MOODY'S
INVESTORS SERVICE

Credit Opinion: Al Hilal Bank PJSC

Global Credit Research - 01 Oct 2014

United Arab Emirates

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Financial Strength	D
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Issuer Rating	A1
ST Issuer Rating	P-1
AHB Sukuk Company Ltd.	
Outlook	Stable
Senior Unsecured	A1

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Key Indicators

Al Hilal Bank PJSC (Consolidated Financials)[1]

	[2]**6-14**	[2]**12-13**	[2]**12-12**	[2]**12-11**	[2]**12-10**	**Avg.**
Total Assets (AED million)	**41,188.7**	**38,705.3**	**32,121.9**	**28,251.1**	**25,792.6**	[3]**12.4**
Total Assets (USD million)	**11,214.5**	**10,537.8**	**8,745.3**	**7,691.4**	**7,022.0**	[3]**12.4**
Tangible Common Equity (AED million)	**4,105.1**	**3,905.6**	**3,474.1**	**2,673.0**	**1,879.3**	[3]**21.6**
Tangible Common Equity (USD million)	**1,117.7**	**1,063.3**	**945.8**	**727.7**	**511.7**	[3]**21.6**
Net Interest Margin (%)	**3.6**	**3.7**	**3.8**	**3.7**	**3.5**	[4]**3.7**
PPI / Average RWA (%)	**--**	**2.4**	**2.2**	**2.4**	**1.9**	[5]**2.2**
Net Income / Average RWA (%)	**--**	**1.6**	**1.1**	**0.9**	**0.8**	[5]**1.1**
(Market Funds - Liquid Assets) / Total Assets (%)	**-2.7**	**-2.7**	**-5.7**	**3.8**	**-6.4**	[4]**-2.7**
Core Deposits / Average Gross Loans (%)	**99.9**	**110.5**	**114.9**	**111.0**	**140.2**	[4]**115.3**
Tier 1 Ratio (%)	**--**	**13.2**	**13.9**	**12.6**	**11.2**	[5]**12.7**
Tangible Common Equity / RWA (%)	**--**	**12.9**	**13.7**	**12.5**	**11.2**	[5]**12.6**
Cost / Income Ratio (%)	**53.8**	**54.1**	**58.3**	**58.0**	**63.0**	[4]**57.4**
Problem Loans / Gross Loans (%)	**--**	**3.7**	**5.0**	**5.2**	**5.2**	[4]**4.8**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**--**	**21.6**	**28.2**	**32.8**	**38.4**	[4]**30.3**

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

Moody's assigns A1 issuer ratings to Al Hilal Bank PJSC (AHB). 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.

AHB's BCA reflects its (1) small and young but rapidly growing Islamic franchise in the United Arab Emirates (UAE; Aa2 stable), (2) solid asset quality and coverage metrics and (3) advanced management information systems that support a solid control environment. These strengths are moderated by AHB's (1) limited operational history, (2) relatively low profitability and liquidity metrics.

Rating Drivers

- Small and young but rapidly growing Islamic franchise

- Advanced management information systems support solid control environment

- Solid asset quality and coverage metrics

- Capitalisation remains solid despite relatively low profitability and rapid asset growth capitalisation

- Improving liquidity metrics but highly concentrated funding profile

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

Rating Outlook

All 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 franchise and (2) a significant improvement in financial fundamentals, i.e. liquidity, capitalisation and asset quality.

What Could Change the Rating - Down

Downwards pressure on AHB's ratings could develop from: (1) a substantial weakening of its franchise in the local market; and/or (2) a deterioration in its asset quality and capitalisation metrics; and/or (3) a reduction in the likelihood of systemic support.

DETAILED RATING CONSIDERATIONS

SMALL AND YOUNG BUT RAPIDLY GROWING ISLAMIC FRANCHISE

AHB has a small but rapidly growing Islamic franchise in the UAE. Despite limited operational history (the bank started operations in June 2008) AHB ranks 11th in the UAE with AED42 billion of total assets as of June 2014 (around US$11 billion). The bank continues to grow its market share which now stands at 1.9% of system assets as of December 2013 (stable at these levels as of June 2014) from 1.1% as of December 2009, a CAGR of 22% between 2009 and 2013 compared to the UAE average of 7%.

