

Credit Opinion: Emirates NBD PJSC

Global Credit Research - 27 Jan 2012

Dubai, United Arab Emirates

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	A3/P-2
Bank Financial Strength	D+
Baseline Credit Assessment	(Ba1)
Adjusted Baseline Credit Assessment	(Ba1)
Senior Unsecured	A3
Subordinate MTN	(P)Baa1
Commercial Paper	P-2
Other Short Term	(P)P-2
Emirates NBD Global Funding Limited	
Outlook	Negative
Bkd Sr Unsec MTN	(P)A3
Bkd Subordinate MTN	(P)Baa1
EIB Sukuk Company Ltd.	
Outlook	Negative
Bkd Senior Unsecured	A3

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Key Indicators

Emirates NBD PJSC (Consolidated Financials)[1]

	[2]9-11	[3]12-10	[2]12-09	[2]12-08	[2]12-07	Avg.
Total Assets (AED million)	271,866.1	286,215.9	281,576.5	282,285.1	253,815.6	[4]1.7
Total Assets (USD million)	74,017.5	77,922.2	76,658.0	76,853.0	69,110.6	[4]1.7
Tangible Common Equity (AED million)	28,720.1	27,625.0	26,559.8	20,155.2	18,114.4	[4]12.2
Tangible Common Equity (USD million)	7,819.2	7,520.9	7,230.8	5,487.3	4,932.3	[4]12.2
Net Interest Margin (%)	2.6	2.5	2.7	2.3	1.7	[5]2.3
PPI / Avg RWA (%)	--	3.0	3.4	2.5	2.5	[6]2.8

Net Income / Avg RWA (%)	--	1.1	1.6	1.8	2.3 [6]1.9
(Market Funds - Liquid Assets) / Total Assets (%)	-1.9	-7.2	5.9	15.1	6.9 [5]3.8
Core Deposits / Average Gross Loans (%)	89.1	93.7	82.4	82.9	119.2[5]93.5
Tier 1 Ratio (%)	--	12.8	13.2	9.4	10.5[6]11.0
Tangible Common Equity / RWA (%)	--	12.7	13.2	9.3	10.5[6]11.0
Cost / Income Ratio (%)	34.3	32.4	34.2	41.5	39.2[5]36.3
Problem Loans / Gross Loans (%)	12.9	10.1	3.0	1.8	1.2 [5]5.8
Problem Loans / (Equity + Loan Loss Reserves) (%)	57.1	49.6	17.5	13.0	7.6[5]29.0

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel I; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel I & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of D+ to Emirates NBD PJSC ("ENBD"), which translates into a baseline credit assessment (BCA) of Ba1. The rating reflects ENBD's dominant franchise in the United Arab Emirates (UAE) and Dubai in particular. It also takes into account its strong ties with the government of Dubai, a relationship that enables ENBD to secure a large amount of government-related business, while at the same time exposing it to significant credit and funding counterparty concentration.

ENBD's long-term global local currency (GLC) deposit rating is set at A3, a four-notch uplift from the bank's BCA. This is based on Moody's assessment of a very high probability of systemic support, due to the bank's systemic importance as the largest bank in the UAE and its indirect ownership by the Dubai government.

Emirates NBD's ratings carry a negative outlook.

Rating Drivers

- Largest franchise in the UAE and systemic importance underpins the deposit ratings
- Satisfactory capitalisation and liquidity metrics
- High levels of credit and funding concentration, and significant related-party risks
- Asset quality challenges still persist in a context of increased refinancing risks for large Dubai corporates

Rating Outlook

Emirates NBD's ratings carry a negative outlook. This reflects the risks and concerns surrounding the increasing concentrations, the related party lending and the restructuring of the exposures to Government-related issuers (GRIs) in ENBD's loan book. While ENBD's liquidity, capital and profitability levels remain satisfactory, the provisioning costs associated with these large GRI impairments are likely to increasingly constrain the bank's bottom line profits.

What Could Change the Rating - Up

Given the negative outlook, an upgrade in the bank's BFSR seems unlikely. However, in the medium term a BFSR upgrade could be triggered by a combination of any of the following: (i) significant improvement in asset quality and profitability; (ii) a reduction in balance sheet concentrations; and/or (iii) a material reduction in related-party lending. The deposit ratings could be upgraded if the BFSR were to be upgraded.

What Could Change the Rating - Down

The bank's BFSR could be downgraded in the event of any of the following: (i) greater-than-currently anticipated asset quality deterioration, exerting significant pressure on profitability and capitalisation levels; (ii) potential liquidity stress associated with large and unexpected outflows of deposits; or (iii) significant erosion of its domestic market position. The deposit ratings could be downgraded in the event of a BFSR downgrade.

