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Research Update:

UAE-Based National Bank of Fujairah Assigned 'BBB+/A-2' Ratings; Outlook Stable

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Overview

- We are assigning our 'BBB+/A-2' ratings to United Arab Emirates (UAE)-based National Bank of Fujairah (NBF).
- NBF is a smaller sized corporate bank specializing in trade finance, with a high level of capital and healthy earnings generation.
- In our view, NBF enjoys a moderately high likelihood of receiving timely and sufficient extraordinary government support if needed.
- The stable outlook reflects our expectation that NBF will remain a conservatively-managed niche bank in the UAE's trade finance and business banking markets, with no major change in its business and financial profile over the next two years.

Rating Action

On March 31, 2014, Standard & Poor's Ratings Services assigned its 'BBB+/A-2' long- and short-term counterparty credit ratings to United Arab Emirates (UAE)-based National Bank of Fujairah (NBF). The outlook is stable.

Rationale

The ratings on NBF factor in our 'bbb-' anchor for banks operating in UAE and our view of the bank's "moderate" business position, "strong" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. We assess NBF's stand-alone credit profile (SACP) at 'bbb-'. The long-term rating benefits from two notches of uplift, reflecting our view of the "moderately high" likelihood that NBF would receive timely and sufficient extraordinary government support if needed.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating in the UAE is 'bbb-', reflecting an economic risk score of '5' and an industry risk score of '5'.

We regard NBF's business position as "moderate." Our assessment reflects the bank's well-established position and expertise in the corporate middle market, its healthy revenue generation, predictable business model, and our expectation that the bank will manage growth conservatively. However, these positive factors are mitigated by the limited market share and niche focus of the bank, in our view.

Established in 1982, NBF is predominantly a corporate bank, and it has historically generated an important portion of its business in Dubai. Over recent years, the bank has visibly expanded its business in Fujairah and Abu Dhabi, and we expect it will continue to do so over the next few years. A substantial amount of the bank's assets are relatively shorter-term working capital facilities.

The Fujairah government, through the Department of Industry and Economy, owns 40% of the bank; 20% is owned by Al Gurg Company LLC; and 9.8% is owned by Investment Corporation of Dubai, an investment arm of the Dubai government. The chairman of the bank, His Highness Sheikh Saleh Bin Mohamed Bin Hamad Al Sharqi, is the brother of the ruler of the Emirate of Fujairah. Although Fujairah has always represented a smaller portion of the bank's lending book, we understand that the bank has preferential access to important infrastructure projects in the emirate.

We assess NBF's capital and earnings as "strong." NBF's risk adjusted capital (RAC) ratio before adjustments, based on 2013 financial statements, stood at 12.2%, which compares favorably in a global context. Hybrid tier 1 capital (subscribed by shareholders and related investors) accounts for approximately 17% of total adjusted capital. We expect the bank will report about 15% annual risk weighted asset growth over the next two years, while maintaining healthy margins and preprovision earnings generation. Specifically, we expect that the bank will maintain an average return on equity generation of about 15%, and keep the dividend payout near 30%-35%. Therefore, we project that our RAC ratio before adjustments for NBF will comfortably remain between 11.5%-12.0% in the next 18-24 months, in line with the strong internal capital generation.

We assess NBF's risk position as "adequate." As a niche player in trade finance, the bank operates with lower single-name concentrations than its peers. For example, the ratio of top-20 funded lending exposures to gross loans was 18.5% at year-end 2013, but this ratio hovers near 30% or more for most of the other rated banks in the UAE. Similarly, the bank exhibits lower real estate and construction exposure--the real estate and construction exposure was about 12% of gross loans at year-end 2013, while this ratio was greater than 25% for most banks in the UAE on the same date. During the recent financial crisis, in common with other banks, the bank incurred loan losses predominantly from its Dubai lending book to certain government-related entities. The nonperforming loans to gross loans ratio peaked at 11.6% in 2010, and since then gradually improved to 4.6% as of year-end 2013. The bank's nonperforming loans coverage stood at 118% in the same period. In line with the ongoing recovery in Dubai and lower loss experience in post-2008 exposures, we expect the NPL ratio to continue to gradually decline.

We consider NBF's funding as "average" and its liquidity as "adequate." The bank funds itself predominantly from customer deposits that are locally raised, and the bank's loans-to-deposits ratio stood at 95.5% at year-end 2013. Also, the bank's ratio of net stable funding resources to stable funding needs stood at a healthy 105% for the same period, as per our calculations. Similar to the other UAE banks we rate, NBF exhibits funding concentrations. The top 20 deposits represented roughly 49% of its deposit base at year-end 2013. Although this ratio looks high, we note that the bulk of the top 20 is sticky deposits placed by the shareholders and affiliated entities, and they have been very consistent during times of stress.

NBF operates with a highly liquid balance sheet. At year-end 2013, the bank maintained more than $1 billion in the form of certificates of deposit and other placements with the Central Bank of the UAE. The bank's broad liquid assets-to-short-term customer deposits ratio was a healthy 2.3x for the same period.

The long-term rating on NBF is two notches higher than the SACP, reflecting our view of the "moderately high" likelihood of timely and sufficient extraordinary government support for NBF if needed. We consider NBF to be of "moderate" systemic importance in the UAE and the government to be "highly supportive" toward its banking sector.

Outlook

The stable outlook reflects our expectation that NBF will remain a conservatively-managed niche bank in the UAE's trade finance and business banking markets, with no significant major change in its business and financial profile over the next two years.

We would consider a positive rating action only if we raised the bank's SACP by two notches to 'bbb+' from 'bbb-'. However, this is a remote possibility. If we revised upward our assessment of the BICRA for the UAE, we could consider a one-notch improvement in the bank's SACP.

Although this is not included in our base case, we would consider a negative rating action if we assessed that NBF's risk appetite had increased significantly, with visibly higher-than-expected credit growth, or if we anticipated a significant rise in credit losses related to the bank's trade and receivables financing.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
SACP	bbb-
Anchor	bbb-
Business Position	Moderate (-1)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)

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  Funding and Liquidity               Average
                                      and Adequate (0)

Support                               +2
  GRE Support                         0
  Group Support                       0
  Sovereign Support                   +2

Additional Factors                    0
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Related Criteria And Research

Related criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related research

- Banking Industry Country Risk Assessment: United Arab Emirates, Jan. 21, 2014
- UAE Banking Sector Outlook 2014: An Uptick In Lending And Economic Activity Signal Continued Profitable Growth, Jan. 21, 2014
- Credit FAQ: How The UAE's Lending Caps Affect Domestic Banks, Government Entities, And The Capital Markets, Jan. 13, 2014
- Credit FAQ: How The United Arab Emirates' Caps On Mortgage Loans Will Affect Banks And Property Developers, Nov. 18, 2013

Ratings List

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New Rating

National Bank of Fujairah PSC
 Counterparty Credit Rating             BBB+/Stable/A-2
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