

Global Credit Research - 22 Sep 2015

United Arab Emirates

## Ratings

Category	Moody's Rating
Outlook	Stable
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Issuer Rating	A1
ST Issuer Rating	P-1
<b>AHB Sukuk Company Ltd.</b>	
Outlook	Stable
Senior Unsecured	A1

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## Key Indicators

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

	[2]6-15	[2]12-14	[2]12-13	[2]12-12	[2]12-11	Avg.
Total Assets (AED million)	43,067.1	41,407.9	38,705.3	32,121.9	28,251.1	[3]11.1
Total Assets (USD million)	11,725.5	11,273.6	10,537.8	8,745.3	7,691.4	[3]11.1
Tangible Common Equity (AED million)	4,084.8	3,885.0	3,905.6	3,474.1	2,673.0	[3]11.2
Tangible Common Equity (USD million)	1,112.1	1,057.7	1,063.3	945.8	727.7	[3]11.2
Problem Loans / Gross Loans (%)	-	5.5	3.7	5.0	5.2	[4]4.8
Tangible Common Equity / Risk Weighted Assets (%)	-	11.2	12.9	13.7	12.5	[5]12.6
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	-	32.4	21.6	28.2	32.6	[4]28.7
Net Interest Margin (%)	3.2	3.5	3.7	3.8	3.7	[4]3.6
PPI / Average RWA (%)	-	2.4	2.4	2.2	2.4	[5]2.4
Net Income / Tangible Assets (%)	0.9	0.1	1.1	0.8	0.6	[4]0.7
Cost / Income Ratio (%)	61.8	50.5	54.1	58.3	58.0	[4]56.5
Market Funds / Tangible Banking Assets (%)	10.1	7.9	13.0	7.8	17.5	[4]11.2
Liquid Banking Assets / Tangible Banking Assets (%)	10.0	13.2	15.7	13.5	13.7	[4]13.2
Gross Loans / Total Deposits (%)	102.1	99.8	89.3	86.1	80.7	[4]91.6

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 issuer ratings to Al Hilal Bank PJSC (AHB), a small but growing bank with 1.9% 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 by our view of the very high likelihood of systemic 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) relatively weak asset quality coupled with rapid growth and concentration risks (2) sound capitalization despite relatively weak profitability and (3) satisfactory liquidity metrics moderated by a concentrated funding profile

### **Rating Drivers**

- A Strong- macro profile supports the bank's ratings
- Relatively weak asset quality coupled with rapid growth and concentration risks
- Sound capitalization despite relatively weak profitability
- Satisfactory liquidity metrics moderated by a concentrated funding profile
- Very high likelihood of support from UAE authorities in case of need

### **Rating Outlook**

Long term ratings assigned to AHB carry a stable outlook

### **What Could Change the Rating - Up**

Upward pressure on AHB's ratings could develop from a combination of the following: (1) a strengthening and diversification of its earnings and (2) a significant improvement in liquidity, capitalisation and asset quality.

### **What Could Change the Rating - Down**

Downwards pressure on AHB's ratings could develop from: (1) decline in profitability; and/or (2) a deterioration in capitalization and liquidity metrics; and/or (3) a reduction in the likelihood of systemic support.

## **DETAILED RATING CONSIDERATIONS**

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

UAE banks are supported 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 that is driving economic diversification which 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 ongoing recovery in Dubai's diversified non-oil private sector. The substantive sovereign wealth fund buffers 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 UAE's Aa2 sovereign rating currently has a stable outlook.

### **RELATIVELY WEAK ASSET QUALITY COUPLED WITH RAPID GROWTH AND CONCENTRATION RISKS**

AHB exhibits relatively weak asset quality metrics with a reported non-performing financings (NPF analogous to NPL ratio) increased to around 5.5% as of December 2014 (stable at these levels as of June 2015) from 3.7% as of December 2013, which although is broadly in line the UAE average of around 6% contrasts with the prevailing trends in the UAE system (we consider all financing exposures over 90 days past due as impaired) and compares

unfavourably with the 3.4% median for global banks with a ba2 BCA. AHB's NPF ratio increased recently from 3.7% as of December 2013 as a result of a single concentrated and idiosyncratic exposure.

New underwriting standards are now in place and as such we expect NPFs to stabilise at around 6% level for 2015. Our expectation is supported by the AHB's: (1) short track record - the bank's six year operational history that means it avoided much of the pre-crisis legacy exposures that have significantly impaired the asset quality of many of its domestic peers and (2) limited exposure to the real estate sector (around 6% of gross financings as of end June 2015). Likewise, AHB's coverage ratio declined 78% as of June 2015 is broadly comparable with the local average but lower than the median for global ba2 peers at around 90%.

Although lower than Abu Dhabi based peers, AHB exhibits high credit concentrations and related-party exposures. The risks of some of these high concentrations are moderated by the relatively high credit quality of some of these exposures. Although AHB's related party exposure decreased to AED 1.8 billion or 47% of tangible common equity (TCE) as of December 2014 (stable at these levels as of June 2015) from AED 2.5bn or 63% of TCE as of December 2013, it still remains high compared to international peers. We note that these concentrations are common to most banks in the UAE due to the large government presence across many sectors of the economy.