Recent Results and Company Events

On 11 October 2011, the government of Dubai announced that ENBD would take over Dubai Bank, a small troubled financial institution operating in the UAE. ENBD announced on the occasion that the merger would be completed by the end of 2011. Dubai Bank total assets were AED 17.4 billion as of December 2009 (date of the latest financials published).

In the nine months ending September 2011, ENBD reported a 20% increase in net profit to AED 2.33 billion compared to AED 1.94 billion in the same period in 2010. However, this positive development is partly due to one-off gains recorded in Q1 2010 after the disposal of a 49% stake in Network International, one of its subsidiary. This transaction triggered the recognition of AED 957 million gains on the sale and AED 857 million fair value gains on the retained 51% stake in the company. ENBD used these one-off gains to boost impairment charges on financial assets and on associated companies. As a result, pre tax operating profits dropped by 72% to AED 538 million against AED 1.95 billion in the first three quarters of 2010.

Net interest income increased by 3% to AED 5.33 billion while net fees and commission income and other operating income decreased slightly by respectively 9% and 6%. Overall, operating income was flat at AED 7.43 billion against 7.46 billion in the first nine months of 2011.

The sharp drop in operating profits is explained by material increases in impairment charges and costs: (i) administrative expenses increased by 8% to AED 2.48 billion; (ii) impairment of financial assets increased by 31% or AED 1 billion to reach AED 3.92 billion and (iii) impairments and losses on associated companies increased to AED 426 million.

In the nine months ending in September 2011, ENBD continued its balance sheet reduction with total assets shrinking by 5% or AED 14 billion to reach AED 271.86 billion. Most of this reduction is accounted for by an AED 17 billion decrease in cash and deposits with the Central Bank between December 2010 and September 2011. Gross loans have increased by 1.5% to AED 208.51 billion but net loans were flat at 196.4 billion due to higher provisions. We note that while lending to most economic sectors has decreased or only slightly increased over the period, lending to Sovereign counterparts has increased by a significant AED 3.2 billion to reach AED 57.24 billion or 27.5% of gross loans (against 26.3% as of December 2010).

After surging in the first half of 2011, customer deposits decreased significantly in Q3 2011, resulting in a drop from AED 200.0 billion to AED 183.6 billion between December 2010 and September 2011. This evolution is in line with the overall evolution seen in the UAE banking system in 2011.

Impaired loans have increased by 31% or AED 6.4bn in the first nine months to reach AED 26.94 billion as of September 2011. This represents 12.9% of gross loans. Moody's definition of problem loans also include loans that are past due over 90 days but not classified as impaired by the bank. As of December

2010, these loans amounted to AED 324 million but this information is not made available by ENBD in its quarterly financials.

Capital adequacy reported under Basel II remains satisfactory with total capital adequacy ratio of 21.1% while Tier 1 capital ratio was 13.4% as of September 2011, compared with 20.1% and 12.8%, respectively, at YE 2010.

DETAILED RATING CONSIDERATIONS

Detailed considerations for ENBD's currently assigned ratings are as follows:

Bank Financial Strength Rating

ENBD's D+ BFSR is supported by the bank's strong franchise in the UAE and particularly in Dubai as well as its satisfactory operating diversification and capitalisation levels. However, these strengths are partially offset by the bank's significant level of related-party loans, its heavy credit concentration to Dubai entities and the rapid deterioration of its asset quality since 2009.

As a point of reference, the assigned BFSR is in line with the D+ outcome of Moody's bank financial strength scorecard.

Qualitative Factors (70%)

Factor 1: Franchise Value

Trend: Neutral

ENBD is the UAE's largest bank, holding around 16.3% of total banking assets (as of September 2011) in a relatively fragmented banking sector. ENBD enjoys a well-established franchise, mainly supported by its strong ties with the government of Dubai (its major shareholder and key business opportunities provider) as well as by local economic activity. With 2% of its loan book located outside the GCC, ENBD enjoys very limited geographical diversification and this acts as a constraint on our overall assessment of the bank's franchise value. Also, conventional retail banking operations account for around 35% of operating income, with corporate and treasury activities accounting for the rest. This gives ENBD a moderate level of earnings stability as per Moody's methodology.

The overall C+ score for this category is amongst the highest in the UAE and reflects our assessment of the bank's franchise value.

Factor 2: Risk Positioning

Trend: Neutral

The bank's risk positioning score is constrained by its very high level of related-party loans exposure, coupled with a significant borrower concentration - two factors that are common to majority government-owned banks in the UAE.