AHB's franchise growth has been supported by its strong ties with Abu Dhabi government (its sole shareholder through ADIC). Around 8% of the bank's asset book and 43% of deposits as of June 2014 are directly sourced from the Abu Dhabi government or its related entities. Additionally, AHB's international expansion into Kazakhstan (around 2% of total assets) was driven by the government's strategic goal to strengthen bilateral ties.

The bank's franchise growth is also supported by its modern branch network (22 branches as of December 2013) and innovative delivery channels (financial `malls' and money `stations'). 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 retail financing book (around 39% of total financings or 28% of total assets) and retail depositor base of around 24% of total customer deposits as of June 2014, primarily amongst UAE nationals. Overall, the retail segment accounted for around 42% of the bank's operating income for the year 2013 (40% for the six months ending June 2014). Going forward, we expect the bank to maintain its retail focus and we also expect the growth to remain above the system average despite some signs of slowing.

ADVANCED MANAGEMENT INFORMATION SYSTEMS SUPPORT SOLID CONTROL ENVIRONMENT

We consider AHB's overall risk positioning to be relatively strong. Our assessment is based on AHB's extensive use of information technology which supports the bank's risk management infrastructure and overall control environment. The accessibility, timeliness and granularity of balance sheet information available is of a very high quality and supports the operational management of a high growth institution. While its peers in the UAE are also investing heavily in advanced information systems, AHB remains at the forefront with respect to its technological capabilities. However, given the short track record (around six years of operations) the overall risk management capability remains untested over a full economic cycle.

The bank exhibits high credit concentrations and related-party exposures. The risks of such high concentrations are moderated by the relatively high credit quality of some of these exposures. Although AHB's related party exposure at AED2.5 billion or 62% of Tier 1 capital as of December 2013 (AED2.4 billion or 39% of Tier 1 capital as of June 2014) remains high compared to international peers, it is lower than Abu Dhabi based peers. We note that these concentrations are common to most banks in the UAE due to the large government presence across all sectors of the economy.

SOLID ASSET QUALITY AND COVERAGE METRICS

AHB exhibits solid asset quality metrics with a reported non-performing financings (NPF analogous to NPL ratio) at around 3.7% as of December 2013 (improved to 2.6% as of June 2014) versus the UAE average of around 9% (we consider all financing exposures over 90 days past due as impaired). The bank's current NPF levels also compare favourably with the 4.3% median for global banks with a ba2 BCA. This solid performance is largely due to the bank's six year operational history that means it has avoided much of the pre-crisis legacy exposures that have significantly impaired the asset quality of many of its domestic peers. Additionally, limited exposure to the real estate sector (around 7% of gross financings as of end June 2014) and strong focus on the retail segment also supports its asset quality.

AHB's adjusted coverage ratio of 86% as of December 2013 (123% as of June 2014) compares favourably to the local average of around 59% and the median of 70% for global banks' with a BCA of ba2.

CAPITALISATION REMAINS SOLID DESPITE RELATIVELY LOW PROFITABILITY AND RAPID ASSET GROWTH

Despite strong core earnings (net margins of around 3.8% compared to UAE average of 2.5%), AHB's profitability metrics are low when compared to domestic peers due to high operating costs. AHB's significant investment in a new branch network and advanced information technology continues to drive a relatively high cost to income ratio which stands at 54% for the year 2013 (stable at these levels as of June 2014) compared to the UAE average of around 32%. As a result, the bank's profitability ratios are relatively low, with pre-provision income (PPI) to risk weighted assets (RWAs) and net income (NI) to RWAs at around 2.2% and 1.5% for the year 2013 compared (2.1% and 1.5% as of June 2014) to UAE averages of 3.3% and 2.2% respectively. Going forward, we expect the bank's efficiencies metrics to eventually improve to around 45% by 2015-16, as in the near term the bank continues to invest in its branch network and infrastructure.

