MOODY'S
INVESTORS SERVICE

Credit Opinion: Al Hilal Bank PJSC

Global Credit Research - 22 May 2016

United Arab Emirates

Ratings

Category	Moody's Rating
Outlook	Negative
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1
ST Issuer Rating	P-1
AHB Sukuk Company Ltd.	
Outlook	Negative
Senior Unsecured	A1

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Key Indicators

Al Hilal Bank PJSC (Consolidated Financials) [1]

	[2]**12-15**	[2]**12-14**	[2]**12-13**	[2]**12-12**	[2]**12-11**	**Avg.**
Total Assets (AED million)	**43,091.3**	**41,291.0**	**38,705.3**	**32,121.9**	**28,251.1**	[3]**11.1**
Total Assets (USD million)	**11,731.9**	**11,241.8**	**10,537.8**	**8,745.3**	**7,691.4**	[3]**11.1**
Tangible Common Equity (AED million)	**3,626.4**	**3,745.3**	**3,905.6**	**3,474.1**	**2,673.0**	[3]**7.9**
Tangible Common Equity (USD million)	**987.3**	**1,019.7**	**1,063.3**	**945.8**	**727.7**	[3]**7.9**
Problem Loans / Gross Loans (%)	**8.9**	**5.4**	**3.7**	**5.0**	**5.2**	[4]**5.6**
Tangible Common Equity / Risk Weighted Assets (%)	**10.0**	**10.9**	**12.9**	**13.7**	**12.5**	[5]**12.0**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**50.8**	**32.7**	**21.6**	**28.2**	**32.6**	[4]**33.2**
Net Interest Margin (%)	**3.1**	**3.4**	**3.7**	**3.8**	**3.7**	[4]**3.5**
PPI / Average RWA (%)	**1.7**	**2.4**	**2.4**	**2.2**	**2.4**	[5]**2.2**
Net Income / Tangible Assets (%)	**0.0**	**0.1**	**1.1**	**0.8**	**0.6**	[4]**0.5**
Cost / Income Ratio (%)	**57.8**	**50.0**	**54.1**	**58.3**	**58.0**	[4]**55.7**
Market Funds / Tangible Banking Assets (%)	**10.2**	**9.0**	**13.0**	**7.8**	**17.5**	[4]**11.5**
Liquid Banking Assets / Tangible Banking Assets (%)	**14.7**	**13.2**	**15.7**	**13.5**	**13.7**	[4]**14.1**
Gross loans / Due to customers (%)	**100.9**	**103.6**	**99.3**	**94.7**	**101.0**	[4]**99.9**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

We assign A1 long term issuer ratings to Al Hilal Bank PJSC (AHB), a small but growing bank with 1.8% market share. These ratings are underpinned by the bank's overall standalone credit strength (reflected in a standalone baseline credit assessment or BCA of ba2) and our view of the very high likelihood of government support if needed. Furthermore, we have assigned AHB Counterparty Risk Assessments (CR Assessments) of A1(cr)/P-1(cr).

AHB's BCA reflects its (1) deteriorating asset quality coupled with concentration risks (2) modest capitalization coupled with relatively weak profitability and (3) low liquidity buffers combined with concentrated funding profile.

Rating Drivers

- A `Strong-` macro profile supports the bank's ratings

- Deteriorating asset quality coupled with concentration risks

- Modest capitalization coupled with relatively weak profitability

- Low liquidity buffers combined with concentrated funding profile

- Very high likelihood of support from UAE authorities in case of need

Rating Outlook

Long terms ratings assigned to AHB carry a negative outlook

What Could Change the Rating - Up

Although we do not expect upward pressure on AHB's ratings over the near term as indicated by the negative outlook, the ratings can be stabilized with a combination of the following: (1) a significant improvement in liquidity, capitalisation and asset quality and (2) a strengthening and diversification of its earnings. AHB's ratings can also be stablised should the government's rating outlook stabilise.

What Could Change the Rating - Down

Downwards pressure on AHB's standalone ratings could develop in the event of (1) the deterioration in the operating environment that may result in lowering the macro profile of UAE; (2) continued declines in asset quality; and/or (3) a deterioration in profitability, capitalization and liquidity metrics.