ENBD is 55.6% owned by the Dubai government through the ICD, therefore it is de facto one of the main banking arms of the Dubai government, a relationship that (by nature) imposes a large exposure to government-related activities, creating a high credit concentration. As of 30 September 2011, ENBD reported close to AED66.27 billion or 24% of total assets in related-party loans (part of these exposures being to Dubai Government related entities); compared with 22% in December 2010 in 17% in December 2009. Such high and increasing levels of related-party exposures are a major constraint on our assessment of the bank's risk positioning.

Furthermore, ENBD exhibits very high concentrations on both sides of its balance sheet. The strong

presence of the bank in the corporate banking segment and the relatively narrow economic base of the UAE explain partly such high concentrations. As the bank has sought to de-risk its balance sheet and reduce the size of its overall lending operations, such concentration have trended higher since 2008 and exert further pressure on the bank's standalone credit profile. With the addition of Dubai Bank to ENBD's balance sheet, we expect the concentration numbers to increase given the exposures to same corporate entities.

Liquidity management became a prime strategic component of the bank. It has effectively curtailed lending and has endeavoured to reduce its potential liquidity requirements, both from contingent liabilities (loan commitments) and from maturing borrowings. However, the contractually short-term nature of ENBD's bulk depositors could potentially expose the bank to liquidity risk in the event of unexpected withdrawals, leading to a moderate score for liquidity management, similar to its UAE peers.

ENBD's score for risk positioning is E, which broadly reflects our view.

Factor 3: Regulatory Environment

This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible; whether they demonstrate enforcement power; and whether they adhere to global standards of best practice for risk control. Moody's discusses UAE's regulatory environment in the most recent Moody's Banking System Profile for UAE, published in October 2010.

Factor 4: Operating Environment

Trend: Neutral

This factor evaluates areas such as economic stability, integrity and corruption, or the effectiveness of the legal system and is common to all UAE banks. For information on the UAE operating environment, please refer to the UAE Banking System Outlook published in November 2011.

The overall operating environment score is D.

Quantitative Factors (30%)

Factor 5: Profitability

Trend: Weakening

Emirates NBD exhibit satisfactory profitability metrics. ENBD's core profitability appears average when compared to other UAE banks with Pre-Provision Income to Average Risk-Weighted Assets reaching 3.0% in December 2010 (3.2% for the UAE average). Bottom-line profits were reduced in 2010 due to high provisioning charges with Net Income to Average Risk-Weighted Assets dropping to 1.1% (compared to 1.7% average for UAE banks).

In 2010 and YTD 2011, interest income were negatively impacted by the reduction in the asset base. However, decreased funding cost did offset this trend and net interest income only decreased slightly in 2010 and were flat in the first nine months of 2011. Other non-interest income followed the same slightly downward trend due to the overall economic slowdown in the UAE since 2009. ENBD's profitability continues to be severely impacted by very high provisioning charges due to the rapid asset quality deterioration of the bank. After taking AED 3.3 billion impairments in 2009 and AED 3.2 billion impairments in 2010, ENBD further accelerated its provisioning efforts in 2011 with around AED 3.9 billion of impairments booked in the first nine months of the year.

Going forward, we expect ENBD's top line revenues to decrease slightly due to the continued contraction of the asset base. With an NPL ratio guidance given at 15-16% for 2013, we expect further provisioning charges to be taken, thus suppressing bottom-line profits.

ENBD's score for profitability is C+, with a weakening trend.

Factor 6:

Liquidity

Trend: Neutral

ENBD's liquidity position is comfortable. With net loans to customer deposits reaching 107% as of September 2011 against 129% as of December 2008, the bank's leverage has been consistently reduced and now appears in line with UAE averages. Also, the bank maintains comfortable liquidity buffers on its balance sheet in the form of liquid assets which represented around 20% of assets as of September 2011. The bank's dominant retail and corporate franchise in the UAE enables it to fund most of its asset base through deposits. Interbank deposits represented only 10% of total assets and short term market borrowings only 2% of total assets as of September 2011. This funding mix has proven broadly stable and resilient even during the market downturn that affected the UAE in general and Dubai in particular in the last three years. We have noticed the withdrawal of deposits from the bank in Q3 2011 but we consider it in large part as a reaction to the bank's policy to let go more expensive funding in the context of subdued loan growth.

Going forward, we expect the bank to maintain its comfortable liquidity position.

ENBD scores C for liquidity management, with a neutral trend.

Factor 7: Capital Adequacy

Trend: Neutral

ENBD's capital position appears favourable compared to global standards but is below UAE and GCC averages. ENBD's Tier 1 ratio stood at 13.4% as of September 2011 and 12.8% as of December 2010 and against UAE averages of respectively 16.7% and 16.1% (as per Central Bank's statistics). In Q4 2011, we expect this ratio to be slightly negatively impacted by the absorption and consolidation of Dubai Bank.