AHB has a small but rapidly growing Islamic business in the UAE and has grown its market share to 1.9% of system assets as of June 2015 from 1.1% as of December 2009 with a CAGR of 19% between 2009 and 2014 compared to the UAE average of 8%. The bank's growth is supported by its modern branch network (24 branches as of June 2015) and innovative delivery channels (financial 'malls' and money 'stations'). While we recognize that this rapid growth is broadly positive for the franchise, it poses additional challenges in managing growth (risk management and operational infrastructure) when coupled with the unseasoned nature of the financing book. The bank continues to be a pioneer in introducing technology enabled banking products and services which support the bank's growing retail franchise. As a result, the bank has built a significant and granular retail financing book (around 41% of total financings or 32% of total assets) and retail depositor base of around 25% of total customer deposits as of June 2015, primarily amongst UAE nationals. Overall, the retail segment accounted for around 37% of the bank's operating income for the year 2014 (42% for the first six months of 2015).

#### SOUND CAPITALISATION DESPITE RELATIVELY WEAK PROFITABILITY

Despite strong core earnings (net margins of around 3.5% compared to UAE average of 2.8%), AHB's profitability metrics are low when compared to domestic peers due to high expansion and operating costs. AHB's limited operational history means the bank has to make 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 50% for the year 2014 (58% as of June 2015) compared to the UAE average of around 36%. Additionally, the bank's recent profitability has been impacted as a result of increase in provisioning cost which was driven by the aforementioned increase in NPFs. As a result, the bank's profitability ratios declined, with net income (NI) to tangible assets at 0.1% as of December 2014 (1.2% as of June 2015) down from 1.1% as of December 2013, compared to UAE averages of 1.9%. Going forward, we expect the bank's profitability and efficiency metrics to improve as the bank will continue to generate more income from its branch network.

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 rapid asset growth will moderate the bank's capital position. AHB's TCE ratio declined to 11.2% as of December 2014 (stable at these levels as of June 2015) from 13.7% as of December 2012. At these levels, such capitalisation metrics compares unfavourably to both the UAE system average of around 14.4% and the 12.2% median of global ba2 peers. It should be noted that in addition to its supportive shareholder, the bank has raised additional capital through hybrid additional Tier1 sukuk issuance representing around 4% of total assets and are not included in Moody's capital calculation. Going forward, in the absence of further external capital, we expect the bank's capitalization metrics to decline from its current levels due to continued asset growth and relatively weak internal capital generating ability.

#### SATISFACTORY LIQUIDITY METRICS MODERATED BY CONCENTRATED FUNDING PROFILE

The bank's overall liquidity position remains relatively weak due to rapid asset growth. The bank's liquidity position as measured by liquid banking assets to tangible banking assets stands at around 13% of total assets as of December 2014, down from 16% as of December 2013. On a standalone basis, such metrics compare unfavourably to both UAE average and global ba2 median of around 30%. The bank's net financing-to-deposit ratio (analogous to net loans to deposits) increased to 99% as of December 2014 (104% as of June 2015), up from 92% as of December 2012, which is higher than the UAE average of around 91%.

Similar to UAE peers, AHB remains primarily funded through short term but stable customer deposits. Such

deposits fund more than 74% of total assets as of December 2014 (stable at these levels as of June 2015) compared to UAE average of around 68%. 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 portion of total deposits. 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 be pressured as the bank continues to grow its asset base.

## Notching Considerations

### GOVERNMENT SUPPORT

AHB's A1 issuer rating incorporates a very high seven notches of uplift from its ba2 standalone BCA. This reflects our assessment of a very high likelihood of systemic (government) support in case of need. 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

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## Rating Factors

### Al Hilal Bank PJSC

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Strong -</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>
<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	5.5%	ba1	← →	b1	Single name concentration	Loan growth
<b>Capital</b>						
<i>TCE / RWA</i>	11.2%	ba1	← →	ba1	Risk-weighted capitalisation	

<b>Profitability</b> <i>Net Income / Tangible Assets</i>	0.1%	b3	← →	ba2	Earnings quality	
<b>Combined Solvency Score</b>		ba2		ba2		
<b>Liquidity</b> <b>Funding Structure</b> <i>Market Funds / Tangible Banking Assets</i>	7.9%	a3	← →	baa2	Deposit quality	
<b>Liquid Resources</b> <i>Liquid Banking Assets / Tangible Banking Assets</i>	13.2%	ba2	↓	ba3	Expected trend	
<b>Combined Liquidity Score</b>		baa2		ba1		

<b>Financial Profile</b>
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<b>ba2</b>
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<b>Qualitative Adjustments</b>
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Business Diversification
Opacity and Complexity
Corporate Behavior
<b>Total Qualitative Adjustments</b>

<b>Adjustment</b>
0
0
0
<b>0</b>

Sovereign or Affiliate constraint
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Aa2
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Scorecard Calculated BCA range
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ba1 - ba3
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<b>Assigned BCA</b>
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<b>ba2</b>
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Affiliate Support notching
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0
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<b>Adjusted BCA</b>
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<b>ba2</b>
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
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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 <http://www.moodys.com> for the most updated credit rating action information and rating history.



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