DETAILED RATING CONSIDERATIONS

AHB'S RATINGS ARE SUPPORTED BY A STRONG- MACRO PROFILE

The bank's `Strong-` macro profile score is underpinned by the country's very high economic strength, which stems from high levels of economic wealth and the country's sizable hydrocarbon reserves. Additionally, the UAE's sound policy framework and the strong growth in the non-oil hydrocarbon sector continues to drive economic diversification that supports the operating environment, particularly in the current low oil price environment.

Our view of UAE's operating environment also incorporates (1) the effects of continued oil price declines which is subduing economic confidence and moderating the country's growth prospects, (2) public spending plans, particularly in Abu Dhabi that continue to drive both public and private-sector economic growth and partially cushion the impact of low oil prices, and (3) the resilience of Dubai's diversified non-oil private sector. The substantive sovereign wealth fund buffers and relatively low debt levels allow for the continuation of spending over the outlook horizon, although the prolonged fall in oil prices has already resulted in prudent budget rationalization, such as the recent withdrawal of fuel subsidies, discussions on regional VAT and corporate tax policies and likely deferral of non-core projects. The country remains moderately susceptible to event risk, owing primarily to geopolitical tensions in the region and Dubai's open economy coupled with its overall leverage appetite. The rating of the UAE government is Aa2 with a negative outlook.

DETERIORATING ASSET QUALITY COUPLED WITH CONCENTRATION RISKS

AHB exhibits severely weakened asset quality metrics with the adjusted non-performing financings ratio (`NPF' - analogous to NPL - as defined by Moody's includes all loans over 90 days past due) increasing significantly to around 8.9% as of December 2015 (5.4% as of December 2014) from 3.7% as of December 2013. This level is captured in our current scorecard and compares unfavourably with the UAE average of around 5% and we note that the weakening trend (since 2014) is opposite to the prevailing improvements observed in most of the UAE system. Such metrics also remain particularly weak when compared with the 3.5% median for global banks with a ba2 BCA. This deterioration in asset quality metrics has stemmed primarily from (1) the classification of a single concentrated and idiosyncratic exposure in 2014, and (2) a sizeable increase in NPF formation during H2 2015 (+77% over the year), mainly in the bank's corporate financing portfolio.

Following the weak asset quality performance in 2014, there has been significant management changes with the new management (key roles of the CEO, CFO and CRO) introduced in the last 12 months and new lending has slowed significantly with new underwriting standards being put in place. Additionally, AHB's coverage ratio declined to 72% as of December 2015 from 89% as of December 2014, which is lower than both local average and median for global ba2 peers of around 95% and 93% respectively.

AHB exhibits high credit concentrations which further constrain its Asset Risk Score. We also note that these concentrations are common to most banks in the UAE due to the large government presence across many sectors of the economy. Furthermore, the rapid growth (CAGR of 22% between 2009 and 2013 compared to the UAE average of 7%) period leaves a relatively unseasoned loan book and is a key source of potential pressure. While this growth has been positive for the banks' retail brand it has clearly challenged the risk management culture, controls and operational infrastructure of the bank. We expect new management introduced in 2015 will continue to drive improvements, although given the more challenging environment we still expect further weakness in asset quality metrics over the next 12 months.

MODEST CAPITALISATION COUPLED WITH RELATIVELY WEAK PROFITABILITY

Despite strong core earnings (net margins in the 3.0-3.5% range compared to UAE average of 2.7%), AHB's profitability metrics are low when compared to domestic peers due to the high expansion and operating costs now compounded by the increased cost of risk. AHB's limited operational history means the bank has made significant investments in (1) establishing a branch network and (2) advanced information technology which continues to drive a relatively high cost to income ratio of around 58% for the year 2015 compared to the UAE average of around 37%.

The bank's recent profitability has been severely impacted by an increase in provisioning costs which was driven by the aforementioned increase in NPFs and has consumed over 80% of pre-provision income on average since 2014. As a result, the bank's profitability ratios declined, with net income (NI) to tangible assets at 0.01% as of December 2015 down from 1.1% as of December 2013, compared to the UAE average of 1.7%. Going forward, we expect the bank's profitability and efficiency metrics will remain weak owing to pressured impairment costs and more generally increase in cost of funding for the UAE banks.