With internal capital generation remaining limited due to elevated provisioning charges, we expect the bank's Tier 1 capital to remain broadly flat in the next quarters. However, the bank's capital ratios may improve marginally due to the overall de-risking of the balance sheet as the bank reduces the size of its loan book.

ENBD scores A for capital adequacy, based on our BFSR methodology. This score does not fully capture the risk associated with ENBD's concentrated balance sheet in a still deteriorated operating environment. For this reason, we assign a weakening trend to this score.

Factor 8: Efficiency

Trend: Neutral

The bank maintains relatively good efficiency indicators. The bank's cost-to-income ratio stood at 34.3% as of September 2011, down from around 40% in pre-crisis years (2007 and 2008). This shows that the bank has been able to control its cost base in an environment of decreasing revenues.

Compared with global standards, the three-year average cost-to-income ratio of 32.4% yields a score of A for ENBD, which is broadly in line with our view.

Factor 9: Asset Quality

Trend: Weakening

ENBD's asset quality has rapidly deteriorated since 2008. Large credit concentrations to some of the troubled Dubai-related companies explain the large increase in NPLs from AED 3.29 billion in December 2008 to AED 26.94 billion or 12.9% of gross loans in September 2011. The bank's coverage ratio dropped to 44.8% as of September 2011 from slightly over 100% in December 2009.

The evolution of ENBD's asset quality metrics reflects the rapid deterioration in the operating environment in the Emirate of Dubai since 2008. The bank virtually froze lending origination on most segments in 2009 except for the Sovereign. As a result, we estimate that the bank's asset base is more exposed and concentrated to large Dubai-related corporate borrowers.

Going forward, the bank has announced market participants that the NPL ratio would reach 15-16% in 2013. These numbers are broadly in line with our own forecasts and lead to us to maintain a weakening trend on the bank's asset quality score.

Based on three-year average, the bank's asset quality score stands at C, with a weakening trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC long-term deposit rating of A3 to ENBD. The GLC deposit rating is supported by the bank's BCA of Ba1, as well as by the UAE's Aa2 local-currency deposit ceiling. The bank receives a four-notch uplift from its BCA.

The probability of systemic support in the event of a stress situation is assessed as being very high, based on: (i) the UAE being considered a 'high support' country; (ii) ENBD's systemic importance, given that it is the largest bank in the UAE; (iii) the fact that ENBD is ultimately controlled by the government of Dubai; and (iv) past evidence of systemic support that has been provided to banks in case of need.

Foreign Currency Deposit Rating

Moody's assigns A3/Prime-2 foreign currency deposit ratings to ENBD.

Foreign Currency Debt Rating

The A3 foreign currency senior debt rating assigned to ENBD and Emirates NBD Global Funding Limited (an irrevocably and unconditionally guaranteed funding vehicle of ENBD) and EIB Sukuk Company are at the same level as its long-term foreign currency deposit rating, while the Baa1 foreign currency subordinated debt rating is placed one notch lower.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Ratings

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, in the form of the local currency deposit ceiling for a country, 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 Local Currency Deposit Ceiling.

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. An 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

Emirates NBD PJSC

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						D-	
Factor: Franchise Value						C+	Neutral
Market Share and Sustainability	x						
Geographical Diversification				x			
Earnings Stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						E	Neutral
Corporate Governance [2]					x		
- Ownership and Organizational Complexity				x			
- 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					x		
- Industry Concentration		x					
Liquidity Management			x				
Market Risk Appetite		x					
Factor: Operating Environment						D	Neutral
Economic Stability					x		
Integrity and Corruption			x				
Legal System				x			
Financial Factors (30%)						B-	
Factor: Profitability						C+	Weakening
PPI / Average RWA - Basel II		3.03%					
Net Income / Average RWA - Basel II			1.08%				
Factor: Liquidity						C	Neutral
(Mkt funds-Liquid Assets) / Total Assets			4.59%				
Liquidity Management			x				
Factor: Capital Adequacy						A	Weakening
Tier 1 Ratio - Basel II	12.75%						
Tangible Common Equity / RWA - Basel II	12.72%						
Factor: Efficiency						A	Neutral

Cost / Income Ratio	36.02%						
Factor: Asset Quality						C	Weakening
Problem Loans / Gross Loans			4.97%				
Problem Loans / (Equity + LLR)			26.72%				
Lowest Combined Score (9%)						C	
Economic Insolvency Override						Neutral	
Aggregate Score						D+	
Assigned BFSR						D+	

[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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