Despite profit retention, multiple capital injections from its sole shareholder, ADIC, since its inception (around AED2.1 billion) and recent hybrid capital issuance, rapid asset growth will continue to moderate the bank's capitalisation position. AHB's Tier 1 ratio (under Basel II) declined to 13.2% as of December 2013 from 13.9% as of December 2012. However, this ratio has improved to 18% after the bank successfully raised AED 1.8 billion (US$500 million) of additional Tier 1 capital by means of issuance of a hybrid sukuk in June 2014 (Moody's ascribes 75% equity credit to the issuance). At these levels, it compares favourably with the 12% median of global ba2 peers and the UAE average of around 16.6%. Going forward, we expect the bank's capitalisation metrics to decline from its current high levels yet remain solid, due to asset growth.

IMPROVING LIQUIDITY METRICS BUT HIGHLY CONCENTRATED FUNDING PROFILE

While the recent hybrid Tier1 sukuk issuance has improved the bank's overall liquidity position, it still remains relatively weak due to rapid asset growth. The bank's liquidity position as measured by liquid assets to total assets stands at around 17% of total assets as of June 2014, up from 15% as of December 2013. On a standalone basis, such metrics compare unfavourably to both UAE average and global ba2 median of around 29%. The bank's net financing-to-deposit ratio (analogous to net loans to deposits) of 96% (100% as of June 2014) is in line with the

UAE average.

Similar to UAE peers, AHB remains primarily funded through short term but stable customer deposits. Such deposits fund more than 73% of total assets (70% as of June 2014) compared to UAE average of around 63%. However, we also observe high concentrations in AHB's deposits, with Abu Dhabi government and its related entities contributing around 47% of bank's total deposits as of December 2013 (41% as of June 2014). In October 2013, the bank had set up a US$ 2.5 billion sukuk program under which it issued a US$ 500 million (around 5% of total assets as of December 2013) sukuk to improve its asset liability maturity mismatch. Going forward, we expect the bank's liquidity and funding profile to improve as the bank continues to grow and diversify its funding base.

Global Local Currency Deposit Rating (Joint Default Analysis)

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.

NOTE ON DATA

Unless noted otherwise, data in this report is sourced from the bank's published financial statements and our Banking Financial Metrics. All figures are based on our own chart of account and are adjusted for analytical purposes.

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the systemic support indicator.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						D	
Factor: Franchise Value						D	
Market share and sustainability					x		
Geographical diversification				x			
Earnings stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						D	
Corporate Governance [2]				x			
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks				x			
Controls and Risk Management			x				
- Risk Management			x				
- Controls		x					
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information				x			
Credit Risk Concentration					x		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration		x					
Liquidity Management				x			
Market Risk Appetite			x				
Factor: Operating Environment						D	
Economic Stability					x		

Integrity and Corruption			x				
Legal System				x			
Financial Factors (30%)						**C-**	
Factor: Profitability						**D+**	
PPI % Average RWA (Basel II)			2.18%				
Net Income % Average RWA (Basel II)				0.95%			
Factor: Liquidity						**C**	
(Market Funds - Liquid Assets) % Total Assets		-2.76%					
Liquidity Management				x			
Factor: Capital Adequacy						**A**	
Tier 1 Ratio (%) (Basel II)	12.57%						
Tangible Common Equity % RWA (Basel II)	12.44%						
Factor: Efficiency						**C**	
Cost / Income Ratio			59.78%				
Factor: Asset Quality						**D**	
Problem Loans % Gross Loans				5.12%			
Problem Loans % (Equity + LLR)				33.14%			
Lowest Combined Financial Factor Score (9%)						**D**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**D+**	
Aggregate BCA Score						**baa3/ba1**	
Assigned BFSR						**D**	
Assigned BCA						**ba2**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.

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