term, over the next 12 months, asset quality will remain relatively weak, given the slowing domestic operating conditions. AHB also exhibits high credit concentrations that make the bank more vulnerable to event risk. Concentration risk is structural in the UAE because of the large government presence across most sectors of the economy, and is a key driver behind the downward adjustments in our scorecard for most banks, including AHB.

### Relatively weak net profitability, combined with modest capitalisation

AHB's bottom-line profitability metrics are lower than those of its domestic peers owing to high operating costs and the increased cost of risk. The bank's limited operational history (operational since 2008) implies that the bank has made significant investments in (1) establishing a branch network; and (2) advanced information technology, which led to a relatively high, albeit improving, cost/income ratio of around 62% in 2017 (67% in 2016), well above the UAE average of around 36%.

More recently, profitability has been impacted by (1) the bank's reduced net profit margin of 2.6% in 2017, down from 3.4% in 2014; and (2) an increase in provisioning costs, driven by the aforementioned increase in NPFs, which consumed around 80% of pre-provision income on an average since 2014. As a result, the bank's net profitability ratios declined, with net income/tangible assets of around 0.1% since 2014 (0.1% in 2017). Such profitability levels compare unfavorably with both the 1.5% UAE average and the 0.9% median for global peers with a ba3 BCA.

Although the new management is refocussing on the core business and reducing operating costs, we expect the bank's profitability to, nevertheless, remain relatively weak owing to elevated provisioning and funding costs.

Despite full profit retention and multiple capital injections from its owner, ADIC, AHB maintains modest capital levels. The bank's tangible common equity (TCE) ratio has been stable at around 10% since 2015 (10.0% as of December 2017), which is well below the

14.6% domestic average and the 12.0% median for global peers with a ba3 BCA. However, the bank's authorised but unissued capital, if subscribed by its sole shareholder, will boost its TCE ratio by around 2.5% to around 12.5%, which will be in line with that of its global peers with a ba3 BCA. The bank has also raised additional capital through a hybrid Additional Tier 1 sukuk issuance, representing around 5% of total risk-weighted assets, which (in line with the local regulatory framework) have contingent point of non-viability triggers, and hence, are not included in our TCE calculations. Consequently, the bank's reported Tier 1 capital ratio (under Basel III) stood at 14.9% as of December 2017, which is above the fully phased-in minimum local regulatory requirement of 11.0% (including a 2.5% capital conservation buffer) and the median for global peers with a ba3 BCA.

We expect the bank's capitalisation to remain broadly stable at its current level owing to a slowing credit growth, which can be funded through its relatively weak internal capital-generating ability.

### Sound liquidity profile, moderated by relatively low liquidity buffers

The bank's funding profile remains solid. AHB remains primarily funded with customer deposits, which represented more than 75% of the bank's total assets as of December 2017, compared with the UAE average of around 63%. Within these deposits, the share of current and savings account balance increased to 31% of total deposits as of December 2017 from 25% as of December 2014. However, in line with its Gulf Cooperation Council peers, we also observe high concentrations in AHB's deposits. As of December 2017, the government and public sector entities contributed around 54% of total deposits (51% as of December 2016).

Additionally, the bank has diversified its funding sources through long-term capital market issuances and syndications. In 2013, the bank set up a \$2.5 billion sukuk programme under which it issued around \$825m (7% of tangible banking assets as of 2017). As a result, a significant proportion of AHB's market funding, representing 10% of tangible banking assets as of December 2017, carries long tenor, which is positive because it lengthens the maturity profile of liabilities and reduces refinancing risks.

However, the bank's liquidity buffers remain relatively low. The bank's liquidity position, as measured by liquid banking assets/tangible banking assets, improved to around 20% of total assets as of December 2017, from 14% as of December 2016. On a standalone basis, these metrics still compare unfavourably with both the UAE average and the median for global peers with a ba3 BCA (which exceed 30%).

We expect the bank's liquidity and funding profiles to broadly remain stable as credit growth slows; however, the tight liquidity environment in the region may strain AHB's overall liquidity position.

## Support and structural considerations

### Government support

AHB's A2 issuer rating incorporates a very high seven notches of uplift from its ba3 standalone BCA and is driven primarily by our "government-backed" support assessment, unlike the "very high" assumptions applied to the majority of its UAE peers.

We base this view on (1) the unique shareholding where AHB is fully owned by the Abu Dhabi government through its investment vehicle ADIC, (2) AHB's role as a government owned flagship Islamic bank, and (3) the UAE's strong track record of supporting banks in times of stress.

### Counterparty Risk (CR) Assessment

The CR Assessment of A1(cr)/P-1(cr) for AHB also benefits from seven notches of systemic support, in line with our support assumptions on its issuer ratings. This reflects our view that any support provided by governmental authorities to a bank that benefits senior unsecured debt is very likely to benefit operating activities and obligations reflected by the CR Assessments as well, consistent with our belief that governments are likely to maintain such operations as a going concern to reduce contagion and preserve a bank's critical functions. As a result, the bank's CR Assessment is one notch higher than the bank's issuer rating.

### Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. The global medians quoted in the report are updated as of the end of November 2017 and are calculated using the most recent full-year financial data for rated banks. Bank-specific figures originate from the banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document Financial

Statement Adjustments in the Analysis of Financial Institutions ([https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_187419](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_187419)), published on 13 June 2017.

### About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our rating committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

### Rating methodology and scorecard factors

Exhibit 3

#### Al Hilal Bank PJSC

##### Macro Factors

**Weighted Macro Profile**                      **Strong - 100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
<b>Solvency</b>						
<b>Asset Risk</b>						
Problem Loans / Gross Loans	9.9%	ba3	← →	b3	Single name concentration	
<b>Capital</b>						
TCE / RWA	10.0%	ba2	↑ ↑	baa3	Access to capital	Expected trend
<b>Profitability</b>						
Net Income / Tangible Assets	0.1%	b3	↑	b3	Earnings quality	Expected trend
<b>Combined Solvency Score</b>		ba3		b1		
<b>Liquidity</b>						
<b>Funding Structure</b>						
Market Funds / Tangible Banking Assets	10.1%	a3	← →	baa2	Deposit quality	
<b>Liquid Resources</b>						
Liquid Banking Assets / Tangible Banking Assets	19.9%	ba1	← →	ba1	Stock of liquid assets	
<b>Combined Liquidity Score</b>		baa2		baa3		
<b>Financial Profile</b>				ba3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
<b>Total Qualitative Adjustments</b>				0		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				ba2-b1		
Assigned BCA				ba3		
Affiliate Support notching				0		
Adjusted BCA				ba3		
<b>Instrument class</b>						
	<b>Loss Given Failure notching</b>	<b>Additional Notching</b>	<b>Preliminary Rating Assessment</b>	<b>Government Support notching</b>	<b>Local Currency Rating</b>	<b>Foreign Currency Rating</b>
Counterparty Risk Assessment	1	0	ba2 (cr)	7	A1 (cr)	--

Source: Moody's Financial Metrics

## Ratings

Exhibit 4

Category	Moody's Rating
<b>AL HILAL BANK PJSC</b>	
Outlook	Stable
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba3
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2
ST Issuer Rating	P-1
<b>AHB SUKUK COMPANY LTD.</b>	
Outlook	Stable
Senior Unsecured	A2

Source: Moody's Investors Service

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