Despite full profit retention and multiple capital injections from its owner, the Abu Dhabi Investment Council (ADIC) since its inception (around AED2.1 billion), we expect that slowing asset growth will stabilise the bank's weak capital position. AHB's TCE ratio declined to 10.0% as of December 2015 from 13.7% as of December 2012. At these levels, such capitalization metrics compares unfavourably to both the UAE system average of around 14.1% and the 11.5% median of global ba2 peers. It should be noted however that the bank has an unpaid capital from its shareholder sufficient to drive a 2.5% increase in TCE ratio which moderates this weakness. The bank has also raised additional capital through hybrid Additional Tier 1 Sukuk issuance representing around 4% of total assets and are not included in Moody's capital calculation. As such, the bank's regulatory Tier 1 ratio stood at 15.4% as of December 2015. Going forward, in the absence of further capital injections, we expect the bank's capitalization metrics to decline from its current levels due to continued asset quality pressures and relatively weak internal capital generating ability.

LOW LIQUIDITY BUFFERS COMBINED WITH CONCENTRATED FUNDING PROFILE

The bank's overall liquidity position remains relatively weak. The bank's liquidity position as measured by liquid banking assets to tangible banking assets stands at around 17% of total assets as of December 2015. On a standalone basis, such metrics compare unfavourably to both UAE average and global ba2 median of around 30%. As financing growth slowed down, the bank's net financing-to-deposit ratio (analogous to net loans to deposits) eased to 94% as of December 2015, from 99% as of December 2014, which is in line with the UAE average of around 94%.

Similar to UAE peers, AHB remains primarily funded through short term but stable customer deposits. Such deposits fund more than 75% of total assets as of December 2015 (stable at these levels since 2012) compared to UAE average of around 62%. However, in line with GCC peers we also observe high concentrations in AHB's deposits, with the government and public sector entities contributing to a significant and potentially volatile portion of total deposits (57% of total deposits as of December 2015). In October 2013, the bank had set up a US$2.5 billion Sukuk program under which it issued a US$ 500 million (around 4% of total assets) Sukuk to improve its asset liability mismatch. Going forward, we expect the bank's liquidity and funding profile to continue to face pressure, particularly in the tightening liquidity environment of the UAE and a context of prolonged low oil prices.

Notching Considerations

GOVERNMENT SUPPORT

AHB's A1 issuer rating incorporates a very high seven notches of uplift from its relatively low ba2 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 100% ownership of Abu Dhabi government through its investment vehicle ADIC; (2) AHB's role as a flagship Islamic bank and (3) the UAE's strong track record of supporting banks in times of stress.

CR ASSESSMENT

The CR Assessment of A1(cr)/P-1(cr) for AHB, also benefits from government support reflecting Moody's view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessments as well, consistent with Moody's belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions. As such, AHB's CR Assessment does not benefit from an additional notch and is positioned at the same level as the deposit ratings, reflecting Moody's view that the probability of default on its operating liabilities would not be materially different from that of deposits after government support. As a result, AHB's CR Assessment is at the same level of the bank's deposit rating.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

The UAE averages quoted in the report are published in the UAE banking system outlook and based on available audited system metrics. Unless noted otherwise, data related to system-wide trends is sourced from the central bank. Bank-specific figures originate from the bank's reports and Moody's Banking Financial Metrics.

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 Factors

Al Hilal Bank PJSC

Macro Factors						
Weighted Macro Profile	**Strong -**	**100%**				
Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**

		Score				
Solvency						
Asset Risk						
Problem Loans / Gross Loans	8.9%	ba3	↓	b2	Single name concentration	
Capital						
TCE / RWA	10.0%	ba2	↓	ba1	Access to capital	Expected trend
Profitability						
Net Income / Tangible Assets	0.0%	b3	↑	b2	Earnings quality	Expected trend
Combined Solvency Score		ba3		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	10.2%	a3	←→	baa2	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	14.7%	ba2	←→	ba2	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		

Financial Profile	**ba2**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	**0**

Sovereign or Affiliate constraint:	Aa2
Scorecard Calculated BCA range	**ba1-ba3**
Assigned BCA	**ba2**
Affiliate Support notching	0
Adjusted BCA	**ba2**

Instrument class	Assigned LGF Notching	Additional Notching	Preliminary Rating Assessment	Government Support	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	1	0	ba1 (cr)	6	A1 (cr)	--

- Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.